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STUDY MATERIAL

PROFESSIONAL PROGRAMME

**RESOLUTION OF  
CORPORATE DISPUTES,  
NON-COMPLIANCES &  
REMEDIES**

**MODULE 2  
PAPER 6**



**THE INSTITUTE OF  
Company Secretaries of India**

**भारतीय कम्पनी सचिव संस्थान**

**IN PURSUIT OF PROFESSIONAL EXCELLENCE**

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# **PROFESSIONAL PROGRAMME**

## **RESOLUTION OF CORPORATE DISPUTES, NON-COMPLIANCES & REMEDIES**

The term Corporate disputes includes the disputes relating to Antitrust, Mala-Fidei, Breach of Contract, Breach of Fiduciary Duty, Business Torts, Class Actions, Debtor/Creditor, Employment and Labour, Fraud and Misrepresentation, Insurance Coverage, Intellectual Property and Patent Infringement, Board Member Disputes, Partnership Disputes, Privacy, Cyber security and Data Breach, Product Liability, Real Estate, Land Use and Environmental Litigation, Restrictive agreement, Securities Litigation, Shareholder Disputes and Derivative Actions, Tax Disputes, Trade Secret and Unfair Competition.

These commercial litigations are different from other civil litigations by virtue of the involvement of businesses rather than just individuals. Further, as the issues involved are very specialized and typically more complex, both factually and legally, the concept of the special court has been introduced in the Companies Act, 2013 to handle such matters in the speedy manner.

Several amendments have been brought in recent past to amend the Companies Act, 2013 and made penal provisions less onerous for procedural lapses and technical breaches, attract minimum non-compliance liability and where public interest is not involved resulting relieve the Special Courts from adjudicating of routine offences and also to de-clog the NCLT.

In the light of above discussion, this study material is published to aid the students in preparing for the paper “Resolution of Corporate Disputes, Non-Compliances & Remedies” for Professional Programme. It is part of the educational kit and takes the students step by step through each phase of preparation emphasizing key concepts, principles, comprehending, integrating and advising to resolve complex issues, corporate disputes, case studies, problem solving and decision making company secretaryship being a professional course, the examination standards are set very high, with emphasis as expert of concepts, applications, procedures and case laws, for which sole reliance on the contents of the study material may not be enough. Besides Company Secretaries Regulations, 1982 requires the students to be conversant with the amendments to the laws made upto six months preceding the date of examination. This study material may therefore be regarded as basic information and must be read along with the respective amendments in the Act, Rules, Regulations, Order, Circulars, Clarification notified by the Central Government or issued by the respective Regulators.

The coverage of subject is “Hybrid” in nature which requires integrated application of several Core / Ancillary areas or references of the other subjects included in the ICSI Syllabus. This study material has covered such topics to a limited context. The students are advised to refer the relevant Bare Acts, Rules & Regulations and study material of the respective subjects and publications such as guidance note, referencer and alike published by the ICSI.

The amendments made up to June, 2020 have been incorporated in this study material. However, it may happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore advised to refer to the supplement uploaded on ICSI website from time to time and ICSI Journal Chartered Secretary and other publications for updation of study material. In the event of any doubt, students may contact the Directorate of Academics at [academics@icsi.edu](mailto:academics@icsi.edu).

Although due care has been taken in publishing this study material yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged, if the same are brought to its notice for issue of corrigendum.

# **PROFESSIONAL PROGRAMME**

## **RESOLUTION OF CORPORATE DISPUTES, NON-COMPLIANCES & REMEDIES**

Resolving of Corporate Disputes, requires the specialised skills and practical exposures in the person dealing with the disputes. However, the consensus-based alternatives under adjudication help in prevention, resolution, and reduction of the negative impact of corporate disputes and consequently contribute to improving companies performance, strengthening investor confidence, and supporting business continuity.

The corporate disputes involve the board's powers and actions or its failure or refusal to act. The conflicts may arise between the board and its shareholders or between directors and executive management. They may also involve issues among the directors themselves and between the board and other stakeholders.

The corporate disputes are different from the organisational internal disputes which are generally taken up by the management to resolve them. However, a corporate dispute makes company and/ or its promoters and/or its officials as one of the party in case of litigations. Such matter includes disputes over a contract, a labour claim, or a commercial matters. Further, the Globalization and cross-border trade increase a company's risks that social, political, and cultural differences can create deep rifts between the company and its external constituencies. Reputational and operational risks can increase dramatically.

When disputes become public and are discussed in the press or trigger litigation, they indicate an important failure of governance in the company. They demonstrate a mismanagement of conflicts within the board or between the company and its stakeholders - mainly its shareholders, but sometimes also its suppliers, clients, creditors, and the communities in which the company operates. Corporate governance disputes reflect the inability of executive managers or directors to address major strategy issues and conflicts.

If disputes become unresolved and left to fester without being addressed quickly and effectively, disputes do not remain hidden for long, resulting the dispute will attract media coverage.

The study material cover the various methods for dealing with the corporate disputes by the professionals like Company Secretaries and the provision and procedure of the compounding, adjudication, investigations and remedies available to resolve the corporate disputes.

The students are advised to refer the latest newspaper articles, media coverage, blogs and action taken by the various regulators in on the disputes which are in the public domain.

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# **PROFESSIONAL PROGRAMME**

## **RESOLUTION OF CORPORATE DISPUTES, NON-COMPLIANCES & REMEDIES**

### **Acts Covered in the Study**

1. Companies Act, 2013 and Rules made thereunder
2. Securities Contracts (Regulation) Act, 1956 and Rules made thereunder
3. Securities and Exchange Board of India Act, 1992 and Regulations made thereunder
4. Depositories Act, 1996
5. Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder (To the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings)
6. Code of Criminal Procedures, 1973
7. Code of Civil Procedures, 1908
8. Insolvency and Bankruptcy Code, 2016
9. NCLT Rules, 2016
10. NCLAT Rules, 2016
11. Securities Appellate Tribunal (Procedure) Rules, 2000
12. Securities Contracts (Regulations) (Appeal to Securities Appellate Tribunal) Rules, 2000
13. SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995
14. Securities Contracts (Regulations) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005
15. Depositories (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 2005
16. SEBI (Settlement Proceedings) Regulations, 2018
17. SEBI (Appeal to Central Government) Rules, 1993

# PROFESSIONAL PROGRAMME

## Module 2

### Paper 6

## Resolution of Corporate Disputes, Non-Compliances & Remedies (Max Marks 100)

### SYLLABUS

#### Objective

To acquire knowledge of various kinds of corporate disputes and non-compliances under various laws and their resolution and management.

#### Detailed Contents

1. **Shareholders' Democracy & Rights** : Law relating to Majority Powers and Minority Protection; Class action suits.
2. **Corporate Disputes** : Oppression & Mismanagement – Law & Practice; Refusal of registration of transfer of securities & appeal against refusal; Wrongful withholding of property of company; corporate criminal liability.
3. **Fraud under Companies Act and IPC.**
4. **Misrepresentation & Malpractices** : Companies Act, 2013, RBI Act, SEBI Act, FEMA, COFEPOSA, Labour Laws; Prevention of Money Laundering Act; Malpractices under various other laws.
5. **Regulatory Action** : Enquiries; Inspection; Investigation; Search and Seizure; Arrest; Bail (ROC, RD, SFIO, Stock Exchange, SEBI, RBI, CCI, Labour Law Authorities, Income Tax Authorities, ED, CBI, Economic Offences Wing).
6. **Defaults, Adjudication, prosecutions and penalties under the Companies Act, Securities Laws, FEMA, COFEPOSA, Money Laundering, Competition Act, Labour Laws & Tax Laws.**
7. **Fines, Penalties and Punishments under various laws.**
8. **Civil and Criminal Trial Procedure and Process.**
9. **Relief and Remedies** : Compounding of offences under Companies Act, SEBI & FEMA; Mediation and Conciliation; Settlement and Proceeding (Consent order under SEBI law); Appeal against the order of Adjudicating officer, SAT, NCLT, NCLAT, Enforcement Directorate, IT Commissioner, GST Commissioner; Revision of order; Appearance before Quasi-judicial and other bodies- NCLT, NCLAT, SAT, SEBI, RD, ROC, RBI, CCI.
10. **Crisis management, Professional Liability, D&O Policy & other Risk and liability mitigation approaches.**

Case Laws, Case Studies and Practical aspects

# LESSON WISE SUMMARY

## RESOLUTION OF CORPORATE DISPUTES, NON-COMPLIANCES & REMEDIES

### Lesson 1 - Shareholders' Democracy

Democracy indicates that Government is the people, by people and for people. In that context shareholder's democracy means the rule of shareholders is by the shareholders', and for the shareholders' in the corporate enterprise, to which the shareholders belong. Precisely it is a right to speak, congregate, and communicate with co-shareholders and to learn about what is going on in the company.

### Lesson 2 - Corporate Disputes

Chapter XVI of the Companies Act, 2013 provides various provisions relating to the Prevention of the Oppression and Mismanagement in the company and aim to maintain a balance between the rights of majority and minority shareholders by admitting in the rule of the majority but limiting it at the same time by a number of well defined minority rights, and thus protecting the minority shareholders.

### Lesson 3 - Class Action Suits

Class action suits is covered in section 245 of CA 2013 as well as National Company Law Tribunal Rules, 2016 ("NCLT Rules"). Section 245 permits members and depositors to file a petition against the company, its directors, auditors or advisors with the National Company Law Tribunal (NCLT) in case they commit any act which is prejudicial to the interest of the company. However, the Banking companies are excluded from its purview.

### Lesson 4 - Fraud under Companies Act, 2013 and Indian Penal Code, 1860

Fraud as a crime is nowhere defined in the Indian Penal Code but we all use this term in general in our day to day life which is seen as synonymous to cheating. A fraud is an act of deliberate deception with the design of securing something by taking unfair advantage of another. It is a deception in order to gain by another's loss. Whenever the term fraud or defraud appears in the context of criminal law, two things are automatically to be assumed. First is deceit or deceiving someone and second is, injury to someone because of such deceit. Explanation to section 447 under the Companies Act, 2013 has provided that fraud" in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. The lesson cover the various aspects relating to the fraud under the Companies Act, 2013 and the Indian Penal Code, 1860.

### Lesson 5 - Regulatory Action

Shareholders have been vested with various rights including the right to elect directors. However, shareholders are often ill-equipped to exercise effective control over the affairs of companies, and, particularly in companies whose shareholders are widely scattered, the shareholders are, by and large, sleeping and passive partners, and the affairs of such companies are managed to all intents and purposes, by its Board of directors to the exclusion of a predominant majority of shareholders. Such a situation leads to abuse of power by persons in control of the affairs of company. It became, therefore, imperative for the Central Government to assume certain

powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Chapter XIV contains Sections 206 to 229 of the Companies Act, 2013, deals with the provisions relating to Inspection, Inquiry and Investigation of the affairs of company. The lesson will cover the detailed procedures of the various action taken by the MCA, SEBI, RBI, CCI and SFIO.

### **Lesson 6 - Adjudication, Prosecutions, Offences and Penalties**

One of the important changes brought in by the Companies Act, 2013 compared to the erstwhile Companies Act, 1956 is the manner of dealing with non-compliances. The constitution of Special Courts as judicial authorities, National Company Law Tribunal (NCLT) as administrative cum quasi-judicial authority and delegation of power of adjudication of penalties to Registrar of Companies (ROC) are the key changes brought in by the Act in the Indian corporate regime. Further, with the intent to promote the ease of doing business in India and ensure better corporate compliance, the Companies Act, 2013 was again amended by the enactment of Companies (Amendment) Act, 2019 to reclassify and decriminalize certain procedural or technical non compliances. The lesson is focused on the substantive provisions of the various corporate laws (concerning the offences and defaults by the companies and officers in default and the Adjudication mechanism under the respective Act.

### **Lesson 7 - Relief and Remedies**

Today's Corporate world, good governance means to comply with all the provisions of Corporate laws. Non-compliance will result in penalties or penalties with imprisonment. Corporate offences are classified into civil and criminal offences. Further it has been classified as Compoundable and Non compoundable offence. The Compounding of offences is a short cut method to avoid litigation. In case of prosecution for an offence in a criminal court, the accused has to appear before the Magistrate at every hearing through an advocate. Further court proceedings are time consuming and expensive. However, in case of compounding, the accused need not appear personally and can be discharged on payment of composition fee which cannot be more than the maximum fine leviable under the relevant provision. Section 442 of The Companies Act, 2013 provides that the Central Government to maintain a panel of experts to be called as the Mediation and Conciliation Panel. The panel is for mediation between the parties during the pendency of any proceedings before the Central Government or NCLT or NCLAT. The lesson cover the compounding procedures under the various legislations and the manner of the appeal before the appellate tribunal and the rules relating to the Mediation and Conciliation under the Companies Act, 2013.

### **Lesson 8 - Crisis Management & Risk and Liability Mitigation**

Crisis management is the process by which an organization deals with a disruptive and unexpected event that threatens to harm the organization or its stakeholders. The study of crisis management originated with large-scale industrial and environmental disasters in the 1980s. It is considered to be the most important process in public relations. Errors and Omissions (E&O insurance), is a special type of coverage that protects a company against claims that a professional service provided caused client to suffer financial harm due to mistakes on the part (errors) of professional or because he may failed to perform some service (omissions). Risk mitigation is a strategy to prepare for and lessen the effects of threats faced by a company. Comparable to risk reduction, risk mitigation takes steps to reduce the negative effects of threats and disasters on business continuity (BC). Threats that might put a business at risk include various factors which may causes of financial and non-financial or virtual damage to a company. The lesson covers understanding of the various technical concepts pertaining to Crisis Management; Professional Liability; D&O Insurance; Other risk management approaches.



## **Lesson 9 - Misrepresentation and Malpractices – Civil and Criminal Trial Procedure**

The NCLT consolidates the corporate jurisdiction of: i. Company Law Board, ii. Board of Industrial and Financial Reconstruction, iii. Appellate Authority for Industrial and Financial Reconstruction and iv. jurisdiction and powers relating to winding up, restructuring and other provisions as vested with the High Courts resulting the Reduction of the burden on courts and will help companies facing issues related to winding up, mismanagement and insolvency of businesses and to Eliminates the overlap the conflicting rulings and minimize the delays in the resolution of disputes. The proceedings before the NCLT or NCLAT are deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973. The lesson cover the various aspects under Code of Criminal Procedures relevant for dealing with the various judicial authorities.

## LIST OF RECOMMENDED BOOKS/WEBSITES

### RESOLUTION OF CORPORATE DISPUTES, NON-COMPLIANCES & REMEDIES

#### MODULE 2 – PAPER 6

#### READINGS

**1. ICSI Publications :**

The Companies Act, 2013  
The Companies Rules  
Premier on Companies Act, 2013  
Guidance note on Secretarial Audit  
Ready Reckoner on Private companies  
Peer review manual  
Quality review manual

**2. Taxmann :** SEBI Manual

**3. Regulations/Rules/Guidelines/Circulars issued by SEBI, RBI, MCA etc. from time to time**

**4. Articles by the professionals and Firms**

**5. Important Websites :** [www.mca.gov.in](http://www.mca.gov.in)  
[www.sebi.gov.in](http://www.sebi.gov.in)  
[www.rbi.org.in](http://www.rbi.org.in)  
[www.icsi.edu](http://www.icsi.edu)  
[www.ebook.mca.gov.in](http://www.ebook.mca.gov.in)  
[www.nclt.gov.in](http://www.nclt.gov.in)  
[www.nclat.nic.in](http://www.nclat.nic.in)

#### JOURNALS

1. Chartered Secretary : ICSI, New Delhi
2. Student Company Secretary : ICSI, New Delhi

Note:

- (i) Students are advised to read the relevant Bare Acts, Regulations/circulars/rules issued by various regulatory authorities like SEBI, RBI, MCA etc. from time to time in addition to reading of journals like Student Company Secretary, Chartered Secretary etc.
- (ii) The reference to websites of different regulatory authorities is essential.

# ARRANGEMENT OF STUDY LESSON

## Module-2 Paper-6

### RESOLUTION OF CORPORATE DISPUTES, NON-COMPLIANCES & REMEDIES

<b>S.No.</b>	<b>Lesson Tittle</b>
1.	Shareholders' Democracy
2.	Corporate Disputes
3.	Class Action Suits
4.	Fraud under Companies Act, 2013 and Indian Penal Code, 1860
5.	Regulatory Action
6.	Adjudication, Prosecutions, Offences and Penalties
7.	Relief and Remedies
8.	Crisis Management & Risk and Liability Mitigation
9.	Misrepresentation and Malpractices – Civil and Criminal Trial Procedure

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# Lesson 1

## Shareholders' Democracy

### LESSON OUTLINE

- Shareholders' Democracy
- Majority Powers and Minority Rights
- Exceptions to the Rule in Foss v. Harbottle
- LESSON ROUND UP
- TEST YOURSELF

### LEARNING OBJECTIVES

In this chapter, students will learn:

- Meaning and Concept of Shareholders Democracy
- Concept related to Majority Powers and Minority Rights
- Rule related to Foss and Harbottle
- Exceptions to Foss and Harbottle

## SHAREHOLDERS' DEMOCRACY

Democracy means the rule of the people, by the people and for the people. In that context, the shareholders democracy means the rule of shareholders, by the shareholders', and for the shareholders' in the corporate enterprise, to which the shareholders belong. Precisely it is a right to speak, congregate, communicate with co-shareholders and to learn about what is going on in the company.

Under the Companies Act, 2013, the powers have been divided between two segments: one is the Board of Directors and the other is of shareholders. The Directors exercise their powers through meetings of Board of directors and shareholders exercise their powers through Annual General Meetings/Extraordinary General Meetings. Although constitutionally, all the acts relating to the company can be performed in General Meetings, most of the powers in regard thereto are delegated to the Board of directors by virtue of the constitutional documents of the company viz. the Memorandum of Association and Articles of Association.

It is a widely acclaimed fact that in any corporate enterprise, the shareholders are the owners. But in fact, they are seldom able to exercise any ownership rights except to sometimes cast votes at General Meetings. The members therefore, are only passive investors rather than active participants in the governance of the corporate process. Still the directors, as per law, are answerable to the shareholders at least for two reasons, one the shareholders are directly concerned with the economic viability of the investee company so to feel sure about the safety of their investment and secondly being the recognised owners of the company to enforce their rights to control the company as and when the company enters into contractual relationship with third persons thereby incurring greater obligation.

Thus the shareholder' democracy can play an important role in stimulating the Board of directors, raising company performance and ensuring that the community at large takes a greater interest in industrial progress.

Recognising the supreme authority of the shareholders', the Companies Act has given authority to them to appoint directors at the Annual General Meetings to direct, control, conduct and manage the business and affairs of the company.

### The Companies Act 2013 and the Rights of Shareholders

Under Section 179 of the Companies Act, 2013, a general power has been conferred on the Board of directors. "The Board of directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorised to exercise and do."

Proviso to this section restricts the power of the Board of directors to do things which are specifically required to be done by shareholders in the General Meetings under the provisions of Companies Act or Memorandum of Association or the Articles of Association.

Thus, the Companies Act has tried to demarcate the area of control of directors as well as that of shareholders. Basically all the business to be transacted at the meetings of shareholders is by means of an ordinary resolution or a special resolution.

Some of the businesses which can be transacted at meetings of shareholders are:

1. Alteration of Memorandum of Association and Articles of Association.
2. Further issue of share capital.
3. To transfer some portions of uncalled capital to reserve capital to be called up only in the event of winding up of the company.
4. To reduce the share capital of the company.
5. To shift the registered office of the company outside the state in which the registered office is situated at present.



6. To decide a place other than the registered office of the company where the statutory books, required to be maintained may be kept.
7. Payment of interest on paid-up amount of share capital for defraying the expenses on Construction when plant cannot be commissioned for a longer period of time.
8. To appoint auditors
9. To approach Central Government for investigation into the affairs of the company.
10. To allow Related Party Transaction
11. To allow a director, partner or his relative to hold office or place of profit.
12. Payment of commission of more than 1% of the net profits of the company to a managing or a whole-time director or a manager.
13. To make loans, to extend guarantee or provide security to other companies or make investment beyond the limit specified.
14. To borrow money and to charge out the assets of the company to secure the borrowed money.
15. To appoint directors.
16. To increase or reduce the number of directors within the limits laid down in Articles of Association.
17. To cancel, redeem debentures etc.
18. To make contribution to funds not related to the business of the company.

In view of the rights conferred on shareholders to be exercised at General Meetings, the Act casts an obligation on the directors to send notices for convening general meetings or else the meetings shall be declared to be void as also all proceedings transacted thereat.

Apart from the rights which are vested in the shareholders to be exercised in relation to the conduct of the business of the company, the directors of the company have certain obligations towards the shareholders.

The courts have determined two broad duties to be performed by a director:

1. Duties of utmost care and skill in managing the affairs of the company or else be liable for damages.
2. Fiduciary duties to act bona fide in the interest of the company, not to exercise powers for collateral benefit and not to earn profit from the position as a director.

Despite the powerful weapons handed over to the shareholders by the Companies Act, the shareholders have not been able to use them and most of the provisions remain dead provisions and have not been used by the shareholders as potential weapons to correct any wrongful act on the part of the directors or to give them any directions. Consequently, the Board of directors of a large number of companies are elected only by a few shareholders who attend the Annual General Meetings and those who can muster sufficient number of proxies and can demonstrate their voting power. Government Companies is an exception. In Government Companies all the directors are appointed on the advice of the Government by the President of India or the Governor of concerned State. Hence, theoretically it can perhaps be said that the shareholders democracy is absolute in such companies.

In other companies, however, the shareholders democracy is dependent upon the voting power of shareholders and also to a great extent on the availability of members attending their General Meetings either by themselves or through their proxy. This again depends on the proximity of Registered Office of the company to the place of residence of the shareholders. Apart from this, most of the shareholders do not have enough time to spare from their busy schedules to concern themselves with the affairs of the company in which they have invested. Besides, they are not always educated enough and experienced enough to

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be conversant with the working of the joint stock companies. Although the concept of shareholders' democracy has been enshrined in the Companies Act, yet, because of the aforementioned deficiencies and flaws in the general body of shareholders as a whole, it is not reflected in the constitution of the Boards of directors of many companies in India.

The Companies Act provided an opportunity to shareholders to participate in the decision making process by introducing provisions relating to passing of resolutions in respect of certain matters through e-voting.

For achieving the shareholders' democracy, the shareholders have to unite and organise themselves on national, state and district levels and get their associations registered under the Societies Registration Act or any other applicable statute so that their voice is heard and they can assert themselves and safeguard the interests of their members. Constitution of such associations should be suitably amended so as to insist upon all the non-Government companies to allot a minimum number of shares to such associations of shareholders so that these associations can attend the Annual General Meetings of all the companies and make sure that the directors elected to company Boards reflect a fair representation.

### MAJORITY POWERS AND MINORITY RIGHTS

A company being an artificial person with no physical existence, functions through the instrumentality of the Board of directors which is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that *prima facie* a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs.

The basic principal relating to the administration of the affairs of a company is that "the will of the majority prevails or majority is supreme". Except the power vested in the Board of Directors, the overall powers of controlling matters relating to the company lies with the shareholders which are exercised in the general meeting of a company. Usually the general rule is that the decision of majority shareholders in a company binds the minority. Therefore, it is only majority of members who can control the board of directors. The majority is in the position where they are connected to every part of the company. They maintain their rights without considering the interests of minority which creates sullen effects. They misuse their power to exploit the rights of minority. In such a case a proper balance of the rights of majority and minority shareholders is essential for the smooth functioning of the company.

In such a case, Oppression of minority or mismanagement by majority can occur where it has some remedial actions.

But the erstwhile Companies Act, 1956 as well as Companies Act, 2013 has laid down certain provisions which restrict the unbridled supreme majority and confer rights on minority to apply to the National Law Company Tribunal or Central Government in case of Oppression or Mismanagement.

According to Section 47 of the Companies Act, 2013, every member of a company, which is limited by shares, holding any equity shares shall have a right to vote in respect of such capital on every resolution placed before the company. Member's right to vote is recognised as right of property and the shareholder may exercise it as he thinks fit according to his choice and interest. A special resolution, for instance, requires a majority of three-fourths of those voting at the meeting and therefore, where the Act or the articles require a special resolution for any purpose, a three-fourth majority is necessary and a simple majority is not enough [**Edwards v. Halliwell, (1950) 2 All. E.R. 1064**].

The resolution of a majority of shareholders, passed at a duly convened and held general meeting, upon any question with which the company is legally competent to deal, is binding upon the minority and consequently upon the company [**North-West Transportation Co. v. Beatty (1887) L.R. 12 A.C. 589**].

Thus, the majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs. But this is subject to two very important limitations. Firstly, the powers of the

majority of members is subject to the provisions of the Company's memorandum and articles of association. A company cannot legally authorise or ratify any act which being outside the ambit of the memorandum, is *ultra vires* of the company [**Ashbury Rly. Carriage and Iron Co. v. Riche, (1875) L.R. 7 H.L. 653**]. Also, where the articles authorise the directors to deal with any matters except those which are outside the scope of the authority of the directors; or with which the directors, having power, are unable or unwilling to deal. Secondly, the resolution of a majority must not be inconsistent with the provisions of the Act or any other statute, or constitute a fraud on minority depriving it of its legitimate rights.

### The Principle of Non-interference (Rule in Foss v. Harbottle)

The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members, the issue is decided by a vote of the majority. Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority. But the protection of the minority is not generally available when the majority does anything in the exercise of the powers for internal administration of a company. The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. In other words, the articles are the protective shield for the majority of shareholders who compose the board of directors for carrying out their object at the cost of minority of shareholders. ***The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of Foss v. Harbottle 67 E.R. 189; (1843) 2 Hare 461 that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.***

### CASE LAW

In *Foss v. Harbottle*, two shareholders, Foss and Turton brought an action on behalf of themselves and all other shareholders against the directors and solicitor of the company alleging that by their concerted and illegal transactions they had caused the company's property to be lost to the company. It was also alleged that there was no qualified Board. Foss and Turton claimed damages to be paid by the defendants to the company. It was held by the court that the action could not be brought by the minority shareholders although there was nothing to prevent the company itself, acting through the majority of its shareholders, bringing action. The wrong done to the company was not which could be ratified by the majority of members. The company (i.e. the majority) is the proper plaintiff for wrong done to the company, so the majority of members are competent to decide whether to commence proceedings against the directors. The reasons for rule were nicely stated by Melish L.J. in *MacDougall v. Gardiner*, (1875) 1 Ch. D. 13 (C.A.) at p. 25 in the following words:

"If the thing complained of is a thing which in substance the majority of company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes."

In *Rajahmundry Electric Supply Co. v. Nageshwara Rao* AIR 1956 SC 213, the Supreme Court observed that:

“The courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general do nothing about it.”

From the above it follows then that a company being a separate legal person from the members who compose it, the company is the proper person to bring an action.

In *Pavrides v. Jensen* (1956) Ch. 565, a minority shareholder brought an action for damages against three directors and against the company itself on the ground that they have been negligent in selling a mine owned by the company for £ 82,000, whereas its real value was about £ 10,00,000. It was held that the action was not maintainable. The judge observed, “It was open to the company, on the resolution of a majority of the shareholders to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of majority to decide that if the directors by their negligence or error of judgement has sold the company’s mine at an undervalue, proceedings should not be taken against the directors”.

In *Edwards v. Halliwell* (1950) 2 All. E.R. 1064, Jenkins, L.J. restated the rule in the following terms: “The rule in *Foss v. Harbottle* comes to no more than this. First, the proper plaintiff in respect of wrong alleged to be done to company is prima facie the company itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company by a simple majority of members, no individual member is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company is in favour of what has been done, then cadit quaestio... (cannot be questioned). If on the other hand, a simple majority of members of the company is against what has been done, then there is no valid reason why the company itself should not sue”.

### Justification and Advantages of the Rule in *Foss v. Harbottle*

The justification for the rule laid down in *Foss v. Harbottle* is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company’s affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Moreover, a company is a person at law, the action is vested in it and cannot be brought by a single shareholder. Where there is a corporate body capable of filing a suit for itself to recover property either from its directors or officers or from any other person then that corporate body is the proper plaintiff and the only proper plaintiff [*Gray v. Lewis*, (1873) 8 Ch. Appl. 1035].

The main advantages that flow from the Rule in *Foss v. Harbottle* are of a purely practical nature and are as follows:

1. **Recognition of the separate legal personality of company:** If a company has suffered some injury, and not the individual members, it is the company itself that should seek to redress.
2. **Need to preserve right of majority to decide:** The principle in *Foss v. Harbottle* preserves the right of majority to decide how the affairs of the company shall be conducted. It is fair that the wishes of the majority should prevail.
3. **Multiplicity of futile suits avoided:** Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are

shareholders. Legal proceedings would never cease, and there would be enormous wastage of time and money.

4. **Litigation at suit of a minority futile if majority does not wish it:** If the irregularity complained of is one which can be subsequently ratified by the majority it is futile to have litigation about it except with the consent of the majority in a general meeting. In *Mac Dougall v. Gardiner*, (1875) 1 Ch. 13 (C.A.), the articles empowered the chairman, with the consent of the meeting, to adjourn a meeting and also provided for taking a poll if demanded by the shareholders. The adjournment was moved, and declared by the chairman to be carried; a poll was then demanded and refused by the chairman. A shareholder brought an action for a declaration that the chairman's conduct was illegal. Held, the action could not be brought by the shareholder; if the chairman was wrong, the company alone could sue.

Application of *Foss v. Harbottle* Rule in Indian context – The Delhi High Court in ***ICICI v. Parasrampuria Synthetic Ltd. SSL***, July 5, 1998 has held that an automatic application of *Foss v. Harbottle* Rule to the Indian corporate would be improper. Here the Indian corporate sector does not involve a large number of small individual investors but predominantly financial institutions funding at least 80% of the finance. It is these financial institutions which provide entire funds for the continuous existence and corporate activities. Though they hold only a small percentage of shares, it is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of *Foss v. Harbottle* Rule would be unjust and unfair.

## EXCEPTIONS TO THE RULE IN FOSS V. HARBOTTLE

The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. Palmer's Company Law recognises the exceptions to the rule in *Foss v. Harbottle* as follows<sup>1</sup> : (a) where there is an ultra vires act; (b) where a special majority is needed; (c) where personal rights are infringed; (d) where fraud has been committed by those in control.

In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

- (a) the common law; and
- (b) the provisions of the Companies Act, 2013.

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases:

### (1) Ultra Vires Acts

Where the directors representing the majority of shareholders perform an illegal or *ultra vires* act, an individual shareholder has right to bring an action. The majority of shareholders have no right to confirm an illegal or *ultra vires* transaction of the company. In such case a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an *ultra vires* act.

In *Bharat Insurance Ltd. v. Kanhya Lal*, A.I.R. 1935 Lah. 792, the plaintiff was a shareholder of the Bharat Insurance Company. One of the objects of the company was : "To advance money at interest on the security of land, houses, machinery and other property situated in India..." The plaintiff complained that "several investments had been made by the company without adequate security and contrary to the provisions of the memorandum and therefore, prayed for perpetual injunction to restrain it from making such investments". The Court observed:

1. Geoffrey Morse, Palmer's Company Law, Sweet and Maxwell, UK, 2007.



## 8 PP-RCDN&R

"In all matters of internal management, the company itself is the best judge of its affairs and the Court should not interfere. But application of assets of a company is not a matter of internal management. As directors are acting *ultra vires* in the application of the funds of the company, a single member can maintain a suit".

It means that the rule in *Foss v. Harbottle* will operate in full force only when the majority of shareholders through their chosen directors act within the extent of the powers of the company.

### (2) Fraud on Minority

Where an act done by the majority amounts to a fraud on the minority, an action can be brought by an individual shareholder. This principle was laid down as an exception to the rule in *Foss v. Harbottle* in a number of cases. In *Menier v. Hooper's Telegraph Works*, (1874) L.R. 9 Ch. App. 350, it was observed that it would be a shocking thing if the majority of shareholders are allowed to put something into their pockets at the expense of the minority. In this case, the majority of members of company 'A' were also members of company 'B', and at a meeting of company 'A' they passed a resolution to compromise an action against company 'B', in a manner alleged to be favourable to company 'B', but unfavourable to company 'A'. Held, the minority shareholders of company 'A' could bring an action to have the compromise set aside.

Though there is no clear definition of the expression "fraud on the minority", but the court decides a particular case according to the surrounding facts. The general test which is applied to decide whether a case falls in the category of fraud on the minority or not is whether a resolution passed by the majority is "bona fide for benefit of the company as a whole" [*Allen v. Gold Reefs of West Africa*, (1900) 1 Ch. 656]. As regards the meaning of the expression "bona fide for the benefit of the company as a whole" Evershed M.R. in *Greenhalgh v. Ardenne Cinemas Ltd.* (1950) 2 All E.R. 1120 has observed thus: "It means that the shareholder must proceed on what, in his honest opinion, is for the benefit, of the company as a whole. Secondly, the phrase 'the company as a whole' does not... mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body." In other words, it can be said that the court ought not to interfere with decision of the majority in a general meeting if that decision is arrived at fairly and honestly [*In Re. Transvaal Gold Exploration and Land Co. Ltd.* (1885) 1 T.L.R. 604]. and is not an act of fraud on the minority.

### (3) Wrongdoers in Control

If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court [*Cf. Birch v. Sullivan*, (1957) 1 W.L.R. 1274]. The reason for it is that if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue [Par Jenkins L.J. in *Edwards v. Halliwell*, (1950) 2 All E.R. 1064, 1067].

In *Glass v. Atkin* (1967) 65 D.L.R. (2d) 501, a company was controlled equally by the two defendants and the two plaintiff. The plaintiff brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use. The Court allowed the action and observed: "While the general principle was for the company itself to bring an action, where it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action."

### (4) Resolution requiring Special Majority but is passed by a Simple Majority

A shareholder can sue if an act requires a special majority but is passed by a simple majority. Simple or rigid formalities are to be observed if the majority wants to give validity to an act which purports to impede the interest of minority. An individual shareholder has the right of action to restrain the company from acting on a special resolution to which the insufficient notice is served [*Baillie v. Oriental Telephone and Electric Co. Ltd.*, (1915) 1 Ch. 503 (C.A.); refer also *Nagappa Chettiar v. Madras Race Club*, 1 M.L.J. 662].

### (5) Personal Actions

Individual membership rights cannot be invaded by the majority of shareholders. He is entitled to all the rights and privileges appertaining to his status as a member. An individual shareholder can insist on the strict compliance with the legal rules and statutory provisions. Provisions in the memorandum and the articles are mandatory in nature and cannot be waived by a bare majority of shareholders [*Salmon v. Quin and Axtens*, (1909) A.C. 442]. In *Nagappa Chettiar v. Madras Race Club*, (1949) 1 M.L.J. 662 at 667, it was observed by the Court that "An individual shareholder is entitled to enforce his individual rights against the company, such as, his right to vote, the right to have his vote recorded, or his right to stand as a director of a company at an election.

Where the candidature of a shareholder for directorship is rejected by the Chairman, it is an individual wrong in respect of which a suit is maintainable [*Joseph v. Jos*, (1964) 1 Comp LJ 105].

### (6) Breach of Duty

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.

In *Daniels v. Daniels*, (1978) 2 W.L.R. 73, the plaintiff, who were minority shareholders of a company, brought an action against the two directors of the company and the company itself. In their statement of claim they alleged that the company, on the instruction of the two directors who were majority shareholders, sold the company's land to one of the directors (who was the wife of the other) for £ 4,250 and the directors knew or ought to have known that the sale was at an under value. Four years after the sale, she sold the same land for £ 1,20,000. The directors applied for the statement of claim to be dismissed as an abuse of the process of the Court.

Held, by the Chancery Division, Templeman, J, the application of director should be dismissed. The exception to the rule in *Foss v. Harbottle* enabling a minority of shareholders to bring an action against a company for fraud where no other remedy was available should include cases where, although there was no fraud alleged, there was a breach of duty by directors and majority shareholders to the detriment of the company and the benefit to the directors; accordingly, on the facts alleged, the minority shareholders had a cause of action.

### (7) Prevention of Oppression and Mismanagement

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement. These are the statutory rights of the minority shareholders and find detailed discussion later in the study.

In *Bennet Coleman & Co. and Ors. v. Union of India & Ors.*, (1977) 47 Com Cases 92 (Bom), the Division Bench of the Bombay High Court held that Sections 397 and 398 of the Companies Act, 1956 are intended to avoid winding up of the company if possible and keep it going while at the same time relieving the minority shareholders from acts of oppression and mismanagement or preventing its affairs from being conducted in a manner prejudicial to public interest. Thus, the Court has wide powers to supplant the entire corporate management by resorting to non-corporate management which may take the form of appointing an administrator or a special officer or a committee of advisers etc., who will be in charge of the affairs of the company.

The exceptions to the rule in *Foss v. Harbottle* are not limited to those covered above. Further exceptions may be admitted where the rules of justice require that an exception to the rule should be made.

It should be noted that the ordinary civil courts are not deprived of the jurisdiction to decide the matters except where the Companies Act expressly excludes it such as matters relating to winding up [*Panipat Woollen & General Mills Co.Ltd. v. R.L. Kaushik*, (1969) 39 Com Cases 249 (Punj & Har)].

### LESSON ROUND UP

- Democracy means the rule of the people, by the people and for the people. In that context, the shareholders democracy means the rule of shareholders, by the shareholders', and for the shareholders' in the corporate enterprise, to which the shareholders belong.
- Precisely it is a right to speak, congregate, and communicate with co-shareholders and to learn about what is going on in the company.
- Under the Companies Act, 2013, the powers have been divided between two segments: one is the Board of Directors and the other is of shareholders.
- Thus the shareholder' democracy can play an important role in stimulating the Board of directors, raising company performance and ensuring that the community at large takes a greater interest in industrial progress.
- Recognising the supreme authority of the shareholders', the Companies Act has given authority to them to appoint directors at the Annual General Meetings to direct, control, conduct and manage the business and affairs of the company.
- Companies Act has tried to demarcate the area of control of directors as well as that of shareholders. Basically all the business to be transacted at the meetings of shareholders is by means of an ordinary resolution or a special resolution.
- Despite the powerful weapons handed over to the shareholders by the Companies Act, the shareholders have not been able to use them and most of the provisions remain dead provisions and have not been used by the shareholders as potential weapons to correct any wrongful act on the part of the directors or to give them any directions.
- The Companies Act provided an opportunity to shareholders to participate in the decision making process by introducing provisions relating to passing of resolutions in respect of certain matters through e-voting.
- A company being an artificial person with no physical existence, functions through the instrumentality of the Board of directors which is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that prima facie a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs.
- The basic principal relating to the administration of the affairs of a company is that "the will of the majority prevails or majority is supreme".
- The majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs. But this is subject to two very important limitations. Firstly, the powers of the majority of members are subject to the provisions of the Company's memorandum and articles of association. A company cannot legally authorize or ratify any act which being outside the ambit of the memorandum, is ultra vires of the company.
- The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of *Foss v. Harbottle* 67 E.R. 189; (1843) 2 Hare 461 that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.
- The justification for the rule laid down in *Foss v. Harbottle* is that the will of the majority prevails.
- The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. Palmer's Company



Law recognises the exceptions to the rule in *Foss v. Harbottle* as follows: (a) where there is an ultra vires act; (b) where a special majority is needed; (c) where personal rights are infringed; (d) where fraud has been committed by those in control.

- In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:
  - (a) the common law; and
  - (b) the provisions of the Companies Act, 2013.
- The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in various cases.

## TEST YOURSELF

*(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)*

1. What do you mean by Shareholders Democracy?
2. Write a Short Note on Majority Powers and Minority Rights
3. Discuss the Rule in Foss v. Harbottle
4. What are the exceptions to the Rule in Foss v. Harbottle
5. "Articles of the company are the protective shield for the majority of shareholders". Comment.

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# Lesson 2

## Corporate Disputes

### LESSON OUTLINE

- Oppression and Mismanagement
- Transfer and Transmission of Securities (Section 56)
- Punishment for Personation of Shareholder (Section 57)
- Refusal of Registration and Appeal Against Refusal (Section 58)
- Rectification of Register of Members (Section 59)
- Punishment for Wrongful Withholding of Property (Section 452)
- LESSON ROUND UP
- TEST YOURSELF

### LEARNING OBJECTIVES

In this chapter, students would learn and understand:

- Various provisions relating to the Prevention of the Oppression and Mismanagement (Section 241 to 246) in the company (as provided under Chapter XVI of the Companies Act, 2013)
- Attempts under Companies Act, 2013 to maintain a balance between the rights of majority and minority shareholders by recognising the rule of the majority but limiting it at the same time by a number of well-defined minority rights, thus protecting the interests of minority shareholders

### OPPRESSION AND MISMANAGEMENT UNDER COMPANIES ACT, 2013

Chapter XVI of the Companies Act, 2013 (Section 241 to Section 246) deals with the provisions relating to prevention of oppression and mismanagement of a company. Oppression and mismanagement of a company mean that the affairs of the company are being conducted in a manner that is oppressive and biased against the minority shareholders or any member or members of the company. To prevent the same, there are provisions for the prevention and mismanagement of a company.

### REGULATORY FRAMEWORK

Section / Regulation	Section /Regulation title	Particulars
241	Application to Tribunal for Relief in cases of oppression	Provides circumstances in which an application may be made to NCLT by any member who has right to apply under Section 244  Or By the Central Government for relief in cases of oppression and mismanagement in the affairs of the company.
242	Power of Tribunal	It deals with powers of NCLT when application is made under Section 241 for relief in cases relating to oppression and mismanagement.
243	Consequences of termination or modification of certain agreements	It deals with consequences of termination or modification of certain agreements as a result of order of tribunal under Section 242.
244	Right to apply under section 241	It deals with rights of members to apply under section 241.  In case of company having a share capital not less than 100 members or not less than one tenth of total number of members whichever is less or any member/s holding not less than 1/10th of the issued share capital  In case of company having share capital not less than 1/5th of total number of members.
245	Class action (procedure, thresholds etc are covered in detail in chapter.)	An application by such number of members, depositors or class of them to NCLT to seek remedy against conduct of affairs of the company prejudicial to the interest of the company or its members or depositors.
Rule 81 of NCLT Rules	Application under Section 241	Format of application and procedural aspects
Rule 82 of NCLT Rules	Application not to be withdrawn without leave of the tribunal	

Rule 83 of NCLT Rules	Application under Section 243	
Rule 83A of NCLT Rules	Application under Section 244	Provides for format of application
Rule 84 to Rule 87 of NCLT Rules	Procedural aspects, thresholds etc relating to class action suits.	

### Meaning of Oppression

The words “oppression” and “mismanagement” are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.

### Understanding the Meaning of Oppression or Mismanagement through Case Laws

#### 1. Supreme Court in case of Shanti Prasad Jain v. Kalinga Tubes Ltd. (Decided On: 14.01.1965)

The Apex Court inter-alia observed

- a. The law, however, has not defined what is oppression for purposes of this section, and it is left to courts to decide on the facts of each case whether there is such oppression as calls for action under this section (i.e. Section 397 and section 399 of Companies Act 1956)
  - b. There must be continuous acts on the part of the majority shareholders, continuing up to the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some part of the members. The conduct must be burdensome, harsh and wrongful and mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless the lack of confidence springs from oppression of a minority by a majority in the management of the company's affairs, and such oppression must involve at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as a shareholder
  - c. The question in each case is whether the conduct of the affairs of a company by the majority shareholders was oppressive to the minority shareholders and that depends upon the facts proved in a particular case.
2. A very clear illustration of mismanagement contemplated by the Section is *Rajahmundry Electric Supply Corporation v. A. Nageswara Rao* (AIR 1956 SC 213). In this case, a petition was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the vice chairman grossly mismanaged the affairs of the company and had drawn considerable amounts for his personal purpose, that large amounts were owing to the Government for charges for supply of electricity, that machinery was in a state of disrepair, that the directorate had become greatly attenuated and “a powerful local junta was ruling the roost”, and that the shareholders outside the group of the chairman were powerless to set matters right. This was held to be sufficient evidence of mismanagement. The Court accordingly appointed two administrators for the management of the company for a period of six months vesting in them all the powers of the directorate.

#### 3. Basis of Single Act Treatment

In *Maharashtra Power Development Corporation Ltd. v. Dabhol Power Company* [AIR 2004 Bom 38, (2004) 1 BOMLR 833, 2003 117 Comp Cas 506 Bom. & (2003) Vol. 117 CC 506] it was held that “an irregular or illegal action is not per se oppressive but the illegality of an action may have a bearing upon its oppressiveness. A single act of oppression would not ordinarily give rise to a cause of action for filing of a petition under Section 397 of the Companies Act. If the effects of a single act are burdensome, wrongful, oppressive and of continuing nature, and the member concerned is deprived of a right and

privilege for all time to come in future, then the petition under Section 397 of the Act can be filed even in respect of a single act”.

*In re. Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd. (Supra)* Supreme Court held that the true position is that “an isolated act, which is contrary to law, may not necessarily and by itself support the inference that the law was violated with a mala fide intention or that such violation was burdensome, harsh and wrongful. But a series of illegal acts following upon one another can, in the context, lead justifiably to the conclusion that they are a part of the same transaction, of which the object is to cause or commit the oppression of persons against whom those acts are directed”.

#### **4. Non Declaration of Dividend :**

In *Mr. Vasudev P Hanji & Others v. Ashok Ironworks Pvt. Ltd.* (2008, 145 Comp. Cases 717), and in the case of *Jaladhar Chakraborty & Ors. v. Power Tools and Appliances Co. Ltd.* (1994, 79 Comp. Cases 505), it was held that “declaration of dividend is left to the collective decision of the Board and its non-declaration cannot be termed to be an oppressive conduct”.

#### **5. Increase of share capital of a company for the sole purpose of gaining control of the company would amount to oppression**

Oppressive to any member or members was clearly mentioned by the Supreme Court in *Dale and Carrington Investment (P) Ltd. v. P. K. Prathapan and Others* [(2004) Vol. 122 CC 161], held that increase of share capital of a company for the sole purpose of gaining control of the company, where the majority shareholder is reduced to minority, would amount to oppression. The director holds a fiduciary position and could not on his own issue shares to himself. In such cases the oppressor would not be given an opportunity to buy out the oppressed.

#### **6. Non-Availability of Records**

In *Chandra Krishan Gupta v. Pannalal Girdhari Lal Pvt. Ltd.* [(1984) 55 Com Cases 702 (Del.)] it was held that “The non-maintaining of the assets register or records cannot amount to acts of oppression being committed on minority shareholders. Similarly no maintaining of statutory books at the registered office may attract evil consequences to the directors and may also, in certain circumstances, amount to an act of mismanagement but under no circumstances, can it be regarded as an act of oppression”.

#### **7. Non Holding of Meetings of the Board**

In *Chandra Krishan Gupta v. Pannalal Girdhari Lal Pvt. Ltd., supra*, it was held that “The non-holding of the meetings of the Board would not amount to oppression of minority shareholders. The rights of the petitioner as a director might have been affected but his rights as a minority shareholder have not been affected thereby”.

#### **8. Filing of Unaudited Balance Sheets**

In *Chandra Krishan Gupta v. Pannalal Girdhari Lal Pvt. Ltd., supra*, it was held that “Filing of the unaudited balance sheets show misconduct in the managing of the affairs of the company. If this act causes prejudice to the company’s interests, it may justify action under Section 398 of the (Old) Act but this by itself cannot be regarded as an ingredient of oppression within the meaning of Sec. 397 of the Act.”

9. Minor acts of mismanagement, however, are not to be regarded as oppression. As far as possible, shareholders should try to resolve their differences by mutual readjustment. Moreover, the courts will not allow these special remedies to become a vexatious source of litigation. For example, in *Lalita Rajya Lakshmi v. Indian Motor Co. A.I.R. 1962 Cal 127*, the petitioner alleged that the Board of directors were guilty of certain acts detrimental to the minority of the shareholders. The allegations were that the income of the company was deliberately shown less by excessive expenditure; that passengers

travelling without ticket on the company's buses were not checked; that petrol consumption was not properly checked; that second hand buses of the company had been disposed of at low price, that dividends were being declared at too low a figure. It was held that even if each of these allegations were proved to the satisfaction of the court, there would have been no oppression.

10. A member can complain of oppression only in his capacity as a member and not in his capacity as director or creditor [*In re. Bellador Silk Ltd.*, (1965) 1 All ER 667].
11. The legal heirs to be registered on probate or will are also entitled to apply. [*K. S. Mothilal v. K.S. Kasimaris Ceranique (P.) Ltd.*, (2007) 135 Com Cases 609 CLB].
12. A shareholder dies and his heirs apply for transmission of shares while their application for succession certificate was pending before the Civil Court. The legal heirs alleged illegal allotment of shares by respondent to themselves, reducing the legal heirs to minority. It has held that the legal heirs are entitled to file a petition alleging oppression and mismanagement. [*Rajkumar Devraj & Anr. v. Jai Mahal Hotels Pvt. Ltd. & Others* (CLB) CA. No. 133 of 2006 in C.P. No. 30 of 2006].
13. In *Re Five Minute Car Wash Service Ltd.* (1966) 1 All ER 242, a petition founded on the ground that the managing director has been unwise, inefficient and careless in the performance of his duties could not succeed.

It should not, however, be supposed that these special remedies against oppression or mismanagement are available only to minorities. "In an appropriate case, if the court is satisfied about the act of oppression or mismanagement, relief can be granted even if the application is made by a majority, who have been rendered completely ineffective by the wrongful acts of a minority group. "Accordingly, a relief under the section was allowed to a majority group by Mitra, J., of the Calcutta High Court in *In Re. Sindhri Iron Foundry Ltd.* (1963) 68 CWN 118. His Lordship observed that "if the court finds that the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, that two different registered offices at two different addresses have been set up, that two rival Boards are holding meetings, that the company's business, property and assets have passed to the hands of unauthorised persons who have taken wrongful possession and who claim to be the shareholders and directors there is no reason why the court should not make appropriate order to put an end to such matters.

Referring to the argument that the majority could always call a meeting and put things in order by passing resolutions, his Lordship said:

"The facts in this case show very clearly, that there is no chance of redress in the domestic forum of the company. If a Board meeting was to be called, one group would contend that there were five directors, whereas the other group would urge that there were seven. If a meeting of the shareholders was to be convened, according to one group there would be only sixteen shareholders, while according to the other the number would exceed twenty- five. There would be complete chaos and confusion."

14. In *Tea Brokers P. Ltd. v. Hemendra Prosad Barooah* (1998) 5 Comp LJ 963 (Cal.) the Division Bench of Calcutta High Court observed that:  
  
'This is undoubtedly, a right and privilege which a member enjoys in his capacity as a member of the company... such an act may be even a single act done on one particular occasion if the effect of such an act will be of a continuing nature and the member concerned is deprived of his rights and privilege for all time to come in future'.
15. In *Ramshankar Prasad v. Sindhu Iron Foundry (P) Ltd.*, AIR 1966 Cal 512, it was held that a petition under Section 397, would be maintainable even if the oppression was of a short duration and of a singular conduct if its effects persisted indefinitely [followed in *Maharashtra Power Development Corporation. Ltd. v. Dabhol Power Co. Ltd.* (2003) 56 CLA 263 (Bom.)].

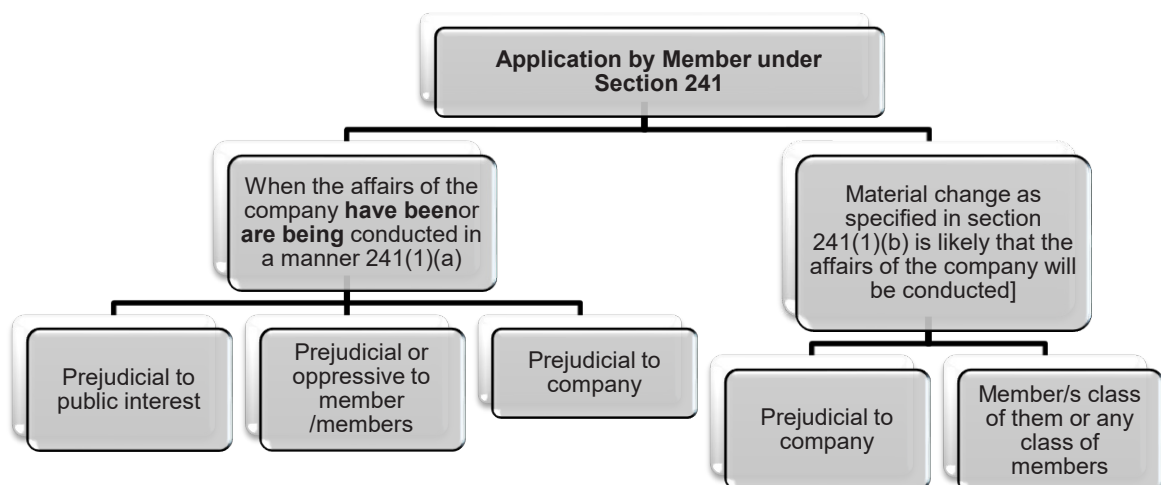
16. In *Bhagirath Agarwala v. Tara Properties P. Ltd.* (2003) 51 CLA 57 (Cal.), also the removal of a director and allotment of shares were set aside as they were done at a meeting which was covered without complying with the requirements of Section 286 and also reflected an oppressive policy. The allotment was made only to one member without simultaneous offer to others on pro rata basis. A single act of issue of additional shares can have a continuous effect. It can constitute oppression. A relief can be had against it. There is no bar of limitation in such a case. [*Ashok Kumar Oswal v. Panchsher Textile Mfg. & Trading Co. Ltd.* (2002) 110 Com Cases 800 (CLB-PB)].
17. Past acts of oppression will not entitle a plaintiff to seek the remedy under Section 397. The purpose of this section is not so much to take up the past as to redeem the future. A catalogue of charges of the past alleged misdeeds will not attract the section [*Thakur Prem Singh v. Thakur Hotel (Simla) Co. (P) Ltd.*, AIR 1963 Punj. 63; *Raghunath Swarup Mathur v. Har Swarup Mathur*, (1970) 40 Com Cases 282 (All)].

### Application to Tribunal for Relief in Cases of Oppression

#### (1) Application by member [Section 241(1)]

According to section 241(1) of the Companies Act, 2013, any member of the company may apply to the Tribunal, provided such member has a right to apply under section 244, for an order under this Chapter, if he who complains that

- (a) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company; or
- (b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members.



#### (2) Application by Central Government Section 241(2)

The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order.



**Circumstances- Section 241(3)**

Where in the opinion of the Central Government there exist circumstances suggesting that –

- (a) any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law or of breach of trust;
- (b) the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices;
- (c) a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or
- (d) the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest,

the Central Government may initiate a case against such person and refer the same to the Tribunal with a request that the Tribunal may inquire into the case and record a decision as to whether or not such person is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.

**Difference between Sub-clause 1(a) & 1(b) of Section 241 and Section 241(2)**

1. Section 241 1(a) deals with the affairs of the company either in the past or present and such oppression is prejudicial to Public interest or to the Members of the company or to the Company itself.
2. Section 241 1(b) deals with a situation where a material changes takes place in the company either in the Board or in the Shareholding pattern and such change is not in the interest of creditors or members of the company and such change is likely to be prejudicial to the Company or its Members. Public interest is not covered under Section 241(1(b))
3. Under Section 241(2) central government may also apply to the tribunal if it is of the opinion that the affairs of the company are being (does not cover the past acts) conducted in a manner prejudicial to public interest.

**Right of Members to Apply**

Section 244(1) provides that the following members of a company shall have the right to apply under section 241, namely: –

- (a) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;
- (b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members:

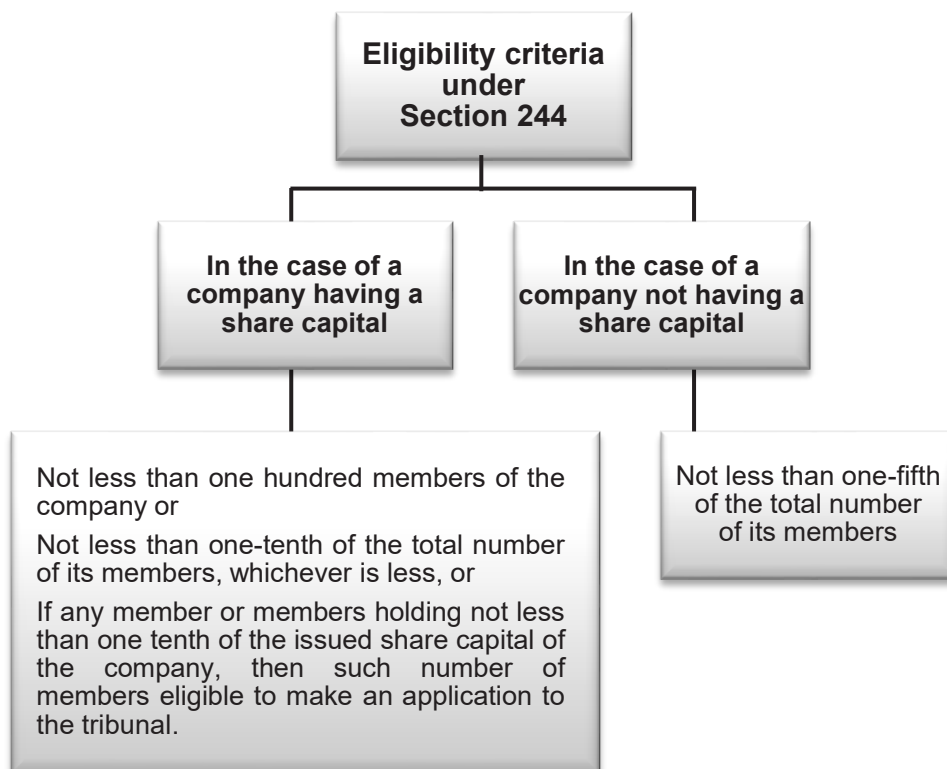
Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b) so as to enable the members to apply under section 241.

*Explanation* – For the purposes of this sub-section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

### Entitlement of Members to make an Application

Section 244(2) provides that where any members of a company are entitled to make an application under sub-section (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.

The criteria prescribed are divided into two categories of companies based on having share capital and not having share capital.



An explanation was provided for the purposes of clarification in relation to joint shareholding. According to the explanation provided where any share or shares are held by two or more persons jointly, they shall be counted only as one member

### Whether a Shareholder is eligible to make an application under this Section?

The word used under this Section is member but not the shareholder. It implies that a person whose name is duly entered as member in the register of members only is eligible to make an application to the Tribunal under this Section.

A person who is holding shares and not entered as member in the register of members of the company is not eligible to make an application under this Section.

A member can complain of oppression only in his capacity as a member and not in his capacity as director or creditor as held in *Re. Bellador Silk Ltd.* [(1965) 1 All ER 667]

### Person who is mentioned as Beneficiary in the records of NSDL and CDSL

The person mentioned as beneficiary is also covered in the definition of member and accordingly any person

who is in the list of ben-poses being submitted by NSDL and CDSL in relation to that company is eligible to make an application to the Tribunal under this Section.

### **Are members holding partly paid shares eligible?**

The words used in the clause (a) of sub-Section (1) of Section 244 is 'the issued share capital'. This implies the issued share capital always consists of paid up capital either fully paid or partly paid based on the calls made by the company.

If the company has made few calls and not yet made the remaining calls to make those shares fully paid, in those circumstances also the members holding those partly paid shares are eligible as per the criteria mentioned in this Section.

But in case if the company has made calls for making the shares fully paid up and few members have not paid such calls, then they shall not be eligible under this Section to make an application with the Tribunal.

### **Body corporate mentioned as member in the Register of Members**

If a body corporate is holding shares in the company and its name is entered in the Register of Members is also eligible to make an application. The member need not necessarily be an Individual. It can be any body corporate which is eligible to hold shares as per the provisions of any statute.

### **Position of Preference shareholder**

Whether preference shareholder can make an application to tribunal for relief in cases of oppression and mismanagement? The answer is affirmative. Since preference shareholder is also a member as per definition of member in sub-clause (iii) of clause (55) of Section 2. Hence he can also make an application to tribunal under this Section for relief in cases of oppression and mismanagement.

### **Position of Debenture holder**

Whether the interest of other stakeholders such as debenture holders etc., other than members of the company is protected? Will the expression under clause (a) of sub Section (1) which reads "...being conducted in a manner prejudicial to public interest..." include interest of debentures? The definition of member does not include debenture holders either holding convertible or not, hence he can't apply to Tribunal under this Section to protect his interest. Debenture holder being creditors, as per terms of contract, and to protect their interest they have to invoke other remedies available to them.

### **Position of other stakeholders**

The sub-clause (a) of sub-section (1) Section 241 categorically includes the expressions "prejudicial to public interest" and "prejudicial to the interests of the company" gives ample scope to protect the interests of others stakeholders also. Though the affected person cannot approach Tribunal, member of the company can go to Tribunal by establishing the same.

### **Examples for calculation under Section 244:**

#### **Example 1:**

If a company is having 5000 members then:

100 members or one tenth of total members i.e, 500 members, which is less.

In this case 100 members is the eligibility criteria.

#### **Example 2:**

If a company is having 500 members then:

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100 members or one tenth of total members i.e, 50 members, which is less.

In this case 50 members is the eligibility criteria.

### **Example 3:**

If a company is having 50 members then:

100 members cannot be considered since total numbers of members are 50 and hence we have to check one tenth of total members i.e., 5 members, which is less.

In this case 5 members is the eligibility criteria.

### **Example 4:**

If a company is having 50 members but 2 members are holding not less than one tenth of the issued share capital of the company then:

In this case 2 members who are holding not less than one tenth of the issued share capital of the company is the eligibility criteria.

### **Example 5:**

If a company is having 50 members but the company is not having share capital and is limited by members then:

Not less than one-fifth of the total number of its members i.e, 10 members.

In this case 10 members of the company is the eligibility criteria.

## **Discretionary power of the tribunal with respect to waiver applications**

### ***Cyrus Investments Pvt. Ltd. & Anr. v. Tata Sons Ltd. & Ors: Case Study***

#### **Background:**

Tata Group is an Indian multinational conglomerate founded in 1868 by Jamsetji Tata, the company gained international recognition after purchasing several global companies. One of India's largest conglomerates, Tata Group is owned by Tata Sons. The group operates in more than 100 countries across six continents, with a mission '**To improve the quality of life of the communities we serve globally, through long-term stakeholder value creation based on Leadership with Trust**'.

Tata Sons is the principal investment holding company and promoter of Tata companies. Approximately 66% of the equity share capital of Tata Sons is held by philanthropic trusts, which supports education, health, livelihood generation, art, culture etc. The next major chunk of approx 18% is controlled by Shapoorji Pallonji Group, whose heir apparent is Cyrus Mistry.

Mr. Cyrus Mistry was appointed as the chairman of Tata Sons in the year December, 2012 who was the sixth chairman of Tata Sons.

#### **Timeline of Events:**

#### **Cyrus Mistry's Ouster**

- 1) In the Board meeting of Tata Sons Limited held on 24th October, 2016, Mr. Cyrus Mistry, was replaced from the post of Executive Chairman with immediate effect on ground of growing trust deficit and repeated departures from the culture and ethos of the Tata group and Mr. Ratan Tata was appointed as the interim Chairman of Tata Sons and a committee was formed to hunt for a new chairman in four months.
- 2) On 25th October, 2016, Tata Sons filed caveats in Supreme Court, Bombay High Court and National Company Law Tribunal to prevent ousted Tata Sons Chairman Cyrus Mistry from getting an ex-parte

order against his sacking. They don't want any court to pass any ex-parte orders without hearing their side of the story.

### Legal Battle

- 3) In December, 2016, two Mistry family backed investment firms - 'Cyrus Investments Private Limited' and 'Sterling Investment Corporation Private Limited', the minority group of shareholders/ 'Shapoorji Pallonji Group' ("SP Group" for short) holding 18.37% of equity share capital "hereinafter referred to as Petitioner" filed a suit in National Company Law Tribunal (NCLT) Mumbai bench under Sections 241-242 of the Companies Act, 2013 alleging prejudicial and oppressional acts of the majority shareholders. They also challenged Cyrus Mistry's removal.
- 4) In reply to this suit, Tata Sons alleged that Mistry family backed investment firms don't have the necessary qualification to file a suit against them. As the petitioners do not hold at least 10% of the "issued share capital" of Tata Sons or representing at least one-tenth of the total number of members, as required by the Companies Act, 2013. According to Tata Sons, though the petitioners hold 18.37% of equity share capital of the company, their holding fell to approximately 2.17% when both equity and preference shares were taken into account. With regard to the power of a tribunal to waive off such requirements if applied for by a petitioner, Tata Sons has contended that since, the petitioners had not sought such a waiver during the filing of the petition, such a request should not be accommodated at a later stage.
- 5) In the application filed by Mistry family firms stated that the Tata Sons' understanding of the legal provision is not correct. They hold 18.37% of equity shares in the Company and if preference shareholding is considered none of the groups would have the requisite 10% issued and paid up share capital and would lead to an absurdity as none of them would be able to maintain an application. Further, it asked the tribunal to waive off the 10% minimum shareholding norm requirement stating that there are enough 'facts, circumstances and sufficient reasons' which warrants the tribunal to exercise its powers so that the petition can be heard on its merits. If not done so "the grave issues raised in the petition would go entirely un-investigated".

### Provision of the Companies Act, 2013

Under Section 244 of Companies Act, 2013, the following members of a Company shall have the right to file application under Section 241 of Companies Act, 2013 namely:

- (a) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one-tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;
- (b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.

Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b) above so as to enable the members to apply under section 241 of Companies Act 2013, for prevention of oppression or mismanagement against minority shareholders.

- 6) Meanwhile during pendency of the case in NCLT, Tata Sons issued notice in month of January calling for Extraordinary General Meeting ('EGM') of the company on 6th February, 2017 with subject of business being removal of Mr. Cyrus Mistry as director of Tata Sons.
- 7) On 6th February, 2017, shareholders of Tata Sons removed Mr. Cyrus Mistry as director of Tata Sons.

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- 8) With effect from 21st February, 2017, Mr. N Chandrasekaran took the charge as Executive Chairman of Tata Sons.
- 9) The National Company Law Tribunal (NCLT), Mumbai Bench, initially dismissed the petition under Sections 241-242 of the Companies Act, 2013 being non-maintainable, citing that no cause of action was established in any of the allegations raised by the Petitioners, they didn't meet the criteria of 10% ownership in a company for the filing of a case of alleged oppression of minority shareholders under the Companies Act, 2013 and also dismissed the petition for waiver.
- 10) Petitioner moved The National Company Law Appellate Tribunal (NCLAT), challenging NCLT order which rejected their petitions over maintainability. They also challenged rejection of their waiver plea.
- 11) NCLAT by its order dated 21st September, 2017 allowed the plea by the petitioners seeking waiver in filing case of oppression and mismanagement against Tata Sons taking into consideration the exceptional circumstances and directed the Mumbai bench of the NCLT to proceed in the matter.

### **Allegations of the Petitioner:**

- i) The Articles of Association of the Company ("Articles") are per se oppressive as they ensure that Sir Ratan Tata Trust and Sir Dorabji Tata Trust control the affairs of the Company.
- ii) Huge interference of Mr. Ratan N. Tata and Mr. N.A. Soonawala in every decision of the Company.
- iii) The Petitioners alleged that the powers vested under certain Articles were not exercised in a judicious manner and should be struck off in entirety. However, the Petitioners failed to disclose in their pleadings whether at the time of making amendments to the specific Articles, they did not attend the meeting, contested and voted against the resolution.
- iv) Overpriced Corus acquisition- Tata Steel Limited purchased Corus Group PLC (Corus) for a sum approximately in excess of USD 12 billion at a substantial premium, the value of which was more than 33% of its original offer price.
- v) Continuation of doomed business of Nano Car Project undertaken by Tata Motors upon insistence of Mr. Ratan Tata.
- vi) Use of Tata Sons shareholding in certain Tata Group Companies to requisition EGM for removal of Cyrus Mistry as Director from the Board of Tata Sons.
- vii) Illegal removal of Mr. Cyrus Mistry as the Chairman of the Company was in violation of law, principles of governance, fairness, transparency and probity.
- viii) Actions of Tata Sons undermined the position and status of independent Directors in listed Tata Group companies and taking steps to remove Nasli Wadia as he expressed support towards Mr. Cyrus Mistry.
- ix) Joint Venture between Air Asia Limited and Telstra Tradeplace Private Limited entering the aviation sector including possible fraudulent, hawala transactions as indicated in the Deloitte Forensic Report.
- x) Actions of Mr. Ratan Tata constitute breach of SEBI Regulations on prohibition of Insider Trading.
- xi) Close relationship of Ratan Tata with Shiva leading to leakage of Board meeting discussions.
- xii) Bestowing contracts upon Mr. Mehli Mistry and enriching him at the cost of Tata companies.

### **Reply to the petition on behalf of Tata Sons:**

- i) The company says that this petition is primarily filed to advocate the cause of Mr. Cyrus Mistry's removal as illegal and prejudicial to the petitioners so that to raise the issues of alleged oppression

against the petitioners and alleged mismanagement in the company, but in reality, it is nothing but a strategy by Mr. Cyrus Mistry to publicly express his displeasure at the loss of his office as executive chairman of the company and also to tarnish the reputation of the company.

- ii) Mr. Ratan Tata was appointed as chairman of the company in the year 1991 and continued for about 21 years until his retirement in the year 2012 upon attaining the retirement age of 75 years, and that in his leadership, Tata group witnessed best significant growth and the valuation of the company increased more than 500 times.
- iii) In December 2012, the board of the company decided to re-designate Mr. Cyrus Mistry as executive chairman of the company, in the same board meeting, the board decided that Mr. Ratan Tata should, as a special and a permanent invitee to the board meetings, continue to receive notices, agenda papers and the minutes of the board meetings, so that Mr. Ratan Tata could attend at his choice, any meeting which he would feel appropriate but whereas Mr. Ratan Tata clarified that he would no longer be on the board, he would always be available if the directors needed his guidance.
- iv) As to the allegations regarding arbitrary articles of the Company are concerned, shareholders of the company passed an unanimous resolution introducing a right to Tata Trusts to jointly nominate "one-third of the prevailing number of directors on the Board" so long as the Trusts own and hold in aggregate at least 40% of the paid-up ordinary share capital of the company and that all "matters before any meeting of the board which are required to be decided by a majority of the directors shall require the affirmative vote of all the directors appointed pursuant to article 104B at the meeting". This article was subsequently amended by the shareholders of the company pursuant to which, the affirmative vote could be exercised by "majority of directors appointed pursuant to Article 104B present at the meeting". Tata Sons states that it is pertinent to note that Mr. Pallonji Shapoorji Mistry was present at the General Meeting and voted in favour of the adoption of the new version of the Articles of Association which the petitioners now want to struck off in entirety.
- v) During the tenure of Mr. Cyrus Mistry, several disturbing facts emerged in relation to his leadership in respect to capital allocation decisions, slow execution on problems that were identified, which are called as "hot spots", strategic plan and business plan lacked specificity and no meaningful steps to enter new growth businesses, reluctant to embrace the articles of association leads to growing trust deficit between the Board of Directors and Mr. Cyrus Mistry.
- vi) Mr. Cyrus Mistry in a systematic manner reduced the representation of the company on the Boards of other major Tata Companies. Over a period of time, several directors of the company on the Board of Tata group Companies retired. Exercising the executive power, Mr. Cyrus Mistry did not appoint any directors of the company on the Boards of other Tata Companies, as was practice in the past. This systemic dilution weakened the bind through which Tata values, ethos, governance principles, group strategies were to be implemented across the Tata Group Companies. In most of the cases, Mr. Cyrus Mistry ensured that he was the only director who was common to the company and Tata group companies, effectively making himself the only channel between the company and Tata Group Companies.
- vii) Mr. Cyrus Mistry acted unwisely in acquiring Welspun Renewables Energy Ltd. by Tata Power Renewable Energy Ltd., a subsidiary of Tata Power company, to which purchase consideration for the transaction was estimated to be approximately in excess of USD 1 billion, because Tata power was in already 40,000 crores debt apart from non-resolution of tariff issue of its Mundra Project. In addition to this problem, Mr. Cyrus Mistry, without placing it before the Directors of the company, agreed for such an execution.
- viii) The Articles of Association against which these Petitioners making hue and cry were unanimously



approved either by the father of Mr. Cyrus Mistry or by Mr. Cyrus Mistry himself, though amendments have come to these Articles long before, they did never become a problem to these Petitioners until before Mr. Cyrus Mistry's removal, now all those past acts have all of sudden become oppressive against the Petitioners from the day he was removed as Chairman.

- ix) As to historical business decision and investment by the Tata Group, the company says, Tata Steel acquisition of Corus Group is the largest overseas acquisition by Indian corporate, making Tata Steel the world's sixth largest steel producer. The launch of Nano Car by Tata Motors, is a revolutionary aimed at changing the landscape of Indian Passenger car market. Siva group is a Consultant to TTSL as an equity investor. The company re-entered into an aviation business through joint ventures with two of Asia's leading airline carriers in the low cost segment and premium full service business. As to Mr. Mehli is concerned, it has nowhere been mentioned in the Petition that Mr. Cyrus Mistry was the director on the board of Tata Power from the year 2002 approving many of the transactions, Tata Power entered into with Mr. Mehli. The company submits that all the above issues raked up by the petitioners were all hit by delay and laches for many of them or almost all of them were issues in between 1993 and 2008, therefore those issues cannot be issues before this Bench solely because Mr. Cyrus Mistry was removed as Chairman.
  - x) The company submits that this petition is sponsored by Mr. Cyrus Mistry to pursue personal vendetta against Mr. Ratan Tata and Mr. Soonawala to adopt a "scorched earth policy" so as to tarnish the reputation of the company on being removed as Chairman of the board of directors of the company.
  - xi) The company submits that the allegations in the petition do not constitute the affairs of the company, which in fact is a petition sought to impugn the affairs of public charitable trusts which is not permissible under law, of course, the allegation of violation of Insider Trading Regulation and FEMA Regulations is not triable by this Bench.
  - xii) The Company submits that it is weird to hear that Tata Trusts acting detrimental to the interest of the company, if such is the case, Trusts are the first persons to suffer because such action would directly hurt the investments held by the Trusts in the company.
  - xiii) The company submits that the petitioners have cherry picked certain business decisions predating Mr. Ratan Tata has taken certain decisions during his tenure which the petitioners consider imprudent and non-judicious which have allegedly caused loss to the company. When they say Corus and Nano are instances of bad business deal, why they have not referred Tetley acquisition and immensely successful Jaguar Land Rover acquisition and phenomenal rise and success of TCS.
  - xiv) As to the allegation of interference by Mr. Soonawala, it has been said that he has held various positions on financial side in the company including that of Finance Director from 1988-89 to 2000, thereafter for 11 years as Vice Chairman and Finance Advisor of the company, therefore it was unanimously resolved that Mr. Soonawala would be available as an advisor to the company as such Mr. Cyrus himself and other persons from the company approached Mr. Soonawala on various occasions seeking his guidance and advice.
  - xv) It is denied that the removal of Mr. Cyrus Mistry as chairman of the company is wholly illegal, ultra-vires and constitutes suppression of the petitioners and it is against the interest of the company. It is submitted that the removal process does not suffer from any impropriety and it is in complete conformity with the provisions of the Act
- 12) On September 21, 2017, Tata Sons' shareholders approved conversion of Tata Sons from Public Limited Company to a Private Limited Company.



- 13) In November, 2017: Cyrus Mistry's camp moves petition to the NCLT, Mumbai, against Tata Sons going private.
- 14) On July 9, 2018: NCLT Mumbai dismissed pleas of Mr. Mistry challenging his removal as Tata Sons chairman and also the allegations of rampant misconduct on part of Mr. Ratan Tata and the company's Board. NCLT said it found no merit in his allegations of mismanagement in the Company. The two-judges bench also cleared the deck for Tata Sons going Private.
- 15) Accordingly, NCLT highlighted the past and products of the 'Tata Sons Limited' and observed that "The petitioners have petitioned to this Tribunal asking to seasoning of Tata Sons functioning, which keeps seasoning our daily food with Tata Salt. Irony is salt also at times needs salt to be seasoned....." and passed stricture observations against the Petitioners and dismissed the petition.
- 16) The Petitioners approached the NCLAT against the order of the NCLT of dismissal of plea of Mr. Mistry challenging his removal as chairman of the company. The NCLAT admitted petition filed by the petitioners and also admitted Mr. Cyrus Mistry's petition in his personal capacity and decided to hear along with the main petitions filed by the two investment firms.
- 17) On August 6, 2018: Tata Sons got nod from Registrar of Companies for conversion from Public to Private Company.
- 18) On May 23, 2019: NCLAT reserves its order after completing the hearing in the matter.
- 19) On December 18, 2019, the NCLAT gave its judgement in favour of Mistry camp and set aside the order of NCLT. The NCLAT reinstated Mr. Mistry as the Executive Chairperson for Tata Sons for his remaining term, and declared that the appointment of Natarajan Chandrasekaran as executive chairman of Tata Sons was illegal, but suspended its implementation for four weeks in order to provide time for Tatas to appeal. The NCLAT order had also set aside Tata Sons' decision to convert itself into a private company. The NCLAT enquired the Registrar of Companies (RoC) to explain the rationale behind allowing Tata Sons to convert into a private company and also sought details of the process for the permission.
- 20) In January 2020, Tata Sons appealed to the Supreme Court against National Company Law Appellate Tribunal (NCLAT) decision to re-instate Mr. Cyrus Mistry as its Chairman as this decision is a blow to corporate democracy and rights of the Board of Directors.

### Ground of Appeal

- i) Restoration of Cyrus Mistry "undermines corporate democracy". He was replaced after a majority in the Board voted against him.
  - ii) Mr. Mistry never sought re-instatement after his tenure ended.
  - iii) NCLAT's conclusions are based on an error that Tata Sons continues to be a Public Company.
  - iv) NCLAT imposed an unsolicited consultative process by asking the Tatas to consult minority shareholders Shapoorji-Pallonji group before appointing the executive chairman.
  - v) Restraint imposed by NCLAT on Mr. Ratan Tata and the nominee of the 'Tata Trusts' "from taking any decision in advance which requires majority decision of the Board of Directors or in the Annual General Meeting". According to Tata Sons such a direction was "wholly nebulous and seeks to stifle the exercise of rights of the shareholders and board members, resulting in their disenfranchisement which cripples corporate democracy".
- 21) Supreme Court on 10th January, 2020 stayed NCLAT order reinstating Mr. Cyrus Mistry as the executive chairman of Tata Sons and restoring his directorships in the holding company, with a preliminary observation that the first impression of the order was "not good" and that the tribunal 'could not have given consequential relief that had not been sought in the first place'.

- 22) On 24th January, 2020 The Supreme Court put stay on the NCLAT order of dismissing the Registrar of Companies (RoC) plea seeking modification of its verdict in the Tata-Cyrus Mistry matter.

### **Powers of Tribunal**

Section 242(1) provides that on any application made under section 241, the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, if it is of the opinion –

- (a) that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; and
- (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.

Section 242(2) provides that without prejudice to the generality of the powers under sub-section (1) an order under that sub-section may provide for –

- (a) the regulation of conduct of affairs of the company in future;
- (b) the purchase of shares or interests of any members of the company by other members thereof or by the company;
- (c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;
- (d) restrictions on the transfer or allotment of the shares of the company;
- (e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;
- (f) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e): No such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;
- (g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;
- (h) removal of the managing director, manager or any of the directors of the company;
- (i) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;
- (j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);
- (k) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;
- (l) imposition of costs as may be deemed fit by the Tribunal;
- (m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

### **Filing of copy of Order of Tribunal**

Section 242(3) provides that a certified copy of the order of the Tribunal under Section 242(1) shall be filed by the company with the Registrar within thirty days of the order of the Tribunal.

### **Interim Order & Recording its Decision**

According to Section 242(4), the Tribunal may, on the application of any party to the proceeding, make any interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable.

Section 242(4A) states that at the conclusion of hearing of the case in respect of section 242(3), the Tribunal shall record its decisions stating therein specifically as to whether or not the respondent is a fit and proper person to hold the office of director or any other office connected with the conduct and management of the company.

### **Alteration through Order of the Tribunal**

According to Section 242(5) and (6), where an order of the Tribunal under Section 242(1) makes any alteration in the memorandum or articles of a company, then, notwithstanding any other provision of this Act, the company shall not have power, except to the extent, if any, permitted in the order, to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order, either in the memorandum or in the articles. The alterations made by the order in the memorandum or articles of a company shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act and the said provisions shall apply accordingly to the memorandum or articles so altered.

### **Certified copy of altered Order shall be filed with the Registrar**

Section 242(7) provides that a certified copy of every order altering, or giving leave to alter, a company's memorandum or articles, shall within thirty days after the making thereof, be filed by the company with the Registrar who shall register the same.

### **Punishment in case of Contravention**

Section 242(8) provides that if a company contravenes the provisions of sub-section (5), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

### **Consequence of Termination or Modification of Certain Agreements**

Section 243(1) states that where an order made under section 242 terminates, sets aside or modifies an agreement such as is referred to in sub-section (2) of that section, –

- (a) such order shall not give rise to any claims whatever against the company by any person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;
- (b) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company:

Section 243 (1A) provides that the person who is not fit and proper person pursuant to section 242(4A) shall not

hold office of directors or any other office connected with the conduct of management of affairs of company for a period of 5 years from the date of the said decision.

Provided that the Central Government may, with the leave of the Tribunal, permit such person to hold any such office before the said period of five years.

According to Section 243(1B), notwithstanding anything contained in any other provision of this Act, or any other law for the time being in force or any contract, memorandum or article, on the removal of a person from the office of a director or any other office connected with the conduct and management of the affairs of the company, that person shall not be entitled to, or be paid, any compensation for the loss or termination of office.

Provided that the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

Further, Section 243(2) provides that any person who knowingly acts as a managing director or other director or manager of a company in contravention of clause (b) of sub-section (1), [or sub-section (1A)] and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both.

## **TRANSFER AND TRANSMISSION OF SECURITIES (SECTION 56)**

### **Conditions for Transfer**

Section 56(1) states that a company shall not register a transfer of securities of the company, or the interest of a member in the company in the case of a company having no share capital, other than the transfer between persons both of whose names are entered as holders of beneficial interest in the records of a depository, unless a proper instrument of transfer in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or the transferee within a period of sixty days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities:

### **When the transfer instrument has been lost or presented late**

Provided that where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to indemnity as the Board may think fit.

#### *Exception:*

Section 56(2) states that nothing in sub-section (1) shall prejudice the power of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted

### **Transfer in case of partly paid shares**

Section 56(3) states that where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.

### **Time limit for delivery of certificates**

Section 56(4) states that every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted –

- (a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;
- (b) within a period of two months from the date of allotment, in the case of any allotment of any of its shares;
- (c) within a period of one month from the date of receipt by the company of the instrument of transfer under sub-section (1) or, as the case may be, of the intimation of transmission under sub-section (2), in the case of a transfer or transmission of securities;
- (d) within a period of six months from the date of allotment in the case of any allotment of debenture:

Provided that where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.

#### **Transfer of shares of deceased person**

(2) Section 56(5) states that the transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.

#### **Transmission in case of nomination**

Section 72 provides that when a shareholder nominates any person, then in case of the death of the shareholder company needs to transfer only to the nominee duly notified. In this case company has no further responsibility. In case of claim or any dispute in this regard the decision of the courts shall be final and binding

#### **Punishment for Default**

Section 56(6) states that Where any default is made in complying with the provisions of sub-sections (1) to (5), the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

In case of transfer of dematerialized shares in a listed company, the company has no role to play. The depository participants would ensure the transfer is effected in accordance with law. In case a depository participant, with intention to defraud a person, transfers the shares illegally it shall be punishable under Section 447. This penalty is in addition to any other liability that may be attracted under Depositories Act 1996.

### **PUNISHMENT FOR PERSONATION OF SHAREHOLDER (SECTION 57)**

If any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

### **REFUSAL OF REGISTRATION AND APPEAL AGAINST REFUSAL (SECTION 58)**

#### **Transfer in case of private company**

Section 57(1) provides that transfer or transmission of securities or interest of a member in respect of a private limited company is to be effected strictly as per its articles of association. In case the same is refused by the company, the company within thirty days to send the notice of refusal along with the reason for the same. This refusal notice is to be issued to the person (transferor or transferee) who has lodged the transfer/ transmission.

### Free transferability of shares in case of public companies

Sub-section (2) provides that securities or other interests shall be freely transferable in a public company. But in case of any contract or arrangement between two or more persons with respect of transfer of securities the same shall be enforceable as a contract.

### Appeal to Tribunal

Sub Section (3) provides that the transferee (not the transferor) may appeal to tribunal within 30 days of refusal notice by the company and in case company does respond in any manner then within 60 days of delivery of instrument of Transfer or intimation given to the company in case of transmission.

### Time limit to approach Tribunal in case of public companies

Sub-section (4) provides that in case of public companies, which refuses to register transfer without sufficient cause within a period of thirty days from the date on which the instrument of transfer or the intimation of transmission, as the case may be is delivered to the company, the transferee may within a period of sixty days of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

### Whether the time limit of sixty days is critical?

Dealing with this issue in the previous 1956 Act under equivalent Section 111A the Calcutta High Court in *Peerless General Finance and Investments Limited v. Poddar Projects Limited* (2008 81 SCL 51 Cal) in para 14 of the order observes as follows:

“The proviso to sub-sections (2) and (3) of Section 111A stipulate that if a company without sufficient cause refuses to register the transfer within two months from the date of lodgment the transferee may approach the Tribunal for relief. Hence, the transferee has to wait for two months to approach the Company Law Board. Such two months period is not an outer limit contemplated in the said Section.”

The above analogy equally applies to Section 58 of the Act. Time limit of sixty days to make an appeal to tribunal can be extended if sufficient reasons can be attributed for the delay.

### Powers of Tribunal

The tribunal after hearing the parties may decide the issue. In case it orders for registration of securities and order for rectification of register, in addition it may also order for damages. Once transfer/transmission is ordered the concerned company has to implement the order within 10 days of the receipt of the order.

### Offence and compoundability

In case orders of Tribunal are not complied with, the concerned person shall be liable for imprisonment of minimum one year and may extend to three years in addition to minimum fine of Rupees One lakh which may go upto Rupees Five Lakhs. Violation of sub-section (5) is not compoundable.

## RECTIFICATION OF REGISTER OF MEMBERS (SECTION 59)

- (1) If the name of any person is, without sufficient cause, entered in the register of members of a company, or after having been entered in the register, is, **without sufficient cause**, omitted there from, or if a default is made, or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved, or any member of the company, or the company may appeal in such form as may be prescribed, to the Tribunal, or to a competent court outside India, specified by the Central Government by notification, in respect of foreign members or debenture holders residing outside India, for rectification of the register.



### Right to appeal

Unlike in Section 58 wherein only transferee can appeal to tribunal, under this Section, the following persons may prefer an appeal:

- (a) A member of the company
- (b) The person aggrieved
- (c) The company itself

It was held in *Chotoo Sud v. Bhagwan Finance Corpn. (P.) Ltd.* [2006] 66 SCL 223 (CLB - KOL.):

“Section 111 of the Companies Act, 1956 - Transfer of shares - Power to refuse registration and appeal against refusal - Whether a petition under Section 111(4) can be filed by an aggrieved person or company or any member so long as he establishes that name of any person is entered or omitted from Register of Members ‘without sufficient cause’ - Held, yes”

In case of foreign members or debenture holders residing outside India, the appeal can be preferred at competent court outside India. In this regard Central Government will specifically notify competent courts outside India which could hear matters for rectification.

### Meaning of sufficient cause

What is without sufficient cause? There are several decisions explaining what is sufficient cause. Some of the decisions are extracted below:

- (a) In *Benarsi Das Saraf v. Dalmia Dadri Cement Ltd.* AIR 1959 Punj. 232, the words ‘sufficient cause’ has been considered in detail. Reference was also made to the observations of Lord Cairns, LJ extracted above. The Court said:

“22. The word ‘sufficient’ means, ‘adequate’, ‘enough’, ‘as much as may be necessary to answer the purpose intended’. It embraces no more than, that which provides a plentitude which, when done, suffices to accomplish the purpose intended in the light of existing circumstances and when viewed from reasonable standard of practical and cautious men.” (p. 235)

- (b) In *Indian Chemical Products Ltd. v. State of Orissa* AIR 1967 SC 253, in paragraph 9, their Lordships said thus:

“(9) The power under article 11 to refuse registration of the transfer is a discretionary power. The directors must exercise this power reasonably and in good faith. The Court can control their discretion if they act capriciously or in bad faith....” (p. 256)

- (c) In *Smt. Mallina Bharathi Rao v. Gowthami Solvent Oils Ltd* [2001] 31 SCL 60 (CLB – CHENNAI), it was held that:

“Whether since company had not only authorised a director to sign transfer instrument on behalf of petitioner but effected transfer without share certificates, entire process of transfer was in violation of mandatory provisions of Section 108 and as such omission of petitioner’s name from Register of Members was without sufficient cause - Held, yes - Whether transfer of shares being in contravention of mandatory provisions of Section 108 and consequent omission of petitioner’s name being without sufficient cause, company should restore her name on Register of Members in respect of her shares and rectify register accordingly - Held, yes”

- (d) In *Asha Purandare v. Integrated Controls (P.) Ltd.* [2002] 39 SCL 970 (CLB – MUM.), that:

Whether minor typographical omission can be said to be sufficient cause for refusal by company to register transfer of shares in name of petitioners - Held, no”

- (e) It was held in *Gulshan Mahindru v. Reliance Industries Ltd.* [2014] 47 taxmann.com 186 (CLB - Mumbai) that:

Reason attributed by a company for refusal of transmission of shares and rectification of register of members that company had already transferred duplicate shares to its registered owners and shares had been dematerialized, cannot be said to be a sufficient and cogent reason as contemplated under Section 111A”

#### **Power of the tribunal**

(2) The Tribunal may, after hearing the parties to the appeal under sub-section (1) by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

#### **No restrictions on rights during pendency of proceedings**

Sub-section (3) provides an interesting feature wherein even during appeal being preferred under this Section, there is no interim restriction on the right of the holder of securities to transfer the same and person acquiring the same during the pendency of the proceedings before Tribunal shall be entitled to vote unless the voting rights have been suspended by an order of tribunal.

#### **Transfer of securities in contravention of statutory provisions**

Sub-section (4) provides that in case of transfer of securities in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, on an application by any of the following persons can be made:

- (a) The depository
- (b) The company
- (c) The depository participants
- (d) Holder of the securities
- (e) Securities Exchange Board of India

The tribunal may direct any company or a depository to set-right a contravention and order rectification.

Violation of SCRA, SEBI Act or any other Law for time being enforced:

- (a) It was held in *Jord Engineers (India) Ltd. v. 3A Capital Services Ltd.* [2014] 50 taxmann.com 376 (CLB - Mumbai) that:

“In case of acquisition of shares in violation of SEBI substantial acquisition takeover code would certainly attract Section 111A and CLB can certainly pass order for rectification even though SEBI violation has been compounded by the acquirers.”

- (b) It was held in *Tirupati Techno Projects Ltd. v. Modi Spinning & Weaving Mills. Co. Ltd.* [2015] 61 taxmann.com 136 (CLB - New Delhi) that:

“Unless RBI, SEBI and SICA provisions are violated and also declared as such by the statutory authority or by any court that violation has occurred company is duty bound to register the shares.”

- (c) It was held in *Transchem Ltd. v. Firstcorp International Ltd.* [2015] 57 taxmann.com 275 (CLB - Mumbai) that:



“CLB, in exercise of its rights and powers conferred upon it by virtue of provisions contained in Section 59(4) is not empowered to make investigation/enquiry into allegation that acquirers acting in concert have acquired shares in violation of Takeover Code”.

### Offence and compoundability

Any company not complying the order of the tribunal the company shall be liable for the fine of minimum Rs. 1,00,000 which may extend to Rs. 5,00,000 and in addition every officer of the company who is in default shall be punishable with imprisonment for a period upto one year or with fine which shall not be less than Rs. 1,00,000 but may extend upto Rs. 3,00,000 or with both. This offence under Section is compoundable.

## PUNISHMENT FOR WRONGFUL WITHHOLDING OF PROPERTY (SECTION 452)

(1) If any officer or employee of a company –

- (a) wrongfully obtains possession of any property, including cash of the company; or
- (b) having any such property including cash in his possession, wrongfully withholds it or knowingly applies it for the purposes other than those expressed or directed in the articles and authorised by this Act, he shall, on the complaint of the company or of any member or creditor or contributory thereof, be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

(2) The Court trying an offence under sub-section (1) may also order such officer or employee to deliver up or refund, within a time to be fixed by it, any such property or cash wrongfully obtained or wrongfully withheld or knowingly misapplied, the benefits that have been derived from such property or cash or in default, to undergo imprisonment for a term which may extend to two years.

## LESSON ROUND UP

- Chapter XVI of the Companies Act, 2013 (Section 241 to Section 246) deals with the provisions relating to prevention of oppression and mismanagement of a company.
- Oppression and mismanagement of a company mean that the affairs of the company are being conducted in a manner that is oppressive and biased against the minority shareholders or any member or members of the company. To prevent the same, there are provisions for the prevention and mismanagement of a company.
- The words “oppression” and “mismanagement” are not defined in the Act.
- The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.
- Section 241 1(a) deals with the affairs of the company either in the past or present and such oppression is prejudicial to Public interest or to the Members of the company or to the Company itself.
- Section 241 1(b) deals with a situation where a material changes takes place in the company either in the Board or in the Shareholding pattern and such change is not in the interest of creditors or members of the company and such change is likely to be prejudicial to the Company or its Members. Public interest is not covered under Section 241(1(b))
- Under Section 241(2) central government may also apply to the tribunal if it is of the opinion that the affairs of the company are being (does not cover the past acts) conducted in a manner prejudicial to public interest.

- Section 242(1) provides that on any application made under section 241, the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.
- Section 242(3) provides that a certified copy of the order of the Tribunal under Section 242(1) shall be filed by the company with the Registrar within thirty days of the order of the Tribunal.
- According to Section 242(4), the Tribunal may, on the application of any party to the proceeding, make any interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable.
- Section 242(4A) states that at the conclusion of hearing of the case in respect of section 242(3), the Tribunal shall record its decisions stating therein specifically as to whether or not the respondent is a fit and proper person to hold the office of director or any other office connected with the conduct and management of the company.

## TEST YOURSELF

*(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)*

1. Discuss Oppression and Mismanagement under the perspectives of Companies Act, 2013
2. What do you mean by Transfer and Transmission of Securities? Discuss
3. Write a short note on Cyrus Mistry Case
4. What are provisions of Punishment for Wrongful Withholding of Property

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# Lesson 3

## Class Action Suits

### LESSON OUTLINE

- Class Action Suits
- Evolution in India
- Impacts of Class Action Suits
- Types of Class Action Suit
- Class Action Suits under Companies Act, 2013
- Who can File Class Action Suits?
- Against Whom Class Action Suit can be Filed
- Clubbing of Similar Application and Bar on Future Litigation
- Class Action Suits And The Related Law In India
- LESSON ROUND UP
- TEST YOURSELF

### LEARNING OBJECTIVES

In this chapter, students will learn and analyze:

- Class Action Suits
- Provisions of Class Action Suit in relation to section 245 of CA 2013
- Process of Class Action Suit
- Related Rules of National Company Law Tribunal Rules, 2016 (“NCLT Rules”).

## INTRODUCTION

### CLASS ACTION SUITS

In a class action suit, a large group of people, having same or similar injuries caused by the same person, collectively bring a claim to court, represented by one or more persons. This form of lawsuit is also called a representative action. One set of persons representing a larger group approach the court for redressal of their grievances. The rationale behind such suits are- firstly to protect the interest of members of a class who are geographically dispersed and secondly to reduce the duplication of the litigation as it combines the various proceedings initiated in different parts/jurisdiction bearing same cause of action(s). Further it also makes adjudication possible; otherwise as per the rule of necessary party all the members of a class are required to be made plaintiff, which otherwise would have made the adjudication impossible.

This form of collective lawsuit is very popular in the United States of America (USA), United Kingdom (UK), Singapore and other European Countries. In USA, Class Action Suits are governed by Federal Rules of Civil Procedure Rule 23 and 28 U.S.C.A. § 1332 (d). In Singapore, Order 15, Rule 12 of Rules of Courts governs such suits. Likewise in UK, Rule 19.6 of the Civil Procedure Rule govern the Class Action Suits.

The origin of the class actions suits in the U.S. was in the year 1842 when the Equity Rule 48 gave the individuals the right to file such suits. After multiple changes and revisions, it gained its current form in the year 1966.

Since then, this option has been used on numerous occasions in the U.S. Even in 2006, many shareholders in the U.S. lost their money after investing in the shares of Enron. They received a total of \$7.2 billion after a probe revealed that the officials of the company had falsified to the investors and had hidden the losses before going bankrupt. Hence, it is pretty clear that the class action suits are pretty common in U.S. and are one of the usual redressal mechanisms.

In India, Class Action Suits will be governed under Section 245-246 of the Companies Act, 2013 (Act) and Rules made there under In India before the emergence of their grievances. The rationale behind such suits are - firstly to protect the interest of members of a class who are geographically dispersed and secondly to reduce the duplication of the litigation as it combines the various proceedings initiated in different parts/jurisdiction bearing same cause of action(s). Further it also makes adjudication possible; otherwise class action suits representative actions were taken via three modes - Civil Court, Consumer Court, and Public Interest Litigation petitions (PIL). The above three modes are discussed in brief hereunder.

### EVOLUTION IN INDIA

The aforesaid three representative actions lack jurisdiction towards the fraud on the minority by wrongdoers who are in control of a company. To be specific, the long adjudication period involved in representative suits discourage claims. Further lack of a provision under the erstwhile Companies Act, 1956 for representative suits by shareholders and other stakeholder leaves stakeholders high and dry in cases of fraud, misappropriations, siphoning of funds etc. This was specially felt at the time of Satyam fiasco, where the small investors were left to see their money go down the drain while the American depositors of the Satyam were able to receive \$ 125 mn in settlement as a result of a strong class action framework in US.

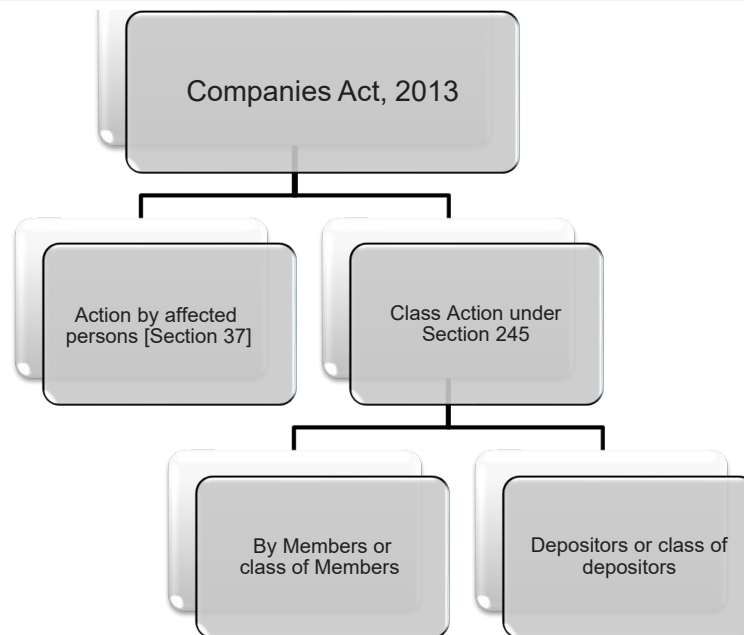
The Company Law Committee headed by Dr. J J Irani anticipated the requirement of such measure in 2005 and specifically advocated the need of such measure under Companies Act, in parallel to counterparts (i.e. USA, Singapore and UK). Subsequently in 2009, it gained its momentum with "India's Enron"- Satyam Fiasco case wherein financial accounts were manipulated to the extent of INR 7,855 Crores .Thereafter in Companies Bill, 2009, Class Action Suits were included as a measure to be available to the members and depositors of the company to approach National Company Law Tribunal (NCLT or Tribunal), if the affairs of the company were conducted in a manner prejudicial to the interest of the company, or its members and depositors.

## Types of Class Action Suit

In general, following are the types of Class Action Suits:

- (a) **Employment Class Actions:** Class action suits by employees against labour law violations
- (b) **Consumer Class Actions:** Class action by group of consumers
- (c) **Securities Class Actions:** Class action suit by shareholders/depositors/members, etc.

## Class Action Suits under Companies Act, 2013



### I. Action by affected persons [Section 37]

A suit can be filed, or any other action may be taken by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus under the following provisions of the Act:

- Section 34 (criminal liability for misstatements in a prospectus).
- Section 35 (civil liability for misstatements in a prospectus).
- Section 36 (punishment for fraudulently inducing persons to invest money).

### II. Class Action under Section 245

Class action suits by members and depositors of the company or any class of them:

The requisite numbers of members who can maintain a Class Action are specified as under: [Section 245(3)(i) and (ii)]

#### A. Class Action Suit by Members (Section 245(3)(i))

- (a) in the case of a company having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

- (b) In case of a company not having share capital, more than one-fifth of the total number of its members.

**B. Class Action Suit by depositors**

The number of depositors required to file class action are more than 100 in number or more than such percentage of the total number of depositors as may be prescribed, whichever is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed. [Section 245(3)(ii)]

Thresholds specified under National Company Law Tribunal (Second Amendment) Rules, 2019 (amended on May 08, 2019) relating to class action suits under Section 245.

**For class action suit by Members**

National Company Law Tribunal (Second Amendment) Rules, 2019 specified the following thresholds under Rule 84(3) of the NCLT Rules, 2016.

In case of a company having a share capital, the requisite number of member or members to file an application under sub-section (1) of section 245 shall be –

- (i) (a) at least five per cent. of the total number of members of the company; or
- (b) one hundred members of the company, whichever is less; or
- (ii) (a) member or members holding not less than five per cent. of the issued share capital of the company, in case of an unlisted company;
- (b) member or members holding not less than two per cent. of the issued share capital of the company, in case of a listed company

**For Class Action suit by Depositors**

National Company Law Tribunal (Second Amendment) Rules, 2019 specified the following thresholds under Rule 84(4) of the NCLT Rules, 2016.

The requisite number of depositor or depositors to file an application under sub-section (1) of section 245 shall be - (i) (a) at least five per cent of the total number of depositors of the company; or (b) one hundred depositors of the company, whichever is less; or; (ii) depositor or depositors to whom the company owes five per cent. of total deposits of the company.

**Class Action Suit vis-a-vis Rule 84 of the National Company Law Tribunal Rules, 2016<sup>1</sup>**

	Section 245 of the Companies Act, 2013	Rule 84 of the National Company Law Tribunal Rules, 2016
Application for class action	<p><b>Section 245 (1):</b></p> <p>Any members/depositors or any class of them, if they are of the opinion that affairs of the company are being conducted in a manner prejudicial to the interests of the company/ members/depositors, may file a petition to the NCLT.</p>	<p><b>Rule 84(1):</b></p> <p>The application specified under Section 245(1) read with sub-section (3) has to be filed in Form NCLT-9.</p> <p><b>Rule 84(2):</b></p> <p>The copy of every application under sub-rule (1) shall be served on the company, respondents and such other persons as may be directed by the Tribunal.</p>

1. <https://taxguru.in/company-law/class-action-suits-via-nclt-second-amendment-rules-2019.html#:~:text=Section%20245%20allows%20the%20members,interests%20of%20members%20or%20depositors.>

<p>Requisite number of persons to file a petition for class action</p>	<p><b>Section 245(3):</b></p> <p>The requisite number of members to file a petition u/s 245(1) shall be as under–</p> <p>For company having share capital, not less than 100 members or such percentage of the total number of members as may be prescribed, whichever is less; OR any member or members holding, singly or jointly, not less than such percentage of the issued share capital as may be prescribed.</p> <p>For company not having share capital, not less than 1/5th of the total number of members.</p> <p>The requisite number of depositors to file a petition u/s 245(1) shall be as under –</p> <p>not less than 100 depositors or such percentage of the total number of depositors as may be prescribed, whichever is less; OR any depositor or depositors to whom the company owes, singly or jointly, such percentage of the company's total deposits as may be prescribed.</p>	<p><b>Rule 84(3):</b> As inserted by the National Company Law Tribunal (Second Amendment) Rules, 2019</p> <p>The requisite number of members to file a petition u/s 245(1) shall be as under–</p> <p>For company having share capital, not less than 100 members or 5 percent of the total number of members, whichever is less; OR any member or members holding, singly or jointly, not less than 5 percent of the issued share capital in case of an unlisted company (2 percent in case of a listed company).</p> <p><b>Rule 84(4):</b> As inserted by the National Company Law Tribunal (Second Amendment) Rules, 2019</p> <p>The requisite number of depositors to file a petition u/s 245(1) shall be as under– not less than 100 depositors or 5 percent of the total number of depositors, whichever is less; OR any depositor or depositors to whom the company owes, singly or jointly, 5 percent of the company's total deposits.</p>
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### For Conducting a Class Action Suit –

Rule 85 National Company Law Tribunal Rules, 2016 provides for conducting Class Action Suit as below:

- (1) Without prejudice to the generality of the provisions of sub-section (4) of section 245 of the Act, the Tribunal may, while considering the admissibility of an application under the said section, in addition to the grounds specified therein, take into account the following:
  - (a) whether the class has so many members that joining them individually would be impractical, making a class action desirable;
  - (b) whether there are questions of law or fact common to the class;
  - (c) whether the claims or defences of the representative parties are typical of the claims or defences of the class;
  - (d) whether the representative parties will fairly and adequately protect the interests of the class.
- (2) For the purposes of clause (c) of sub-section (4) of section 245, while considering the desirability of an individual or separate action as opposed to a class action, the Tribunal may take into account, in particular, whether admitting separate actions by member or members or depositor or depositors would create a risk of:-
  - (a) Inconsistent or varying adjudications in such separate actions; or
  - (b) Adjudications that, as a practical matter, would be dispositive of the interests of the other members;
  - (c) Adjudications which would substantially impair or impede the ability of other members of the class to protect their interests.

### Rule of Opt-Out

Rule 86 National Company Law Tribunal Rules, 2016 provides for Opt-Out as below:

- (1) A member of a class action under section 245 of the Act is entitled to opt-out of the proceedings at any

time after the institution of the class action with the permission of the Tribunal, as per Form No. NCLT1.

- (2) For the purposes of this rule, a class member who receives a notice under clause (a) of sub section (5) of section 245 of the Act shall be deemed to be the member of a class, unless he expressly opts out Of the proceedings, as per the requirements of the notice issued by the Tribunal in accordance with rule 38.
- (3) A class member opting out shall not be precluded from pursuing a claim against the company on an individual basis under any other law, where a remedy may be available, subject to any conditions imposed by the Tribunal.

### **Publication of Notice**

Rule 87 provides for Publication of Notice, which is as below:

- (1) For the purposes of clause (a) of sub section (5) of section 245 of the Act, on the admission of an application filed under sub-section (1) of section 245 of the Act, a public notice shall be issued by the Tribunal as per Form No. NCLT-13 to all the members of the class by-
  - (a) publishing the same within seven days of admission of the Application by the Tribunal at least once in a vernacular newspaper in the principal vernacular language of the State in which the registered office of the company is situated and at least once in English in an English newspaper that is in circulation in that State;
  - (b) requiring the company to place the public notice on the website of such company, if any, in addition to publication of such public notice in newspaper under sub-clause (a):

Provided that such notice shall also be placed on the websites of the Tribunal and the Ministry of Corporate Affairs, the concerned Registrar of Companies and in respect of a listed company on the website of the concerned stock exchange where the company has any Of its securities listed, until the application is disposed of by the Tribunal.

- (2) The date of issue of the newspaper in which such notice appears shall be considered as the date of serving the public notice to all the members of the class.
- (3) The public notice shall, inter alia, contain the following
  - (a) name of the lead applicant;
  - (b) brief particulars of the grounds of application;
  - (c) relief sought by such application;
  - (d) statement to the effect that application has been made by the requisite number of members/ depositors;
  - (e) statement to the effect that the application has been admitted by the Tribunal after considering the matters stated under sub-section (4) of section 245 and these rules and it is satisfied that the application may be admitted;
  - (f) date and time of the hearing of the said application;
  - (g) time within which any representation may be filed with the Tribunal on the application;
  - (h) the details of the admission of the application and the date by which the form of opt out has to be completed and sent as per Form NCLT-1 and shall be accompanied with such documents as are mentioned in Annexure and such other particulars as the Tribunal thinks fit.
- (4) The cost or expenses connected with the publication of the public notice under this rule shall be borne by



the applicant and shall be defrayed by the company or any other person responsible for any oppressive act in case order is passed in favor of the applicant.

### WHO CAN FILE CLASS ACTION SUITS

There are following set of classes recognized under the Act to file class action suits – (i) members (ii) depositors and (iii) any class of them. The Companies Act, 2013 just like its predecessor recognizes the following persons as members of a company :

- (i) The subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members;
- (ii) Every other person who agrees in writing to become a member of the company and whose name is entered in the register of members of the company;
- (iii) Every person holding shares of the company and whose name is entered as a beneficial owner in the records of a depository.

In simple words:

- i. subscriber to the memorandum of the company;
- ii. persons who give consent to become shareholder of the company, in form of allotment letter or request for transfer, as the case may be and his name appears in the register of members;
- iii. in listed entity a person whose name appears in the records of the depository as beneficial owner.

The other class which is allowed to file class action suit is depositors, which is defined under the Companies (Acceptance of Deposits) Rules, 2014 (in short “Deposit Rules”) as under:

- (i) any member of the company who has made a deposit with the company in accordance with the provisions of sub-section (2) of section 73 of the Act, or
- (ii) any person who has made a deposit with a public company in accordance with the provisions of section 76 of the Act.

Further the phrase other classes of them under Section 245 of the Act refers to different classes of members and depositors viz. equity shareholders, preference shareholders, equity shareholders having different voting right, amongst preference shareholders convertible, non-convertible, cumulative non-cumulative, and bearing different rate of dividend; amongst depositor with different rate of return, different term of maturity, etc. As per the provisions of the Act, there is qualification which needs to be fulfilled prior to filing the Class Action Suits by members or depositors or any class of them.

### NCLT Jurisdiction for filling Class Action Suit

Section 245 allows the members of a company, depositors or a class of them, to file a petition for relief before the National Company Law Tribunal (NCLT), if they are of the opinion that the company’s affairs are being conducted in a manner prejudicial to its own interests or to the interests of members or depositors.

The Government vide notification dated July 19, 2016 provided that:

‘In the exercise of the powers conferred on the Hon’ble President by the first proviso of Sub-Section 3 of Section 419 of the Companies Act, 2013, the matters related to Section 245 – Class Action Suits are hereby assigned to the Principal Bench of New Delhi.

### AGAINST WHOM CLASS ACTION SUIT CAN BE FILED

A class action suit is a new mechanism to claim the loss caused to the specified stakeholders (as discussed herein before) of the company not only from the company but also from other entities.

Various persons/ entities against whom such actions can be taken are:

- A company or its directors for any fraudulent, unlawful or wrongful act or omission;
- An auditor including audit firm of a company for any improper or misleading statement of particulars made in the audit report or for any unlawful or fraudulent conduct.
- An expert or advisor or consultant for an incorrect or misleading statement made to the company.

#### **Orders that may be sought from the National Company Law Tribunal [Section 245(1)]**

Section 245(1) provides that such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (3) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely: –

- (a) to restrain the company from committing an act which is ultra vires the articles or memorandum of the company;
- (b) to restrain the company from committing breach of any provision of the company's memorandum or articles;
- (c) to declare a resolution altering the memorandum or articles of the company as void, if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;
- (d) to restrain the company and its directors from acting on such resolution;
- (e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;
- (f) to restrain the company from taking action contrary to any resolution passed by the members;
- (g) to claim damages or compensation or demand any other suitable action from or against –
  - (i) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;
  - (ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
  - (iii) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;
- (h) to seek any other remedy as the Tribunal may deem fit.

#### **Factors taken into Consideration by NCLT while Considering Application under Section 245**

Section 245(4) provides that in considering an application under sub-section (1), the Tribunal shall take into account, in particular –

- (a) Whether the member or depositor is acting in good faith in making the application for seeking an order;
- (b) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of sub-section (1);
- (c) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;

- (d) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;
- (e) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be –
  - a. authorised by the company before it occurs; or
  - b. ratified by the company after it occurs;
- (f) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

### **In case of admission of Application**

Section 245(5) provides that if an application filed under sub-section (1) is admitted, then the Tribunal shall have regard to the following, namely: –

- (a) public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed;
- (b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side;
- (c) two class action applications for the same cause of action shall not be allowed;
- (d) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

### **Order shall be Binding:**

Section 245(6) provides that any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.

### **Punishment for Non-Compliance:**

According to Section 245(7) any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

### **Application filed is Frivolous/Vexatious:**

Section 245(8) states that where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost, not exceeding one lakh rupees, as may be specified in the order.

### **Exemption from Application of Section:**

According to Section 245(9), nothing contained in this section shall apply to a banking company.

### **Application may be filed on behalf of Affected persons:**

Section 245(10) provides that subject to the compliance of Section 245, an application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1) of 245.

### Application of Certain Provisions to Proceedings under Section 241 or Section 245

Section 246 provides that the provisions of sections 337, 338, 339, 340 and 341 (both inclusive) related to winding up, shall apply mutatis mutandis, in relation to an application made to the Tribunal under section 241 or section 245.

### CLUBBING OF SIMILAR APPLICATION AND BAR ON FUTURE LITIGATION

When the facts are similar in suits filed in different dominions by the members of the same class, standing against the same or similar defendants, it makes sense to combine them all and adjudicate it under one roof. Clubbing of similar claims/suits would also result in efficiency of judiciary, as the same would save precious time of judiciary from adjudicating similar dispute numerous times.

Therefore specific provisions are incorporated under the Act to enable NCLT to club all similar applications in any jurisdiction, into one. For better understanding of this facet, it is profitable to analyse the provision of section 245(5) (b) of the Companies Act, 2013, which is reproduced below:

“(b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant’s side”.

The legislature intends to consolidate “all similar applications” existing at a time in any jurisdiction into one. The usage of word “similar” instead of “same” will invest vast powers in NCLT to adjudicate the matters and resist the multiplicity of proceedings.

Hence Class Action Suits against similar defendants/respondents seeking similar relief may be consolidated into one. Further the legislature also intends to bar the future class action on same subject matter. Same can be inferred from Section 245 (5)(c) of the Act, which is reproduced below:

“(c) two class action applications for the same cause of action shall not be allowed”.

On a bare perusal of the above, the intention of law makers is clear that no two class action applications shall be entertained on the same cause of action. It is pertinent to note that the bar is only upon class action and it does not cover other measures. Thus, other civil actions can be invoked on same cause of action. On a literal interpretation of the clause, it will not be wrong to state that any class action, whether brought by members or depositors, both are based on same cause of action.

### Class Action Suits and the Related Law in India

The Code of Civil Procedure, 1908 provides for representative suits where one or more persons can sue on behalf of all those who have a common interest or grievance. Such suits are also provided for under several other laws with varying scope. Shareholders and depositors may file a case for oppression and mismanagement under the Companies Act, 2013. Under the Consumer Protection Act, 1986, a consumer can file an action on behalf of all other interested consumers before a consumer court. A suit may also be filed under the Competition Act, 2002 to challenge anti-competitive agreements and market positions. The scheme of class actions suits may hence be summarized as follows:

Law	Subject Matter	Class	Example
Code of Civil Procedure	There are no limits on the subject matter except for actions that cannot be filed in the civil courts at all, such as mismanagement suits.	Persons having the 'same interest' in the suit	Excess demand by housing board

Companies Act	A suit can only be brought for oppression and mismanagement of the company but does not include a banking company.	Shareholders and Depositors in the Company	Depriving shareholders of their right to dividends
Competition Act	A class may dispute an agreement which causes an appreciable adverse effect on competition within India or abuse of dominant position by an enterprise.	Any person, consumer, or their association	Price-fixing, output limitation, market sharing, and bid-rigging
Consumer Protection Act	The suit is restricted to goods and services sold/provided or delivered or agreed to be sold/provided or delivered.	Consumers of the goods or services	Mis-selling of products by a banking or insurance company

Source: *The Leap Blog*

As the table shows, the subject matter and class depend on the law under which the suit is sought to be filed. However, there are two problems with this system:

**A Representative Class:** Persons who approach the court in a class-action suit need to represent an adequate portion of the class. The National Consumer Dispute Redressal Commission (NCDRC) has said that it would not permit a case if only 10 persons out of a class of 100 wish to litigate. They argue that if they accept the case, the other 90 would have to either file individual complaints or file on behalf of another class (*Ambrish Kumar Shukla v. Ferrous Infrastructure*). One could, however, argue that the other 90 could always opt-in to the action already initiated, or the court could club matters if two class-actions are initiated. This standard is also difficult where the class is likely to be millions of customers. For example, consider a dispute between a bank and its million customers over fees charged by a bank. While 10 out of 100 injured parties may seem inadequate, it is hard to argue the same if 100,000 customers out of a million formed a class. This issue is not unique to consumer disputes. The Companies Act prescribes a high adequacy standard if shareholders want to initiate class actions for oppression or mismanagement. The class needs to include at least 5% or 100 shareholders of the company. This may be difficult to meet since such cases are usually filed by minority shareholders.

**The new Consumer Protection Law, 2019:** India enacted a new consumer protection law in 2019. Unlike the erstwhile law which permitted a class to initiate a case before a consumer commission in cases of mis-selling, the 2019 law establishes a new regulator in the regime of consumer protection i.e. the Central Consumer Protection Authority (CCPA). The CCPA is tasked with protecting and enforcing the rights of consumers as a class. As per section 17 of the new Act, a complaint relating to violations of consumer rights prejudicial to the interests of consumers as a class is to be forwarded to the CCPA. It would then conduct a preliminary inquiry as to whether there exists a prima facie case of violation of consumer rights and instruct for an investigation to be conducted. This has taken away the power to initiate class actions from individuals and vested them into the hands of the regulator. Unlike earlier, where a class of consumers could approach consumer commissions with their common grievance, they are now required to meet the subjective satisfaction of the CCPA. This is then meant to result in an investigation, and consequent orders, if any. The difficulties of public management now impact the enforcement process in consumer grievances. Persons who have suffered harm are now supplicants before the regulator, requesting it to enforce consumer law. Several steps have been added in the process, which could lead to a lesser filing of class action suits.

The laws in India create a system which either prohibits or disincentives class actions. This article is not a definitive finding on how to cure such a situation; however, our analysis shows that the two reasons for the absence of class action in India require independent solutions.

To achieve a sound law on class action, two changes have to be brought to Indian legislation. Laws that allow for such suits may provide for what constitutes an adequate portion of the class to approach a court.

Further, the new consumer protection law could give more clarity on what constitutes a prima facie case of violation of consumer rights and the elements of the investigation thereon. We need to explore the possibility of transitioning away from the loser-pays principle in class actions and toward contingency fees for lawyers and third-party investors.

Indeed, these reforms have the potential to pave the way for class action suits in a wide range of areas.

Particulars	Section 241	Section 245	Remarks
Who can apply?	Member(s)	Member(s) or Depositors(s) or any class of them	The ambit is extended to depositors also along with members or any class of them under Section 245 compared to Section 241
When can apply?	When the affairs of the company have been or are being conducted in a manner prejudicial	The Management or conduct of the affairs of the company are being conducted in a manner prejudicial	
Opinion vs. Compliant	any member of a company, who complains that....	such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that...	Under Section 241 the member has to suffer and under Section 245 simple formation of opinion is enough
Aspect of continuation of the act	"....have been or are being..." either concluded or still going on, both scenarios it is possible to make an application	"...are being conducted..." implies only on going acts are considered. The concluded actions are not eligible for making an application under class action suit	Only the continual acts are considered under Section 245 whereas the concluded acts are also eligible under Section 241
To whom?	Under 241(1)(a) Prejudicial to public interest Prejudicial or oppressive to member or any other member(s) Prejudicial to the interests of the company Under 241(1)(b) Prejudicial to the interests of its members or any class of members	Prejudicial to the interests of the Company or its members or depositors	Under Section 245 the public interest is not considered

Power of Central Government	If the affairs of the company are being conducted in a manner prejudicial to public interest, CG may itself apply under Section 241(2)	There is no such power given under Section 245	In addition to that the Central government power can be exercised only in the case of continual acts but not for concluded acts
Inclusion of auditors, consultants etc	There is no such provision available	Under Section 245 The auditor including audit firm, any expert or advisor or consultant or any other person also included against whom the order can be passed	The scope is enhanced to include outsiders also to provide real remedy under Section 245
Public Notice	There is no such requirement of issuing public notice	Under this Section it is required to issue public notice	Because of group of people are involved in class action suits and to make relevant disclosures to huge number of people it was prescribed under Section 245 but not under Section 241
Consolidation of various applications under different jurisdictions	There is no such mention anywhere	Consolidation of various applications of similar nature under different jurisdictions is made by the tribunal and can appoint a lead applicant	Under class action suits various applications may be filed by different people at different places and hence this kind of facility is provided in order to deal with all applications of similar nature in holistic manner
Waiver of conditions to make an application	Under Section 244 the Tribunal has got power to waive any requirements to be fulfilled in order to make an application under Section 241	There is no such concept of waiver under Section 245	In order to provide relief to the affected member the Tribunal may consider waiving the requirements under Section 244. But in class action suits, since huge class of people are involved it may not do so.

### LESSON ROUND UP

- In a class action suit, a large group of people, having same or similar injuries caused by the same person, collectively bring a claim to court, represented by one or more persons.
- The origin of the class actions suits in the U.S. was in the year 1842 when the Equity Rule 48 gave the individuals the right to file such suits.
- In general, following are the types of Class Action Suits.
  - (a) Employment Class Actions: Class action suits by employees against labour law violations
  - (b) Consumer Class Actions: Class action by group of consumers
  - (c) Securities Class Actions: Class action suit by shareholders/depositors/members etc



- National Company Law Tribunal (Second Amendment) Rules, 2019 specified thresholds under Rule 84(3) of the NCLT Rules, 2016.
- Rule 85 National Company Law Tribunal Rules, 2016 provides for conducting Class Action Suit.
- Rule 86 National Company Law Tribunal Rules, 2016 provides for the Rules of Opt-Out.
- Rule 87 provides for Publication of Notice.
- There are following set of classes recognized under the Act to file class action suits – (i) members (ii) depositors and (iii) any class of them.
- 'In the exercise of the powers conferred on the Hon'ble President by the first proviso of Sub-Section 3 of Section 419 of the Companies Act, 2013, the matters related to Section 245 – Class Action Suits are hereby assigned to the Principal Bench of New Delhi.
- A class action suit is a new mechanism to claim the loss caused to the specified stakeholders (as discussed herein before) of the company not only from the company but also from other entities.
- When the facts are similar in suits filed in different dominions by the members of the same class, standing against the same or similar defendants, it makes sense to combine them all and adjudicate it under one roof. Clubbing of similar claims/suits would also result in efficiency of judiciary, as the same would save precious time of judiciary from adjudicating similar dispute numerous times.
- Therefore specific provisions are incorporated under the Act to enable NCLT to club all similar applications in any jurisdiction, into one. For better understanding of this facet, it is profitable to analyse the provision of section 245(5) (b) of the Companies Act, 2013.
- Persons who approach the court in a class-action suit need to represent an adequate portion of the class. The National Consumer Dispute Redressal Commission (NCDRC) has said that it would not permit a case if only 10 persons out of a class of 100 wish to litigate. They argue that if they accept the case, the other 90 would have to either file individual complaints or file on behalf of another class (Ambrish Kumar Shukla v. Ferrous Infrastructure).
- To achieve a sound law on class action, two changes have to be brought to Indian legislation. Laws that allow for such suits may provide for what constitutes an adequate portion of the class to approach a court.
- Further, the new consumer protection law could give more clarity on what constitutes a prima facie case of violation of consumer rights and the elements of the investigation thereon.
- We need to explore the possibility of transitioning away from the loser-pays principle in class actions and toward contingency fees for lawyers and third-party investors.

### TEST YOURSELF

1. What do you mean by Class Action Suit?
2. What is class action suits and what reliefs can be sought under class action suits by the applicant under class action suits?
3. State the persons against whom the class action suit can be filed.
4. Write a short note on Class Action Suits and the related Law in India.



[illegible]



# Lesson 4

## Fraud under Companies Act, 2013 and Indian Penal Code, 1860

### LESSON OUTLINE

- Introduction
- Intention to Commit a Fraud
- Unlawful Gain or Loss
- Criminal Breach of Trust
- LESSON ROUND UP
- TEST YOURSELF

### LEARNING OBJECTIVES

In this chapter, students will learn and analyze:

- Definition of Fraud
- Fraud under Companies Act, 2013
- View of the Committee on De-criminalisation of Offences
- Who can make fraud
- Fraud Reporting by Auditors
- Fraud under IPC
- Cheating
- Criminal breach of trust
- Fraudulent Deeds and Dispositions of Property
- Penal Provision
- Fraud under SEBI Regulation

## INTRODUCTION

The JJ Irani Committee set up by the government in 2004 submitted its report in 2005 with far reaching recommendations. The recommendations of the committee have received shape in the Companies Act, 2013. One of the recommendations of the committee was that there should be deterrent penalties for companies that show irresponsible behavior or conduct fraudulent activities. The relevant extract of the report is as below:-

“26. The provisions of the Companies Act relating to penalties for fraudulently inducing persons to invest money should be made more stringent. The practice relating to imposition of penalties under provisions in the present Companies Act have been found to ineffective since there are not many cases under which punishment has actually been imposed. The legal procedure associated with such prosecution should be revisited so as to make the process more effective. The offence of fraudulent inducement should be non-compoundable. The Government may also consider actions such as attachment of bank accounts in such cases subject to the orders of Judicial Magistrate First Class.”

Thus, the committee felt that there should be stringent penalty for fraudulent inducement of persons to invest and also it opined that the then prevalent practice of imposing penalties was ineffective. The Committee also felt that such offences should be non – compoundable. The committee also went ahead in recommending attachment of bank accounts backed by approval of courts.

The committee also took note of the fact that corporate frauds involve serious intricacies that may not be easy for state level law enforcement agencies to deal with them effectively and the same need to be referred to the Serious Fraud Investigation Office (SFIO). As a consequence, vide Section 211, the Companies Act, 2013 has provided for establishment of the SFIO.

The committee further recommended that if the investigation reveals fraudulent conduct then the law should provide for lifting the corporate veil to make available access to promoters and shareholders to ascertain the role. The committee also felt that the companies should be allowed to raise capital so long as they provide true and correct information to investors and the regulators. There could be flexibility to raise capital by making adequate disclosures. However non-compliance with disclosure norms or raising money fraudulently should be subject to strict penalty regime.

Where a company or its officer(s) become aware of some default under the Companies Act, 2013 it would always be advisable to avail the benefit of compounding provisions under the Act so that the company remains fully compliant with the provisions of the Act.

### Meaning and Definition of Fraud:

As discussed, fraudulent behaviour requires stringent action when compared to mere procedural violations. While the term fraud is commonly used by one and all; the meaning of which changes in a legal connotation depending on the definition, if any, contained in the respective piece of law.

‘Fraud’, in general, refers to a wrongful or criminal deception practiced which is intended to result in financial or personal gain to oneself and a financial or personal loss to the other.

As per Business Dictionary, ‘Fraud’ is an act or course of deception, an intentional concealment, omission, or perversion of truth, to:

- (1) Gain unlawful or unfair advantage,
- (2) Induce another to part with some valuable item or surrender a legal right, or
- (3) Inflict injury in some manner.<sup>1</sup>

‘Wilful fraud’ is a criminal offence which calls for severe penalties, and its prosecution and punishment (like that of a murder) is not bound by the statute of limitation.

1. Definition of Fraud, Business Dictionary, Business Dictionary.com.

However, incompetence or negligence in managing a business or even a reckless waste of firm's assets (by speculating on the stock-market, for example) does not constitute an act of fraud, but yes, invites legal liabilities.

## What is Fraud

'Fraud', in general, refers to a wrongful or criminal deception practiced which is intended to result in financial or personal gain to oneself and a financial or personal loss to the other.

As per Business Dictionary, 'Fraud' is an act or course of deception, an intentional concealment, omission, or perversion of truth, to:

- (1) Gain unlawful or unfair advantage,
- (2) Induce another to part with some valuable item or surrender a legal right, or
- (3) Inflict injury in some manner.<sup>2</sup>

'Wilful fraud' is a criminal offence which calls for severe penalties, and its prosecution and punishment (like that of a murder) is not bound by the statute of limitation.

However, incompetence or negligence in managing a business or even a reckless waste of firm's assets (by speculating on the stock-market, for example) does not constitute an act of fraud, but yes, invites legal liabilities. In such cases, if the act of causing financial loss to the business or manipulating the stock market is attempted with the clear intention of deceit, this would tantamount to financial frauds.

In law, fraud is a deliberate deception to secure unfair or unlawful gain, or to deprive a victim of a legal right.<sup>3</sup>

Fraud can also be a civil wrong (*i.e.*, a fraud victim may sue the fraud perpetrator to avoid the fraud or recover monetary compensation), a criminal wrong (*i.e.*, a fraud perpetrator may be prosecuted and imprisoned by governmental authorities) or it may cause no loss of money, property or legal right but still be an element of another civil or criminal wrong.

The ultimate object of practising fraud may be some monetary gain or other benefit, such as, obtaining a passport or travel document, driver's license or qualifying for a mortgage by way of false statements.<sup>4</sup>

As per Black Law Dictionary, 'Fraud' refers to 'All multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprises, tricks, cunning or dissembling, and any unfair way which another is cheated.'<sup>5</sup>

With the clear analysis of the above definitions, it could be asserted that Fraud is a –

*False Representation of a Matter of Fact*

*Whether by words or by conduct, by false or misleading allegations, or by concealment of what should have been disclosed*

*The Deceives or is intended to deceive another - to enable the individual to act upon the legal injury.*

**Fraud**

- False representation of a matter of fact;
- Whether by words or by conduct, by false or misleading allegations, or by concealment of what should have been disclosed;
- That deceives and is intended to deceive another;
- So that the individual will act upon it to her or his legal injury.

'Fraud' is commonly understood as dishonesty calculated for advantage. A person who is

2. Definition of Fraud, Business Dictionary, Business Dictionary.com.

3. Definition of Fraud, Legal Dictionary, Law.com.

4. Basic Legal Concepts, Journal of Accountancy.

5. Black's Law Dictionary, 5th ed., by Henry Campbell Black, West Publishing Co., St. Paul, Minnesota, 1979.

dishonest may be called a fraudster. In almost all the legal systems, fraud is a specific offence with certain unique features.

'Fraud' is most commonly practiced in the acts of buying or selling of property, including real estate, personal property, and intangible property, such as, stocks, bonds, and copyrights. Indian law under various statutes criminalizes fraud, but not all cases graduate to the level of criminality. Prosecutors also have discretion in determining which case to pursue and which not. Victims may also seek redress in civil court, provided that the fraud conducted does not affect the society at large. For example, if a fraud is carried out in a company and has adversely affected the profit generation in that company without in any way affecting any counter of the economy, the victims might seek relief under the civil remedy. On the other hand, if the fraud conducted in the company affects the entire economy altogether then the only way to punish the accused is through criminal prosecution against the accused under different criminal law statutes, including the Indian Penal Code, 1860 along with the recovery of amount earned through fraudulent transactions. For instance, in the recent ill-fated Punjab National Bank Scam, CBI added the charges of Criminal Breach of Trust under section 409 of IPC along with charges of Fraud under section 420 IPC, 1860.<sup>6</sup>

As it is clear that fraud is recognized as an act of deceit which is subject to criminal as well as civil legal action in almost all the jurisdictions, including India, hence, it would be apt to discuss the definition and meaning of Fraud under specific laws like Companies Act, 2013, Criminal Procedure Code, 1973 and Indian Penal Code, 1860.

### **Meaning and Definition under the Companies Act, 2013 and Criminal Procedure Code, 1973**

#### **Meaning and Definition under Criminal Procedure Code, 1973**

The Code of Criminal Procedure, 1973 is the procedural law providing the machinery for punishment of offenders under substantive criminal law. The Code contains elaborate details/provisions regarding the procedure to be followed in every investigation, inquiry and trial, for every offence under the IPC or any other criminal law. In general, the Code does not provide for the definition of various terms rather it only describes certain limited terms like Complaint, Cognizable Offence, Warrant Case and alike, which helps in the interpretation of the Code. For rest of the terms, section 2(y) of Code says that "words and expressions used herein and not defined but defined in the Indian Penal Code (45 of 1860) have the meanings respectively assigned to them in that Code." Therefore, to understand the meaning of 'Fraud' in the sphere of criminal law, one has to take recourse of Indian Penal Code, 1860.

#### **Meaning and Definition under Indian Penal Code, 1860**

The term 'Fraud' is not defined in the Indian Penal Code per se, but yes Section 25 defines as to what would amount to 'fraudulently'. As per the definition, fraudulently refers – "A person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise."

This shows that fraud as a crime is nowhere defined in the Indian Penal Code, but implication of this term is made at various places in Indian Penal Code.

In general, fraud is an act of deliberate deception with the design of securing something by taking unfair advantage of another. It is a deception in order to gain by another's loss.

Whenever the term fraud or defraud appears in the context of criminal law, two things are automatically to be assumed.

- First is deceit or deceiving someone; and
- Second is, injury to someone because of such deceit.

<sup>6</sup> See, *PNB Scam: CBI adds charge of Criminal Breach of Trust to FIR: Mehul Choksi, and Others may face life term if found guilty*.

Implications of fraud is found in the following sections of IPC namely, 421, 422, 423 and 424.

- Fraudulent removal or concealment of property to prevent distribution among creditors.
- Fraudulently preventing debt being available for creditors.
- Fraudulent execution of deed of transfer containing false statement of consideration.
- Fraudulent removal or concealment of property.

Though Fraud is not clearly defined in CrPC and IPC, yet Indian Contract Act, 1872 defines the term Fraud quite clearly. In the context of Corporate Fraud, there is no harm in exploring the definition of Fraud as per the other related statutes.

### Meaning and Definition under Indian Contract Act, 1872

Section 17 of the Act defines Fraud as –

“Fraud” means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto his agent, or to induce him to enter into the contract.

**Section 17(1)** – the suggestion as to a fact of that which is not by one who does not believe it to be true – is known as SUGGESTIO FALSI or suggestion of falsehood.

**Section 17(2)** – the active concealment of a fact by one having the knowledge or belief of the fact – is known as SUPPRESIO VERI or suppression of a fact.

**Section 17(3)** – a promise made without any intention of performing it. It means a promise made falsely with the intention of inducing the other party to make a reciprocal promise and thereby enter into a contract.

**Section 17(4)** – any other Act fitted or designed to deceive.

**Section 17(5)** – any such act or omission as the law specially declares to be fraudulent

### Explanation to Section 17

This explanation states a very important proposition of law. According to Explanation to Section 17 – the mere silence as to a fact likely to affect the willingness of a person to enter into a contract is not fraud. However, such silence is to be held as fraud, if the circumstances of the case that –

- It is the duty of the person keeping silence – to speak
- That his silence in itself is equivalent to speech.

### Definition of Fraud: The Judicial View

The Supreme Court of India in *Dr. S. Dutt v. State of Uttar Pradesh*<sup>7</sup>, while dilating upon the words “with intent to deceive” has observed that it does not indicate a bare intent to deceive, but an intent to cause a person to act, or omit to act, on account of deception practiced upon him, to his advantage. The words ‘but not otherwise’ after the words ‘with intent to deceive’ in the definition of ‘fraudulently’, it has been observed, clearly show, “..... that the words intent to defraud are not synonymous with intent to deceive and requires some action resulting in some disadvantage which but for the deception, the person deceived would have avoided”.

So, under the Indian law a penal offence of fraud, demands for successful prosecution, the twin elements of ‘intent to defraud’ of the offender *i.e.* –

- (i) An intent to deceive another; and

7. (AIR 1966 SC 523)

- (ii) An intent to cause, by that deception, injury to some person.<sup>8</sup>

Now to clearly understand the term 'fraud' in reference of penalizing, preventing and regulating this act, one should be well-versed with the elements of fraud.

## Elements of Fraud

Few Essential Elements of Fraud are listed as below<sup>9</sup>:

1. **False and Wilful representation or Assertion:** To constitute fraud there must be some representation or assertion, which is untrue. In the absence of representation or assertion except in the following two cases, there can be no fraud.
  - Where silence may itself amount to fraud, and
  - Where there is active concealment of facts

The person making the representation should not believe it to be true, otherwise he/she will not be guilty of fraud. Moreover, to constitute fraud, the false representation must have been made wilfully or intentionally. For example, X, intending to deceive Y, informs him that his estate is free from encumbrance. Y thereupon buys the estate. The estate is, however, subject to mortgage. The contract is induced by fraud.
2. **Perpetrator of Representation:** The false representation or misstatement must have been made by a party to the contract or by anyone with its connivance, or by its agent. If a stranger makes the misstatement to the contract, it cannot result in fraud. For instance, A suggests B to buy C's car, which according to A runs 15 kms per litre. Later on, B finds that the car runs only 8 kms per litre. A was, however, acting neither at the instance of C nor was his agent; he was a stranger. The contract that took place between B and C cannot be stated to be induced by fraud.
3. **Intention to deceive:** Intention to deceive the other party is the essence of fraud. In order to commit a fraud, one person asserts or misstates the fact with the intention that it should be acted upon. As a matter of fact, misrepresentation elevates to the level of fraud when it is prefixed by the element of intention to deceive the other party. For example, A, intending to deceive B, falsely represents that 1,000 tons of sugar is produced annually at his factory, although A is fully aware that only 600 tons of sugar can be produced annually. B thereby agrees to buy the factory. A has resorted to fraud to obtain the consent of B.
4. **Representation must relate to a fact:** The representation made by the party must relate to a fact, which is material to the formation of the contract. A mere statement of opinion, belief, or commendation cannot be treated as fraud. For instance, A states that the detergent produced at his factory washes whiter than whitest. The statement made by A is merely a commendation of the product and not a fact. But if A describes the ingredients, which the detergent contains, it becomes a statement of fact. And if that is found incorrect, it amounts to fraud provided A knows it to be a false statement.
5. **Active concealment of facts:** 'Active concealment' must be distinguished from 'passive concealment'. Passive concealment implies mere silence as to material facts, which barring a few cases, does not amount to fraud. Whereas, active concealment implies 'when the party takes positive or deliberate steps to prevent information from reaching the other party and this is treated as fraud.' For example, A sells a horse to B in an auction despite knowing that the horse is unsound. A says nothing to B about the horse's soundness. This is a case of passive concealment of fact and cannot tantamount to fraud.
6. **Promise made without intention of performing it:** If a person while entering into a contract has no

8. Justice Satheesa Chandran S.S. (2016), *offences of Fraud: Need for New Perspective*, *The Live Law*.

9. *Top Ten Essentials Elements of Fraud*, *Money Matters – Management Articles*.



intention to perform his/her promise, there is a fraud on his/her part, for the intention to deceive the other party is there from the very beginning. For example, an English merchant appointed an Indian woman as his personal secretary and promised that he would marry her. Later she came to know that he was already married and had made the promise without any intention to perform it. It was held that she could avoid the contract on the ground of fraud.

On similar count, a purchase of goods without any intention of paying the price is a fraud and the contract can be avoided on this ground.

7. **Representation must have actually deceived the other party:** The representation made with the intention to deceive must actually deceive. The party, induced by fraudulent statement, must have relied on it to accord its consent.

Thus, an attempt to deceive does not amount to fraud until the other party is deceived thereby. A case in point is the following example. A had a defective cannon. With a view to conceal the defect, he put a metal plug on it. B without examining it bought it. The cannon burst when used by B. B refused to pay the price and accused A of fraud. It was held that B was bound to pay because he was not actually deceived, as he would have bought the cannon even if the deceptive plug had not been inserted.

8. **Any other act fitted to deceive:** The expression 'any other act fitted to deceive' obviously means any act, which is done with the intention of committing fraud. This category includes all tricks, dissembling, and other unfair ways, which are used by cunning and clever people to cheat others. For example, a husband persuaded his illiterate wife to sign certain documents telling her that by the papers he was going to mortgage her two plots of land to secure his indebtedness. But, in fact, he mortgaged four plots of land belonging to her. This was held as an act done with the intention of deceiving the wife.
9. **Any such Act or omission that the law specially declares as void:** This category includes the act or omission that the law specially declares to be fraudulent. For example, the Insolvency Act and the Companies Act declare certain kinds of transfers to be fraudulent. Similarly, under the Transfer of Property Act, the transferor of real estate is bound to disclose to the transferee the following details:
  - Material defects, if any, in the property such as, cracks in the wall or in beams, and/or
  - Any defect or dispute as regards transferor's title, such as property is subject to encumbrance, i.e., mortgaged or is subject to some dispute pending in a court of law. An omission to make such disclosure on the part of transferor amounts to fraud.
10. **Wrongful Loss and Wrongful Gain is Immaterial.** For the purposes of "Fraud" under the Companies Act, 2013, it is immaterial whether there has been some wrongful loss to one and/or wrong gain to another. The only important thing is intention to deceive and the act or omission actually deceiving the victim. Common corporate frauds for example are, if the CMD husband benefits from a loan transaction sanctioned by her it is a fraud. If a CEO take bribe to approve a contract that is a fraud.

On the same principle, Indian Penal Code too works, as for IPC to constitute an offence, two elements are required which are *Mens Rea* – Intention to Commit Offence and *Actus Reus* – The Wrongful Act.

#### Examples – Corporate Fraud

There are a number of ways in which a corporation can commit fraud. Corporate fraud can encompass the loss of assets by a corporation, or acts perpetrated by the corporation to take funds from others. Here are several examples:

- **Personal purchases.** An employee can divert funds to buy goods or services on his own behalf. This is usually done by approving his own expense reports or supplier invoices. The person must hold a

sufficiently senior position to be able to browbeat other employees into participating in this diversion of assets. Usually, the potential amount of funds diverted increases with the seniority of the job title of the individual committing the fraud.

- **Ghost employees.** The payroll staff can create fake employees and then pay these “ghost employees,” directing the funds into their own bank accounts. Weak controls over the payment of employees makes this type of fraud more likely.
- **Skimming.** Incoming funds are intercepted before they can be recorded in a company’s accounting records. This is usually caused when a person is allowed to both open the mail and record accounting transactions.
- **Tax avoidance.** A company can alter its tax returns to reveal less taxable corporate income than is really the case, resulting in lower tax remittances. This can only be done with the connivance of senior management, which typically signs off on the tax returns.
- **Asset theft.** Any employee can steal from an organization by making off with assets, such as cash or fixed assets. Weak controls can encourage employees to engage in this activity.
- **Unauthorized use.** An employee may use company assets in an unauthorized manner, such as driving a company car for personal use, or using a company condominium for personal use. Though the asset is not stolen, it is being consumed, so its value lessens over time.
- **Financial statement falsification.** An organization can falsify its financial statements to reveal excellent financial results. These documents can then be used as the basis for obtaining bank loans or selling stock to investors. Such falsification can be conducted entirely within the accounting department, or be forced upon it by management. Examples of such falsification are:
  - Extending the depreciation period to delay depreciation recognition
  - Shifting debt to special purpose entities
  - Accelerate the recognition of revenues and delay the recognition of expenses
  - Capitalize expenses
  - Counting non-existent inventory, which reduces the cost of goods sold

Corporate fraud can be extremely difficult to contain, and is essentially impossible to stop if senior management is willing to engage in it. In such cases, even the most robust control systems can be breached. This contemplates the significance of Forensic Audit, wherein a check and vigil mechanism could be establishing in finding out the probability of fraud as well as real culprit behind corporate frauds.

In such cases, if the act of causing financial loss to the business or manipulating the stock market is attempted with the clear intention of deceit, this would tantamount to financial frauds.

In law, fraud is a deliberate deception to secure unfair or unlawful gain, or to deprive a victim of a legal right.<sup>10</sup>

Fraud can also be a civil wrong (*i.e.*, a fraud victim may sue the fraud perpetrator to avoid the fraud or recover monetary compensation), a criminal wrong (*i.e.*, a fraud perpetrator may be prosecuted and imprisoned by governmental authorities) or it may cause no loss of money, property or legal right but still be an element of another civil or criminal wrong.

The ultimate object of practising fraud may be some monetary gain or other benefit, such as, obtaining a passport or travel document, driver’s license or qualifying for a mortgage by way of false statements.<sup>11</sup>

As per Black Law Dictionary, ‘Fraud’ refers to ‘All multifarious means which human ingenuity can devise, and which

10. Definition of Fraud, Legal Dictionary, Law.com.

11. Basic Legal Concepts, Journal of Accountancy.

are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprises, tricks, cunning or dissembling, and any unfair way which another is cheated.<sup>12</sup>

Fraud consists of some deceitful practice or willful device, resorted to with an intent to deprive another of his right, or in some manner to do him an injury. As distinguished from negligence, it is always positive, intentional (Maher v. Hibernia Inst. Co., 67 N. Y. 292)

The Hon'ble Supreme Court of India in the matter of Dr. Vimla vs Delhi Administration (29 November, 1962) citing Haycraft v. Creasy (1) LeBlanc, noted that:

“by fraud is meant an intention to deceive; whether it be from any expectation of advantage to the party himself or from the ill-will towards the other is immaterial.”

As per Section 17 of the Indian Contracts Act, 1872, the term “fraud” means an act committed by a party to a contract with an intention to deceive another.

The term fraud has also been defined in Regulation 2(c) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 which reads as follows:-

“(c) “fraud” includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss, and shall also include— (1) a knowing misrepresentation of the truth or concealment of material fact in order that another person may act to his detriment; (2) a suggestion as to a fact which is not true by one who does not believe it to be true; (3) an active concealment of a fact by a person having knowledge or belief of the fact; (4) a promise made without any intention of performing it; (5) a representation made in a reckless and careless manner whether it be true or false; (6) any such act or omission as any other law specifically declares to be fraudulent, (7) deceptive behaviour by a person depriving another of informed consent or full participation, (8) a false statement made without reasonable ground for believing it to be true. (9) the act of an issuer of securities giving out misinformation that affects the market price of the security, resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price. And “fraudulent” shall be construed accordingly.

### **Fraud under Companies Act**

In the erstwhile Companies Act, 1956 frauds detected at the time of winding up are dealt with under Section 542. Though punishments were specified in various Sections in the Companies Act, 1956 there was no one unified Section that dealt with fraud or prescription of penalties.

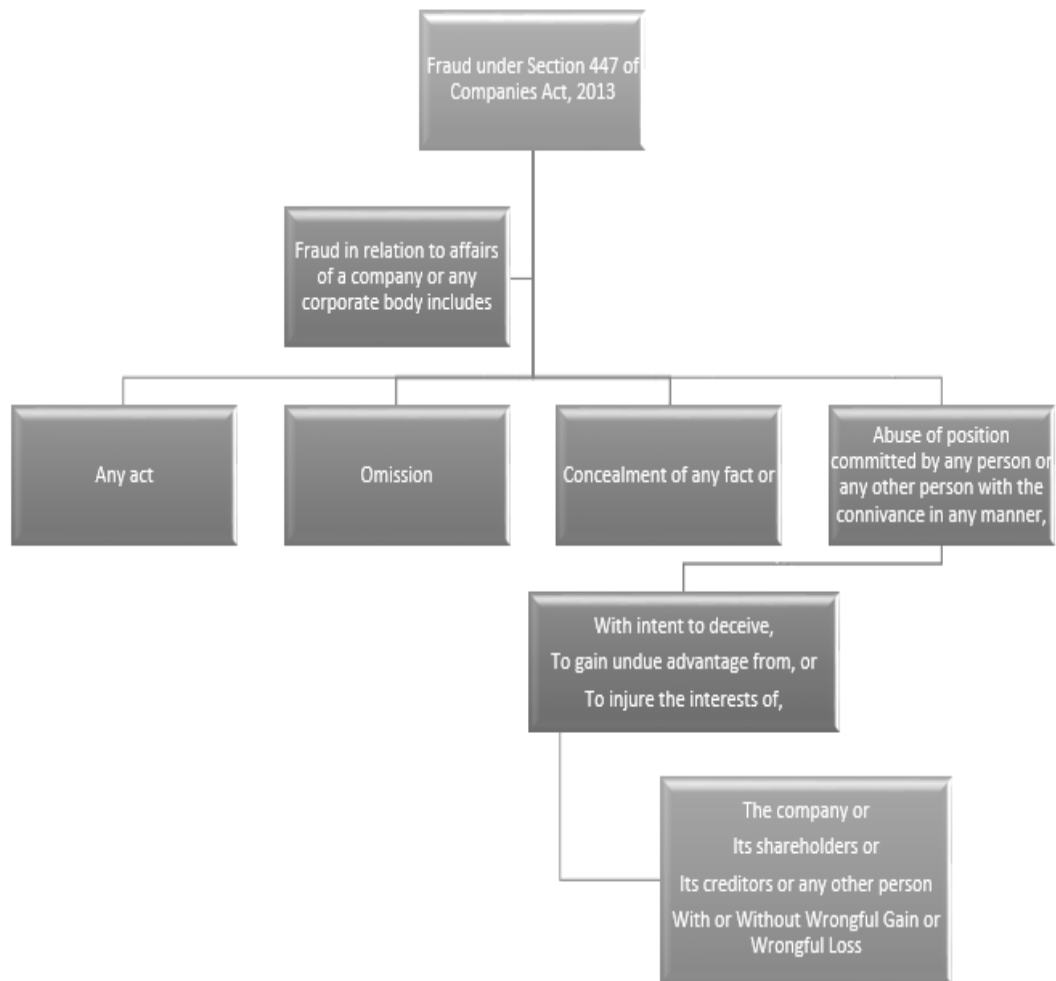
The Companies Act, 2013 deals with the term fraud exclusively and provides an overarching Section to deal with it. The term Fraud, for the first time, has been defined in the Companies Act, 2013 by way of an explanation.

### **Meaning and Definition under Companies Act, 2013**

Explanation of Section 447 of Companies Act 2013 defines Fraud and related terms as below:

- (i) ‘Fraud’ in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;
- (ii) ‘Wrongful gain’ means the gain by unlawful means of property to which the person gaining is not legally entitled;
- (iii) ‘Wrongful loss’ means the loss by unlawful means of property to which the person losing is legally entitled.

12. Black’s Law Dictionary, 5th ed., by Henry Campbell Black, West Publishing Co., St. Paul, Minnesota, 1979.



In the context of this definition, it could be said that Corporate Fraud is a Fraud in relation to affairs of a company or any corporate body as defined in the explanations of Section 447 of Companies Act 2013, which includes

- a. Any act,
  - b. Omission,
  - c. Concealment of any fact or
  - d. Abuse of position committed by any person or any other person with the connivance in any manner, -
    - i. with intent to deceive,
    - ii. to gain undue advantage from, or
    - iii. to injure the interests of,
- a. the company or
  - b. its shareholders or
  - c. its creditors or any other person,

Whether or not there is any wrongful gain or wrongful loss.

On a close analysis of the definition of the term fraud as provided in the Companies Act, 2013, the following points emerge:-

1. The definition of the term fraud is inclusive in nature.
2. Fraud need not only in relation to a company; it may relate to any body corporate also. Thus, the horizon is larger.
3. Fraud includes any act, omission, concealment of facts or abuse of position by a person.
4. The definition also extends to those persons who connive with another in committing a fraud.
5. Intention is important.
6. The targets of the fraud could be the company, its shareholders, its creditors or any other person.
7. It is not necessary that there should be a wrongful gain or wrongful loss to do a fraud. Thus, gain or loss arising out of the fraud cannot be a basis for deciding the violation or handing over punishment.

On a plain reading of the definition it is amply vivid that the term has a wide encompassing coverage of the acts and also of the fraudsters.

Something to note here, is that the section uses the words 'any person'. It is therefore, possible that the commission of the act, omission etc. is by someone other than a director or an employee and still falls within the purview of section 447.

#### Use of Section 447 in various places in the Act

As has been mentioned Section 447 of the Companies Act, 2013 is an overarching Section that deals with fraud providing for definition as well as the punishment for the same. Such a cogent provision was missing in the Companies Act, 1956. The Companies Act, 2013, at different places, has invoked the provisions of Section 447. Following are the provisions wherein Section 447 has been referred to:

Table

Sl. No.	Section No.	Nature of violation
1	7	Incorporation of company
2	8	Charitable companies
3	34	Criminal liability for misstatement in prospectus
4	36	Punishment for fraudulently inducing persons to invest money
5	38	Punishment for personation for acquisition etc. of securities.
6	46	Certificate of shares
7	56	Transfer and transmission of securities
8	66	Reduction of share capital
9	75	Damages for Fraud
10	76A	Punishment for Contravention of Section 73 or Section 76
11	86	Punishment for wilfully furnishes any false or incorrect information
12	90	Register of significant beneficial owners in a company
13	140	Removal, resignation of auditor and giving of special notice.
14	206	Power to call for information, inspect books and conduct inquiries

15	212	Investigation into Affairs of Company by Serious Fraud Investigation Office
16	213	Investigation into the company's affairs in other cases
17	229	Penalty for furnishing false statement, mutilation, destruction of documents
18	251	Fraudulent application for removal of name
19	339	Liability for fraudulent conduct of business
20	448	Punishment for false statement

Though the above table brings out the specific Sections where Section 447 has been used, it is not necessary that only to those Sections it is applicable. The relevant provisions of the Sections are discussed in the subsequent paragraphs:-

### **1. Section 7: Incorporation of company**

The Section deals with the documents to be filed with the concerned RoC for incorporation of a company. While dealing with the requirements, under sub-section (5) it has been stated that if a person furnishes false information or incorrect particulars or suppresses material information then the person is liable for action under Section 447.

Further under sub Section 6 of Section 7 it has also been provided that the promoters, the first directors and the fiduciaries viz, the chartered accountant, the company secretary in practice or the cost accountant or the advocate, the managing director or the secretary of the company who have given a declaration in the prescribed format shall also be liable for action under Section 447. Thus the penal provision extends to the professionals also apart from the officers of the company. A section to be borne in mind by professionals.

### **2. Section 8: Charitable companies**

Sub-Section 11 of Section 8 provides for punishment for default in compliance with the requirements laid in the Section. In the proviso to sub Section 11, it has been provided that every officer in default shall be liable for action under Section 447 if it is proved that the affairs of the company were conducted fraudulently.

### **3. Section 34: Criminal liability for mis-statement in prospectus**

The Section has a parallel in terms of Section 63 of the Companies Act, 1956. Section 63 provides for punishment for mis-statements in prospectus. The current provision in Section 34 deals with a situation wherein every person who has authorized the issue of a prospectus carrying misstatement shall be liable under this provision. A proviso similar to Section 63 has been provided in Section 34 wherein the person believed the statement to be true then in such cases the person does not attract any penalty.

### **4. Section 36: Punishment for fraudulently inducing persons to invest money**

This Section also has a parallel provision under Section 68 of the Companies Act, 1956 providing for action for fraudulent inducement of persons to invest money.

### **5. Section 38: Punishment for personation for acquisition etc. of securities**

This Section is similar to Section 68A of the Companies Act, 1956. The Section provides for punishment under Section 447 of the Companies Act, 2013. Additionally, provision has been made enabling the Court to order disgorgement of gain. The power for disgorgement was not provided for in the Companies Act, 1956 and to that extent there is an improvement over the 1956 act. Also, the maximum imprisonment term could be five years under the 1956 act whereas the maximum could be 10 years under the 2013 act.

**6. Section 46: Certificate of shares**

Issuance of duplicate shares with a fraudulent intent finds traces in the cases of shares held in physical form. Companies which were under trading suspension for a long time where practically no business operations are not carried out, then such companies become a wonderful tool in the hands of fraudsters. The operating part of this provision is similar to Section 84 of the Companies Act, 1956. In terms of sub Section 5 of Section 46 of the Companies Act, 2013, cases of frauds with respect of issuance of share certificate attract a punishment with fine of not less than five times the face value of the shares involved in fraudulent duplicate issue with a maximum penalty of ten times the face value of such shares or Rs. 10 crores whichever is higher. Also, the officers in default attract punishment under Section 447.

**7. Section 56: Transfer and transmission of securities**

The Section carries a provision for action against DP/Depository. Sub Section 7 of the Section provides for punishment under Section 447 intentional fraudulent transfer of shares by a depository or depository participant. This is in addition to the liabilities arising out of the Depository Act 1996. A parallel provision is not there in the Companies Act, 1956.

**8. Section 66: Reduction of share capital**

Section 66 of the Companies Act, 2013 deals with reduction of share capital of a company. The provision is similar to those contained in Sections 100 to 105 of the Companies Act, 1956. Sub Section 10 of Section 66 deals with a similar situation as provided under Section 105 of the Companies Act, 1956 and the same reads as follows:-

- a. Knowingly conceals the name of any creditor entitled to object to the reduction
- b. Knowingly misrepresents the nature of amount of the debt or claim of any creditor
- c. Abets or is privy to any such concealment or misrepresentation as aforesaid

Section 105 provides for imprisonment for a maximum term of one year for the aforesaid violation. Apparently the magnitude of punishment is much severe under Section 447 of the Companies Act, 2013.

**9. Section 75: Damage of Fraud**

When it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in sub-section (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

**10. Section 76A: Punishment for Contravention of Section 73 or Section 76**

When it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447.

**11. Section 86: Punishment for Fraud**

If any person wilfully furnishes any false or incorrect information or knowingly suppresses any material information, required to be registered in accordance with the provisions of section 77, he shall be liable for action under section 447.



## **12. Section 90: Register of Significant Beneficial Owners in a Company**

If any person wilfully furnishes any false or incorrect information or suppresses any material information of which he is aware in the declaration made under this section, he shall be liable to action under section 447.

## **13. Section 140: Removal, Resignation of Auditor and Giving of Special Notice**

The second proviso to sub Section 5 of Section 140 deals with punishment for auditor of a company who has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by or in relation to the company or its directors or officers. Apart from debarring the auditor from appointment as auditor of any company for a period of five years of passing of order by the NCLT, the auditor shall also be liable under Section 447. Action under this provision is a new move considering the importance of the role played by the auditor as a fiduciary. The term auditor includes a firm of auditors.

## **14. Section 206:- Power to call for information, inspect books and conduct inquiries**

The Section provides for the power of the RoC to call for information from a company. Such powers are accorded in Section 234 of the Companies Act, 1956 also. If the information collected by the registrar or the inspection reveals that the business of the company has been conducted for a fraudulent or unlawful purpose, then every officer of the company who is in default shall be punishable for fraud as per Section 447. This is in addition to penalties for failure to furnish information sought. It may also be noted that under Section 224 of the Companies Act, 2013, further actions including prosecution or winding up etc. may also be attracted. Thus, action under Section 447 is one of the punitive measures prescribed in the Section.

## **15. Section 212: Investigation into affair of company by SFIO**

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, offence covered under section 447 of this Act shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless –

- (i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and
- (ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail

The Government in the backdrop of major failure of non-banking financial institutions, phenomenon of vanishing companies, plantation companies and the recent stock market scam had decided to set up Serious Fraud Investigation Office (SFIO), a multi-disciplinary organization to investigate corporate frauds. The Organization has been established and it has started functioning since 1st October, 2003. Latest updates related to SFIO may be accessed at <https://sfio.nic.in/>

## **16. Section 213: Investigation into the company's affairs in other cases**

The Section corresponds to Section 237 of the erstwhile Companies Act, 1956. The Section deals with a situation wherein the NCLT finds it necessary to investigate the affairs of the company if it finds that the affairs are conducted fraudulently as described in clause (b) of Section 213. If the investigation reveals that the business of the company was being conducted with an intent to defraud its credits, members or any other person or otherwise for a fraudulent or unlawful purpose, or that the company was formed for such purposes or any person involved in the formation of the company was found to be guilty of fraud, then every officer in default or other concerned person shall be liable for punishment under Section 447.

## **17. Section 229: Penalty for furnishing false statement, mutilation, destruction of documents**

This Section deals with falsification or mutilation of records or destroying of documents etc. by any officer of the



company who is required to furnish certain information during the course of inspection, inquiry or investigation. Such acts attract punishment under Section 447. The corresponding provision under the erstwhile Companies Act, 1956 is Section 424L.

### **18. Section 251: Fraudulent application for removal of name**

This is a new provision in the Companies Act, 2013 which provides for action for fraudulent application for removal of name, made to the Registrar of Companies. An application for removal of name can be made under Section 248(2) of the Companies Act, 2013 after extinguishing all its liabilities. Whereas if such an application has been made by the company with a fraudulent intent to evade the liabilities of the company or to defraud its creditors or other persons then the person in charge of the management of the company shall be liable for action under Section 447. This liability shall accrue even if the company has been notified as dissolved.

### **19. Section 339: Liability for fraudulent conduct of business**

This Section corresponds to Section 542 of the erstwhile Companies Act, 1956. This Section casts personal responsibility without any limit on the liability of the directors, manager, or officer of the company or any other person who was knowingly a party to the carrying on the business of the company with an intention to defraud the creditors or any other person or for any fraudulent purpose. Besides Sub-Section (3) of Section 339 also invokes punishment under Section 447. It may be noted that in the explanation to this Section the term officer has been defined to include any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.

### **20. Section 448: Punishment for false statement**

This Section corresponds with Section 628 of the erstwhile Companies Act, 1956. The Section calls for punishment under Section 447 for making false statement that is false in respect of any material particulars or omits any material fact by a person. It may be noted that such false statement or omission could be with respect to any return, report, certificate, financial statement, prospectus, statement or other document that require submission under the act. It may be noted that individual Sections also deal with misstatements say in prospectus etc.

As mentioned earlier, Section 447 is an overarching provision that is applicable to every situation. The above mentioned provisions have direct reference to Section 447 in their application and therefore they have been discussed individually in the preceding paragraphs.

## **Compoundable and Non-Compoundable Offences**

Recently, in order to boost ease of doing business in India and to reduce the pendency of cases filed with courts, the Companies (Amendment) Act, 2019 has de-criminalised 16 compoundable offences under the Act which are of the nature of minor violations relating to the technical defaults.

Non-compliance with the provisions of the Companies Act, 2013 ("Act") will entail penalties and/or imprisonment as specified under the Act. Further, offences under the Act have been classified as Compoundable and Non-compoundable offence. Compounding of offence is a process whereby the person/entity committing default will file an application to the compounding authority accepting that it has committed an offence and so that same should be condoned. The compounding authority may compound the offence and ask the defaulting party to deposit compounding fee as decided by it on case to case basis. Once the said compounding fee is paid, the defaulting will no more be treated in default of the offence which has been so compounded.

The provisions pertaining to compounding of offences under the Act are set forth under Section 441 of Act. Section 441 of the Act provides for compounding of following offences:

- Offence punishable with fine only, or

- Offence punishable with fine or imprisonment or both.

The following offences cannot be compounded under the Act:

- Offence punishable with imprisonment only.
- Offence punishable with both imprisonment and fine.

### **Who are compounding authorities under the Act?**

Under the Act, the compounding authority shall be either Regional Director or National Company Law Tribunal. An offence shall be compounded by Regional Director where the maximum amount of fine which may be imposed for such offence does not exceed INR 25,00,000. All offences where the maximum amount of fine which may be imposed for such offence exceed INR 25,00,000 shall be compounded by National Company Law Tribunal.

### **Examples of offences compoundable under the Act**

- Section 56 (6) – non-compliance relating to transfer and transmission of securities;
- Section 64(2) – failure notice to be given to registrar for alteration of share capital;
- Section 99 – default in holding of Annual General Meeting;
- Section 102(5) – not annexing explanatory statement to notice;
- Section 117(2) – failure in filing of resolutions and agreements with the Registrar of Companies;
- Section 203(5) – Failure to appoint Key Managerial Personnel.

### **Threshold of Compounding Offences**

Under the Companies Act, a regional director can compound (settle) offences with a penalty of up to five lakh rupees. Recently Companies (Amendment) increases this ceiling to Rs 25 lakh.

### **Punishment for fraud (Section 447)**

*According to Company Law Review Committee :*

*28.14 Section 447 of the Act lays down the punishment for any person found guilty of fraud to imprisonment not less than six months but which may extend to ten years and fine not less than the amount involved in fraud but which may extend to three times the amount involved. Further, in case the fraud involves public interest, the minimum imprisonment shall be not less than three years.*

*28.15 The Committee received suggestions that the ambit of Section 447 was too broad and would result in minor infractions being punished with severe penalties, which are non-compoundable. However, it was also suggested during the discussions that once the offence of fraud is established, it would not be tenable to provide for a threshold for it to be punishable under Section 447. The Committee observed that the provision has a potential of being misused and may also have a negative impact on attracting professionals in the post of directors etc. and, therefore, recommends that only frauds, which involve at least an amount of rupees ten lakh or one percent of the turnover of the company, whichever is lower, may be punishable under Section 447 (and non-compoundable). Frauds below the limits, which do not involve public interest, may be given a differential treatment and compoundable since the cost of prosecution may exceed the quantum involved. Compounding of certain offences (Section 441)*

*28.16 As per Section 441 of the Act, any offence punishable under the Act with fine only is compoundable by the Tribunal. Other offences punishable with imprisonment or fine or both are compoundable only by the special court. Previously, in the Companies Act, 1956, offences punishable with fine as well as offences punishable with imprisonment or fine or both were compoundable by the Tribunal. The compounding provision was inserted*

*by the Companies Amendment Act, 1988 on the recommendation of the Sachar Committee, as it was felt that leniency is required in the administration of the provisions of the Act particularly penal provisions because a large number of defaults are of technical nature and arise out of ignorance on account of bewildering complexity of the provisions. The Committee observed that as per the scheme of the Act, most of the offences which are punishable with fine or imprisonment or both are technical / procedural in nature, and thus, for the leniency and ease in administration of the Act, the old provisions relating to compounding may be re-instated. Therefore, under sub-Section (1), the Tribunal should have the power to compound offences punishable with fine as well as offences punishable with imprisonment or fine or both.*

In furtherance to the above, vide the Companies (Amendment) Act, 2017 Section 447 was amended by inserting the trigger limit for invocation of the Section for imposing larger penalty by inserting the words and phrases “involving an amount of at least ten lakh rupees or one per cent of the turnover of the company, whichever is lower”. After the amendment section 447 provides as under:

Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.

#### **Duties of Auditors of the Company / Company Secretary / Cost Accountant on fraud reporting**

Section 143 of the Companies Act, 2013 confers certain powers on the auditors of the company as well it casts certain duties on them. Section 143 (12) carries a *non-obstante* clause casting a duty on the auditors of the company to report to the central government an offence of fraud committed by the company or by its officers or employees. The first proviso to Section 143(12) also requires the auditors of the company to report to the audit committee of the company in cases of fraud involving amounts lesser than the specified amount or to the board in other cases. The companies (Audit and Auditors) Rules, 2014 contains the operational procedures for reporting of fraud as mandated in Section 143(12). Similar obligations are cast upon the company secretary in practice (secretarial auditor) and the cost accountant in practice (cost auditor) also. Non-compliance with the duties by an auditor attracts punishment upto Rs. 25 lakh.

#### **Who can be performing a fraud on the company and why?**

Understanding who can commit fraudulent acts and possible motives can help in stall appropriate prevention mechanisms. This can include directors or any of the employees or even auditors or external consultants. For the purposes of this article, we will limit the discussion to directors and employees, since the company can be considered to be quite vulnerable to consequences of their actions.

The motives of such commission can be many - greed, intention to bring disrepute to the company on account of being ousted, and in some cases, just the thrill of having power enough to circumvent or make others circumvent the law. There may even be ‘Robin hood’ fraudsters who believe they are just increasing the balance in the society by defrauding the rich and bringing the benefits to the less fortunate.

## Some examples of fraud

### *By promoters / directors*

- Deceiving investors and making them invest in the company on the basis of fraudulent documents or financial statements or false assurances or ponzi schemes. Funds procured in this way will generally not be used for the purposes stated to the investors. Senior management can typically be involved in this. Further, this can also improve the share price, since a big investment will give the impression of demand for the shares. Promoters, who tend to hold a large stake in the company can benefit from this. *[Saradha chit fund scam]*
- Deceiving lenders - banks or financial institutions to lend money to the company, which can then be used for purposes other than those stated to the lenders. Usually committed in collusion with bank / financial institution officials, this type of fraud can benefit promoters or senior management. *[Kingfisher Airlines / IDBI Bank]*
- Deceiving customers by devising schemes which would give the customer an incorrect impression about the products and services of the company and thus deceiving them into buying such products or services. *[Speak Asia scam]*
- Deceiving government / regulators by false submissions or resorting to tax evasion mechanisms. *[Recent GST fraud]*

### *By senior management / employees*

- Getting a kickback of any sort from any supplier of the company or a lender who lends at rates higher than the market rate. This amounts to gaining an undue advantage at the cost of the company.
- Payment systems or identity theft frauds by the employees. This can include making fake payments to related parties or other fictitious entities for work that may not have been done at all. This can typically involve employees working in the accounting / finance or information technology departments who can swing the payment systems of the company in their favour.
- Stealing and leaking of confidential information to secure personal benefits.
- Outright forgery where employees can use signature of their managers or directors to make company transactions for personal benefit.
- Stealing company products every so often and using these for personal benefits. This can happen in case of factory employees involved in the bulk production of standardised items.

## **Fraud by Promoters / Directors**

Directors are expected to perform in the best interests of the company. However, the kind of power that they wield in the functioning of the company puts them in a position where it is not difficult for them to bend the rules. It's difficult to have an entire board of directors acquiesce to fraudulent activities, but it is possible that even a single director's intentions to gain an undue advantage out of stakeholders' money can result in fraud of a significant amount.

## **Will fraud by just one director make the other directors liable?**

Executive directors can usually be caught in the net of suspicion of fraud, since they are hands on involved in the day to day operations of the company and are aware of where there are loopholes in the systems prevalent within the company. However, the non executive directors or the independent directors cannot escape responsibility simply by virtue of their position. Section 2(60) of the Act implicates 'every director' in

respect of a contravention of the provisions of the Act (including Section 447 - Fraud as discussed above) who consented to the fraud or is aware of the contravention can become covered within the term '*officer who is in default*'.

The method of awareness is also provided for - this must be either by participating in board proceedings without objecting to the same or even by virtue of *receipt of proceedings of the board*. 'Proceedings of the board' can normally be understood to mean the minutes, but can it also include board papers? What if an independent director receives board papers relating to details of the annual financial statements? Often board papers can be so bulky that they comprise of an entire lever arch file. Can the director be expected to reasonably read everything and will this prove his '*awareness*' of the fraud? These are some questions to be pondered.

Resignation may seem to be the immediate recourse to a non executive director, but that does not absolve someone from liability, since the proviso to Section 168(2) of the Act clearly provides that the director who has resigned shall be liable even after his resignation, for the offences which occurred during his tenure.

Here's where the attendance registers, board papers and minutes which you thought were mundane, suddenly become relevant. Attendance at the board meeting promptly brings a director within the '*awareness*' purview discussed above. A recording of who attended the meeting, where they did not participate in the discussion and voting and where they dissented is very relevant to affixing liability.

The board papers need to be concise and clear. Board papers circulated over a period of time, if efficiently compiled, might be instrumental in throwing up a red flag for a director, and might result in an independent either recording his dissent or in extreme cases, resignation.

**Interestingly, the SS- 1 :** Secretarial Standard on Meetings of the Board of Directors requires that the draft minutes need to be circulated to *all* the members of the board of directors, not only those who attended the meeting. Thus the *proceedings of the Board* can be available even to those who did not attend the meeting and they can therefore be considered to be *aware* of a contravention. It certainly makes sense to have your minutes fairly detailed and also for the directors who receive the draft, to read it thoroughly.

### In a Fraud by a Director – Company, a Fraudster or Victim

When directors are acting on behalf of the company, if they deceive third parties, the company will also be penalised for this. In most legislations, the sections speaking about the offences by companies implicate the company *and* the officers in default. Although the company might be able to recover the loss from the director, this would be at a later stage. Initially, the company will have to make good the losses of the third parties or pay the penalties for the violations.

In a 2013 UK case *Jetivia SA & Anr vs. Bilta (UK) Limited (in liquidation) & ors [2013] EWCA Civ 968* the UK Court of Appeals decided that where the directors had acted to deprive the company of its assets and thus made it default in VAT payments to the UK HMRC, the company was the victim and did have a claim towards the breach of fiduciary duties owed to it by its directors.

### Consequences of fraud by Directors

Section 447 seeks to penalise *any person* guilty of fraud involving amounts of at least ten lakh rupees or one percent of the turnover, whichever is less, with imprisonment from six months to ten years and fine ranging from the amount involved in the fraud to three times such amount. If the fraud involves public interest, the imprisonment will not be less than three years.

If the amount involved is less than ten lakh rupees or one percent of the turnover and the fraud does not involve public interest, the punishment shall be imprisonment up to five years or fine up to fifty lakh rupees or both. It must be noted that the liability will be personal here i.e. the personal assets will be used to pay up the penalty.

It's not just the above penalty that is relevant. If a director is found to be guilty of fraud and sentenced to imprisonment for six months or more, he would need to wait five years to be over after the expiry of the sentence to become a director of any other company.

If any director/ person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company.

### **Employees (including Middle and Senior Level Management below the Board Level)**

Employees in today's world aren't the ones to put their heads down and do as directed. Greed can take its play and you can have a *Whale* for an employee. Where employments are at a senior managerial level, they can go on to impact the functioning of the board and consequently, their confirmations to the shareholders.

### **Corporate Governance Mechanisms to Prevent fraud from Sprouting**

The Act has elaborate deterrent sections and penalties for fraudulent activities, particularly where unwary investors are made to place their money in untrustworthy hands. The sudden 'awakening' and action by the regulators can also make someone cautious. There are also a host of forensic audit techniques and methods available for analyzing how exactly the fraud was born and implemented.

But these are all relevant after it is discovered that a fraud actually took place and after discovery of who was involved in it.

### **Safe Guarding Strategy for Fraud**

#### **Corporate Culture**

A strong corporate culture is the pre-requisite for any organization. Corporates should fix certain procedures and policies to govern its employees. The main accountable person, organizational structure of reporting systems, the reporting manager, job responsibilities, segregation of duties, and limitations must all be clearly defined. The organization should investigate a candidate's history and background before hiring.

Organizations must be crystal clear to the employees about their fraud prevention tactics. Proper training should be provided to employees about any documented policies defining fraud, its prevention and detection measures, before implementation. A zero-tolerance policy for all kinds of fraud should be introduced to get rid of internal fraudsters.

### **Screening and Background Checking**

If you are going to place such substantial power in the hands of a director (refer Section 179 (1) of the Companies Act, 2013) and involve a senior employee in the functioning of the company from scratch, it is only appropriate that there be abundant screening, background checking and verification before someone is recommended for and appointed to director and senior managerial level positions. In case of regulated entities, particularly, there would be some kind of 'fitness and probity' norms for someone to be appointed as directors. Further, in cases where foreign nationals are appointed as directors, this checking would be exhaustive since criminals in a country might flee and join entities in other countries.

### **Strong Internal Controls**

The importance of strong internal control systems can never be underestimated. In the *London Whale* story it was established that JP Morgan incurred a loss more because of the risk management systems in the bank were not adequately geared to prevent this from happening. The BFSI (Banks, Financial Services, Insurance) sector entities are required to follow regulatory directions in relation to internal audit and risk



management systems since a lot of money changes hands in these entities and there is substantial public stake involved.

Nevertheless, the Companies Act, 2013 also realizes the importance of internal controls. Section 134(5)(e) of the Act requires the directors of a listed company to confirm, in their responsibility statement, that they had laid down internal financial controls to be followed by the company and that such controls are adequate and operating effectively. Section 134(5)(f) further requires them to confirm that they had devised proper systems to ensure compliance with provisions of all applicable laws and that such systems are adequate and operating effectively.

As per the provisions of regulation 17(8) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR), the CEO and CFO are required to furnish a compliance certificate to the board of directors confirming their responsibility to maintain adequate internal controls pertaining to financial reporting and that they have evaluated the effectiveness and disclosed any deficiencies and design and operation of such internal controls to the auditors and the audit committee. The board of directors will therefore, rely on such certificate. If this is fraudulently provided, chances are, the responsibility statement as discussed above will turn out to be incorrect too. Although in many cases, the CEO and CFO will both also hold the positions of directors.

Clearly laid down internal control systems and techniques such as established policies and procedures, maker - checker processes (separate people to generate and authorize transactions), limits on operation, block leaves etc. can all contribute towards reducing the possibilities of fraud and early detection. Since certain internal controls like maker checker and transaction limits can be installed through software systems, this is one of the very few fear or bias free fraud prevention mechanisms.

### **Whistle Blowing**

That an established vigil mechanism and its reporting methods finds a specific mention in the provisions of section 177(9) of the Act and that the LODR requires listed entities to devise effective whistle blower mechanism reflects on how necessary the lawmakers think these systems are. It is so important that the Act expressly requires that whistleblowers be provided direct access to the Chairman of the Audit Committee and for adequate safeguards to avoid victimisation of the whistleblowers. The ineffective protection mechanisms for whistleblowers might result in creating an atmosphere of fear for whistleblowers. However, it still doesn't stop some crusaders from going ahead and blowing off the lid of corruption. The stronger the protection to the whistleblowers, more can be the chances of early fraud detections.

### **Remuneration**

Remuneration seems to be a strange item to include in fraud prevention mechanisms, but the feeling of not being adequately remunerated can be one reason why a director or senior employee can be driven to 'take what they are due' from an entity irrespective of whether the means are acceptable. Appropriate board evaluation and remuneration policies can result in establishing a measure for rewards against performance.

The metrics should neither be so lenient that the management can achieve it easily nor should they be so strict to seem an insurmountable barrier. Once the yardstick is clear in the minds of the management and employees, they will want to beat it and achieve the remuneration they desire. If that happens, there would be less chances of fraud.

### **Exit Checks and Clawbacks**

Exit interviews, particularly when employees are performing and are remunerated well, can raise red flags about possible involvement in fraud. Somewhere there are likely to be some answers which do not add up. The organisation can then investigate.

Clawback provisions in employment agreements, which enable the company to recover incentive and additional compensation paid to executives are an effective deterrent tool, since executive compensation tends to be largely performance linked. Clawback provisions would provide for recovery of such compensation (usually other than the base salary) in case of fraudulent misrepresentation or misstatements.

The biggest fraud prevention mechanisms are, in reality growth oriented companies which have appropriate recognition and remuneration mechanisms and thus, a high employee morale. A positive community environment is difficult to quit, and even more difficult to ditch.

### **Independent Audit System**

Regular and surprise audits should be conducted by an independent audit team to keep a regular check on the safety of the system. All types of vacation balances should also be checked without fail.

The audit committee should be in charge of monitoring the quarterly and annual audits. This team of experts should also be responsible for validating the results of any internal audit. As stated by reports, it is the internal audit system that is accountable for the detection of 29% of all fraud cases.

### **Operational Reporting System**

A reporting system that is operational and effective can be helpful in reducing fraud in companies. Employees should be aware of the reporting system if they need to report any kind of suspicious activity. A reporting system that keeps the person reporting the fraud anonymous might be more fruitful as it will keep the identity of the employee private while reporting his/her colleague.

To make this system more beneficial, the employees should be encouraged and ensured that they won't land in trouble if they report anything that sparks doubt in their head.

### **Professional Expert for Fraud Prevention**

This is another surefire strategy to mitigate the deceitful activity. Companies can hire certified fraud prevention experts as a part of the fraud prevention program. These experts can prove to be very crucial for creating and instigating fraud prevention policies and invincible strategies.

### **Fraud under Indian Penal Code, 1860**

The Indian Penal Code, 1860, does not define fraud; it defines 'cheating'. Interestingly, the Section 420, which has become synonymous with fraud isn't even the core section dealing with fraud. It's Section 415, in fact, which defines cheating and states that if someone deceives another to deliver any property or do or not do something that he or she wouldn't, if they were not deceived, is said to cheat.

Deceiving other people is a crime if you

- a) intended to deceive them
- b) made them do something under deception and
- c) they wouldn't have done that something if they had not been deceived.

An important requirement is that there must be some sort of harm or damage done to the person cheated, because of the cheating. The damage need not necessarily be of a financial nature; it could even be some sort of harm to the body or mind or reputation.

The standout essentials here, are 'intent to deceive', 'to gain undue advantage' or to 'injure someone's interests.

If there's a lack of a mala fide intention as discussed above, there's no fraud.



## INTENTION TO COMMIT A FRAUD

According to the act, intention is one of the essential ingredients to commit a fraud. In this regard it may be noted that the Hon'ble Supreme Court of India held in the matter of *Dr. Vimla vs. Delhi Administration* in the year 1962, in the context of the matter that fraud has to satisfy two conditions viz., (a) deceit or injury to the person deceived (b) intention to deceive.

In the matter of *The State of Mysore vs. Padmanabhacharya etc.*, the Hon'ble Supreme Court of India held a view that the intention can be assumed. In the case under reference the matter relates to certain smuggling activities involving violation of the Sea Customs Act, 1887. In this matter the Hon'ble Supreme Court of India held considering the facts of the case that the intention to defraud continues even after the actual importation of goods and continues in the hands of the subsequent purchasers also. Thus, intention has been accorded a wider amplitude and applicability.

An unintentional and mere accidental omission or commission generally will not stand the test of legal scrutiny in establishing a fraud. Intention can be provided by looking into the attendant factors relating to the impugned fraudulent act. In this regard it is relevant to note the following decision of the Hon'ble Securities Appellate Tribunal,

The Hon'ble SAT, in *Ketan Parekh vs. Securities & Exchange Board of India* (Appeal No. 2 of 2004) dated July 14, 2006, observed that, *Whether a transaction has been executed with the intention to manipulate the market or defeat its mechanism will depend upon the intention of the parties which could be inferred from the attending circumstances because direct evidence in such cases may not be available. The nature of the transaction executed, the frequency with which such transactions are undertaken, the value of the transactions, whether they involve circular trading and whether there is real change of beneficial ownership, the conditions then prevailing in the market are some of the factors which go to show the intention of the parties. This list of factors, in the very nature of things, cannot be exhaustive. Any one factor may or may not be decisive and it is from the cumulative effect of these that an inference will have to be drawn.*"

## UNLAWFUL GAIN OR LOSS

Another important ingredient as per the definition of the term fraud is making unlawful gain or loss. As has been discussed earlier, in committing a fraud it is not necessary there should be a gain or a loss. Even without that ingredient getting fulfilled, a fraud can still be committed. It may not be possible to precisely understand the object of intentional frauds in each case. If gain is considered to be the object some may disprove by establishing gain was not the object whereas loss was the object. Thus, the object need not necessary to reap any direct gain or to lose a deceit has to be established.

## CRIMINAL BREACH OF TRUST

Section 405 and 409 of the Indian Penal Code, 1860 deal with Criminal Misappropriation of Property.

### Criminal breach of trust (Section 405)

Whoever, being in any manner entrusted with property, or with any dominion over property, dishonestly misappropriates or converts to his own use that property, or dishonestly uses or disposes of that property in violation of any direction of law prescribing the mode in which such trust is to be discharged, or of any legal contract, express or implied, which he has made touching the discharge of such trust, or wilfully suffers any other person so to do, commits "criminal breach of trust".

**Explanation 1.** – A person, being an employer of an establishment whether exempted under section 17 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (19 of 1952) or not who deducts the employee's contribution from the wages payable to the employee for the credit to a Provident Fund or Family Pension Fund established by any law for the time being in force, shall be deemed to have been entrusted with

the amount of contribution so deducted by him and if he makes default in the payment of such contribution to the said Fund in violation of the said law, shall be deemed to have dishonestly used the amount of the said contribution in violation of a direction of law as aforesaid.

*Explanation 2.* – A person, being an employer, who deducts the employees' contribution from the wages payable to the employee for credit to the Employees' State Insurance Fund held and administered by the Employees' State Insurance Corporation established under the Employees' State Insurance Act, 1948 (34 of 1948), shall be deemed to have been entrusted with the amount of contribution so deducted by him and if he makes default in payment of such contribution to the said Fund in violation of the said Act, shall be deemed to have dishonestly used the amount of said contribution in violation of a direction of law as aforesaid.

### Illustrations

- (a) A, being executor to the will of a deceased person, dishonestly disobeys the law which directs him to divide the effects according to the will, and appropriates them to his own use. A has committed criminal breach of trust.
- (b) A is a warehouse-keeper. Z going on a journey, entrusts his furniture to A, under a contract that it shall be returned on payment of a stipulated sum for warehouse room. A dishonestly sells the goods. A has committed criminal breach of trust.
- (c) A, residing in Calcutta, is agent for Z, residing at Delhi. There is an express or implied contract between A and Z, that all sums remitted by Z to A shall be invested by A, according to Z's direction. Z remits a lakh of rupees to A, with directions to A to invest the same in Company's paper. A dishonestly disobeys the directions and employs the money in his own business. A has committed criminal breach of trust.
- (d) But if A, in the last illustration, not dishonestly but in good faith, believing that it will be more for Z's advantage to hold shares in the Bank of Bengal, disobeys Z's directions, and buys shares in the Bank of Bengal, for Z, instead of buying Company's paper, here, though Z should suffer loss, and should be entitled to bring a civil action against A, on account of that loss, yet A, not having acted dishonestly, has not committed criminal breach of trust.
- (e) A, a revenue-officer, is entrusted with public money and is either directed by law, or bound by a contract, express or implied, with the Government, to pay into a certain treasury all the public money which he holds. A dishonestly appropriates the money. A has committed criminal breach of trust.
- (f) A, a carrier, is entrusted by Z with property to be carried by land or by water. A dishonestly misappropriates the property. A has committed criminal breach of trust.

The gist of the offence of criminal breach of trust as defined under section 405 of the Indian Penal Code, 1860 is 'dishonest misappropriation' or 'conversion to own use', another person's property.

### Criminal Breach of Trust – Essential Ingredients

The essential ingredients of the offence of criminal breach of trust are as under :

1. The accused must be entrusted with the property or with dominion over it,
2. The person so entrusted must use that property, or;
3. The accused must dishonestly use or dispose of that property or wilfully suffer any other person to do so in violation,
  - (i) of any direction of law prescribing the mode in which such trust is to be discharged, or;
  - (ii) of any legal contract made touching the discharge of such trust.

The Supreme Court of India in *V.R. Dalal v. Yugendra Naranji Thakkar*, 2008 (15) SCC 625, has held that the

first ingredient of criminal breach of trust is entrustment and where it is missing, the same would not constitute a criminal breach of trust. Breach of trust may be held to be a civil wrong but when *mens-rea* is involved it gives rise to criminal liability also. The expression 'direction of law' in the context of Section 405 would include not only legislations pure and simple but also directions, instruments and circulars issued by authority entitled therefor. In a landmark judgment of *Pratibha Rani v. Suraj Kumar*, AIR 1985 SC 628, the appellant alleged that her stridhan property was entrusted to her in-laws which they dishonestly misappropriated for their own use. She made out a clear, specific and unambiguous case against in-laws. The accused were held guilty of this offence and she was held entitled to prove her case and no court would be justified in quashing her complaint.

The Supreme Court in *Onkar Nath Mishra v. State* (NCT of Delhi), 2008 CrLJ 1391 (SC), has held that in the commission of offence of criminal breach of trust, two distinct parts are involved. The first consists of the creation of an obligation in relation to property over which dominion or control is acquired by accused. The second is a misappropriation or dealing with property dishonestly and contrary to the terms of the obligation created. In another case, *Suryalakshmi Cotton Mills Ltd. v. Rajvir Industries Ltd.*, 2008 (13) SCC 678, it was held that a cheque is property and if the said property has been misappropriated or has been used for a purpose for which the same had not been handed over, a case under Section 406 of the Code may be found to have been made out.

In *S.K. Alagh v. State of U.P. and others*, 2008 (5) SCC 662, where demand drafts were drawn in the name of company for supply of goods and neither the goods were sent by the company nor the money was returned, the Managing Director of the company cannot be said to have committed the offence under Section 406 of Indian Penal Code. It was pointed out that in absence of any provision laid down under statute, a director of a company or an employer cannot be held vicariously liable for any offence committed by company itself.

After analyzing all the cases we may conclude that for an offence to fall under this section all the four requirements are essential to be fulfilled.

1. The person handing over the property must have confidence in the person taking the property so as to create a fiduciary relationship between them or to put him in position of trustee.
2. The accused must be in such a position where he could exercise his control over the property i.e; dominion over the property.
3. The term property includes both movable as well as immovable property within its ambit.
4. It has to be established that the accused has dishonestly put the property to his own use or to some unauthorized use. Dishonest intention to misappropriate is a crucial fact to be proved to bring home the charge of criminal breach of trust.

#### **Punishment for criminal breach of trust (Section 406)**

Whoever commits criminal breach of trust shall be punished with imprisonment of either description for a term which may extend to three years, or with fine, or with both.

#### **Criminal breach of trust by carrier (Section 407)**

Whoever, being entrusted with property as a carrier, wharfinger or warehouse-keeper, commits criminal breach of trust in respect of such property, shall be punished with imprisonment of either description for a term which may extend to seven years, and shall also be liable to fine.

#### **Criminal breach of trust by clerk or servant (Section 408)**

Whoever, being a clerk or servant or employed as a clerk or servant, and being in any manner entrusted in such capacity with property, or with any dominion over property, commits criminal breach of trust in respect of that

property, shall be punished with imprisonment of either description for a term which may extend to seven years, and shall also be liable to fine.

### **Criminal breach of trust by public servant, or by banker, merchant or agent (Section 409)**

Whoever, being in any manner entrusted with property, or with any dominion over property in his capacity of a public servant or in the way of his business as a banker, merchant, factor, broker, attorney or agent, commits criminal breach of trust in respect of that property, shall be punished with imprisonment for life, or with imprisonment of either description for a term which may extend to ten years, and shall also be liable to fine.

The acts of criminal breach of trust done by strangers is treated less harshly than acts of criminal breach of trust on part of the persons who enjoy special trust and also in a position to be privy to a lot of information or authority or on account of the status enjoyed by them, say as in the case of a public servant. In respect of public servants a much more stringent punishment of life imprisonment or imprisonment up to 10 years with fine is provided. This is because of special status and the trust which a public servant enjoys in the eyes of the public as a representative of the government or government owned enterprises.

The persons having a fiduciary relationship between them have a greater responsibility for honesty as they have more control over the property entrusted to them due to their special relationship. Under this section the punishment is severe and the persons of fiduciary relationship have been classified as public servants, bankers, factors, brokers, attorneys and agents.

In *Bagga Singh v. State of Punjab*, the appellant was a taxation clerk in the Municipal Committee, Sangrur. He had collected arrears of tax from tax-payers but the sum was not deposited in the funds of the committee after collection but was deposited after about 5 months. He pleaded that money was deposited with the cashier Madan Lal, a co-accused, who had defaulted on the same but the cashier proved that he had not received any such sum and was acquitted by lower court. The mere fact that the co-accused cashier was acquitted was not sufficient to acquit accused in the absence of any proof that he had discharged the trust expected of him. As such the accused was liable under section 409 of Indian Penal Code, 1860.

In *Bachchu Singh v. State of Haryana*, AIR 1999 SC 2285, the appellant was working as 'Gram Sachiv' for eight gram panchayats. He collected a sum of Rs. 648 from thirty villagers towards the house tax and executed receipts for the same. As he was a public servant, and in that capacity he had collected money as house tax but did not remit the same, he was charged under Section 409 of Indian Penal Code, 1860. It was held that the appellant dishonestly misappropriated or converted the said amount for his own use and his conviction under section 409 of Indian Penal Code, 1860 was upheld by the Supreme Court.

In *Girish Saini v. State of Rajasthan*, a public servant was accused of neither depositing nor making entries of stationery required for official purpose. Accused public servant was in charge of the store in the concerned department at the time of commission of offence. Hence entrustment was proved. It was held accused could not take the benefit of misplacing of one of registers of company as he could not prove maintenance of two registers by department. Therefore, the accused was held guilty of committing criminal breach of trust.

### **Cheating**

Sections 415 to 420 of Indian Penal Code, 1860 deal with the offence of cheating. In most of the offences relating to property the accused merely get possession of thing in question, but in case of cheating he obtains possession as well as the property in it.

Section 415 provides that whoever, by deceiving any person, fraudulently or dishonestly induces the person so deceived to deliver any property to any person, or to consent that any person shall retain any property, or intentionally induces the person so deceived to do or omit to do anything which he would not do or omit if he were not so deceived, and which act or omission causes or is likely to cause damage or harm to that person in body, mind, reputation or property, is said to "cheat".

*Explanation.* – A dishonest concealment of facts is a deception within the meaning of this section.

### Illustrations

- (a) A, by falsely pretending to be in the Civil Service, intentionally deceives Z, and thus dishonestly induces Z to let him have on credit goods for which he does not mean to pay. A cheats.
- (b) A, by putting a counterfeit mark on an article, intentionally deceives Z into a belief that this article was made by a certain celebrated manufacturer, and thus dishonestly induces Z to buy and pay for the article. A cheats.
- (c) A, by exhibiting to Z a false sample of an article intentionally deceives Z into believing that the article corresponds with the sample, and thereby dishonestly induces Z to buy and pay for the article. A cheats.
- (d) A, by tendering in payment for an article a bill on a house with which A keeps no money, and by which A expects that the bill will be dishonoured, intentionally deceives Z, and thereby dishonestly induces Z to deliver the article, intending not to pay for it. A cheats.
- (e) A, by pledging as diamond articles which he knows are not diamonds, intentionally deceives Z, and thereby dishonestly induces Z to lend money. A cheats.
- (f) A intentionally deceives Z into a belief that A means to repay any money that Z may lend to him and thereby dishonestly induces Z to lend him money, A not intending to repay it. A cheats.
- (g) A intentionally deceives Z into a belief that A means to deliver to Z a certain quantity of indigo plant which he does not intend to deliver, and thereby dishonestly induces Z to advance money upon the faith of such delivery. A cheats; but if A, at the time of obtaining the money, intends to deliver the indigo plant, and afterwards breaks his contract and does not deliver it, he does not cheat, but is liable only to a civil action for breach of contract.
- (h) A intentionally deceives Z into a belief that A has performed A's part of a contract made with Z, which he has not performed, and thereby dishonestly induces Z to pay money. A cheats.
- (i) A sells and conveys an estate to B. A, knowing that in consequence of such sale he has no right to the property, sells or mortgages the same to Z, without disclosing the fact of the previous sale and conveyance to B, and receives the purchase or mortgage money from Z. A cheats.

### Cheating – Main Ingredients

The main ingredients of cheating are as under:

1. Deception of any person.
2. (a) Fraudulently or dishonestly inducing that person
  - (i) to deliver any property to any person; or
  - (ii) to consent that any person shall retain any property; or
- (b) Intentionally inducing that person to do or omit to do anything which he would not do or omit if he were not so deceived, and which act or omission causes or is likely to cause damage or harm to that person in body, mind, reputation or property.

The Supreme Court in *Iridium India Telecom Ltd. v. Motorola Incorporated and Ors.*, (2005) 2 SCC 145, has held that deception is necessary ingredient under both parts of section. Complainant must prove that inducement has been caused by deception exercised by the accused. It was held that non-disclosure of relevant information would also be treated a misrepresentation of facts leading to deception.

The Supreme Court in *M.N. Ojha and others v. Alok Kumar Srivastav and anr*, (2009) 9 SCC 682, has held that where the intention on the part of the accused is to retain wrongfully the excise duty which the State is

empowered under law to recover from another person who has removed non-duty paid tobacco from one bonded warehouse to another, they are held guilty of cheating.

In *T.R. Arya v. State of Punjab*, 1987 CrLJ 222, it was held that negligence in duty without any dishonest intention cannot amount to cheating. A bank employee when on comparison of signature of drawer passes a cheque there may be negligence resulting in loss to bank, but it cannot be held to be cheating.

### **Cheating by personation**

As per section 416 a person is said to “cheat by personation” if he cheats by pretending to be some other person, or by knowingly substituting one person for another, or representing that he or any other person is a person other than he or such other person really is.

*Explanation.* – The offence is committed whether the individual personated is a real or imaginary person.

### **Illustrations**

- (a) A cheats by pretending to be a certain rich banker of the same name. A cheats by personation.
- (b) A cheats by pretending to be B, a person who is deceased. A cheats by personation.

### **Punishment for cheating**

Section 417 provides that whoever cheats shall be punished with imprisonment of either description for a term which may extend to one year, or with fine, or with both.

### **Cheating with knowledge that wrongful loss may ensue to person whose interest offender is bound to protect**

According to section 418 whoever cheats with the knowledge that he is likely to cause wrongful loss to a person whose interest in the transaction to which the cheating relates, he was bound, either by law, or by a legal contract, to protect, shall be punished with imprisonment of either description for a term which may extend to three years, or with fine, or with both.

### **Punishment for cheating by personation**

Section 419 states that whoever cheats by personation shall be punished with imprisonment of either description for a term which may extend to three years, or with fine, or with both.

### **Cheating and dishonestly inducing delivery of property**

As per section 420 whoever cheats and thereby dishonestly induces the person deceived to deliver any property to any person, or to make, alter or destroy the whole or any part of a valuable security, or anything which is signed or sealed, and which is capable of being converted into a valuable security, shall be punished with imprisonment of either description for a term which may extend to seven years, and shall also be liable to fine.

Simple cheating is punishable under section 417 of the IPC. Section 420 comes into operation when there is delivery or destruction of any property or alteration or destruction of any valuable security resulting from the act of the person deceiving.

In *Kuriachan Chacko v. State of Kerala*, (2004) 12 SCC 269, the money circulation scheme was allegedly mathematical impossibility and promoters knew fully well that scheme was unworkable and false representations were being made to induce persons to part with their money. The Supreme Court held that it could be assumed and presumed that the accused had committed offence of cheating under section 420 of the IPC.

In *Mohd. Ibrahim and others v. State of Bihar and another*, (2009) 3 SCC (Cri) 929, the accused was alleged



to have executed false sale deeds and a complaint was filed by real owner of property. The accused had a bonafide belief that the property belonged to him and purchaser also believed that suit property belongs to the accused. It was held that accused was not guilty of cheating as ingredients of cheating were not present.

In *Shruti Enterprises v. State of Bihar and ors*, 2006 CrLJ 1961, it was held that mere breach of contract cannot give rise to criminal prosecution under section 420 unless fraudulent or dishonest intention is shown right at the beginning of transaction when the offence is said to have been committed. If it is established that the intention of the accused was dishonest at the time of entering into the agreement then liability will be criminal and the accused will be guilty of offence of cheating. On the other hand, if all that is established is that a representation made by the accused has subsequently not been kept, criminal liability cannot be fastened on the accused and the only right which complainant acquires is to a decree of damages for breach of contract.

### **Fraudulent Deeds and Dispositions of Property**

Fraudulent Deeds and Dispositions of Property are covered under section 421 to 424 of the Indian Penal Code, 1860. These sections deal with fraudulent conveyances referred to in section 53 of the Transfer of Property Act and the Presidency-towns and Provincial Insolvency Acts.

### **Dishonest or fraudulent removal or concealment of property to prevent distribution among creditors (Section 421)**

Whoever dishonestly or fraudulently removes, conceals or delivers to any person, or transfers or causes to be transferred to any person, without adequate consideration, any property, intending thereby to prevent, or knowing it to be likely that he will thereby prevent, the distribution of that property according to law among his creditors or the creditors of any other person, shall be punished with imprisonment of either description for a term which may extend to two years, or with fine, or with both.

Guwahati High Court in *Ramautar Chaukhany v Hari Ram Todi & Anr*, 1982 CrLJ 2266, held that an offence under this section has following essential ingredients:

- (i) That the accused removed, concealed or delivered the property or that he transferred, it caused it to be transferred to someone;
- (ii) That such a transfer was without adequate consideration;
- (iii) That the accused thereby intended to prevent or knew that he was thereby likely to prevent the distribution of that property according to law among his creditors or creditors of another person;
- (iv) That he acted dishonestly and fraudulently.

This section specifically refers to frauds connected with insolvency. The offence under it consists in a dishonest disposition of property with intent to cause wrongful loss to the creditors. It applies to movable as well as immovable properties. In view of this section, the property of a debtor cannot be distributed according to law except after the provisions of the relevant enactments have been complied with.

### **Dishonestly or fraudulently preventing debt being available for creditors (Section 422)**

Whoever dishonestly or fraudulently prevents any debt or demand due to himself or to any other person from being made available according to law for payment of his debts or the debts of such other person, shall be punished with imprisonment of either description for a term which may extend to two years, or with fine, or with both.

This section, like the preceding section 421, is intended to prevent the defrauding of creditors by masking property.

The expression 'debt' has not been defined in the IPC or in the General Clauses Act but there are judicial pronouncements on the same. In *Commissioner of Wealth Tax v G.D. Naidu*, AIR 1966 Mad 74, it was held

that the essential requisites of debt are- (1) ascertained or ascertainable, (2) an absolute liability, in present or future, and (3) an obligation which has already accrued and is subsisting. All debts are liabilities but all liabilities are not debt.

The Supreme Court in *Mangoo Singh v. Election Tribunal*, AIR 1957 SC 871, has laid down that the word 'demand' ordinarily means something more than what is due; it means something which has been demanded, called for or asked for, but the meaning of the word must take colour from the context and so 'demand' may also mean arrears or dues.

### **Dishonest or fraudulent execution of deed of transfer containing false statement of consideration (Section 423)**

Whoever dishonestly or fraudulently signs, executes or becomes a party to any deed or instrument which purports to transfer or subject to any charge on property, or any interest therein, and which contains any false statement relating to the consideration for such transfer or charge, or relating to the person or persons for whose use or benefit it is really intended to operate, shall be punished with imprisonment of either description for a term which may extend to two years, or with fine, or with both.

This section deals with fraudulent and fictitious conveyances and transfers. The essential ingredient of an offence under section 423 is that the sale deed or a deed subjecting an immovable property to a charge must contain a false statement relating to the consideration or relating to the person for whose use or benefit it is intended to operate.

Though dishonest execution of a benami deed is covered under this section, the section stands superseded by The Prohibition of Benami Properties Transactions Act, 1988 because the latter covers a wider field, encompassing the field covered by this section.

### **Dishonest or fraudulent removal or concealment of property (Section 424)**

Whoever dishonestly or fraudulently conceals or removes any property of himself or any other person, or dishonestly or fraudulently assists in the concealment or removal thereof, or dishonestly releases any demand or claim to which he is entitled, shall be punished with imprisonment of either description for a term which may extend to two years, or with fine, or with both.

The essential ingredients to bring an offence under section 424 are as follows:

- (i) There is a property;
  - (ii) That the accused concealed or removed the said property or assisted in concealing or removing the said property;
  - (iii) That the said concealment or removal or assisting in removal or concealment was done dishonestly or fraudulently.
- Or,
- (i) That the accused was entitled to a demand or claim;
  - (ii) That the accused released the same;
  - (iii) That he so released dishonestly or fraudulently.

### **Forgery**

Forgery is defined under section 463 of the Indian Penal Code, 1860 and the punishment for it is prescribed under section 465.



### Forgery (Section 463)

Whoever makes any false document or false electronic record or part of a document or electronic record, with intent to cause damage or injury, to the public or to any person, or to support any claim or title, or to cause any person to part with property, or to enter into any express or implied contract, or with intent to commit fraud or that fraud may be committed, commits forgery.

### Punishment for Forgery (Section 465)

Whoever commits forgery shall be punished with imprisonment of either description for a term which may extend to two years, or with fine, or with both.

The making of a false document or false electronic record is defined under section 464 of the Indian Penal Code, 1860.

The Supreme Court in *Ramchandran v. State*, AIR 2010 SC 1922, has held that to constitute an offence of forgery document must be made with dishonest or fraudulent intention. A person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise. The Supreme Court in *Parminder Kaur v. State of UP*, has held that mere alteration of document does not make it a forged document. Alteration must be made for some gain or for some objective.

Similarly, in *Balbir Kaur v. State of Punjab*, 2011 CrLJ 1546 (P&H), the allegation against the accused was that she furnished a certificate to get employment as ETT teacher which was found to be bogus and forged in as much as school was not recognized for period given in certificate. However the certificate did not anywhere say that school was recognized. It was held that merely indicating teaching experience of the accused, per-se, cannot be said to indicate wrong facts. So the direction which was issued for prosecution is liable to be quashed.

## FRAUD UNDER SEBI REGULATIONS

### Fraud under SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003

“fraud” includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss, and shall also include –

- (1) a knowing misrepresentation of the truth or concealment of material fact in order that another person may act to his detriment;
- (2) a suggestion as to a fact which is not true by one who does not believe it to be true;
- (3) an active concealment of a fact by a person having knowledge or belief of the fact;
- (4) a promise made without any intention of performing it;
- (5) a representation made in a reckless and careless manner whether it be true or false;
- (6) any such act or omission as any other law specifically declares to be fraudulent,
- (7) deceptive behaviour by a person depriving another of informed consent or full participation,
- (8) a false statement made without reasonable ground for believing it to be true.
- (9) the act of an issuer of securities giving out misinformation that affects the market price of the security, resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price.

And “fraudulent” shall be construed accordingly;

Nothing contained in this clause shall apply to any general comments made in good faith in regard to –

- (a) the economic policy of the government;
- (b) the economic situation of the country;
- (c) trends in the securities market;
- (d) any other matter of a like nature whether such comments are made in public or in private;

No person shall directly or indirectly –

- (a) buy, sell or otherwise deal in securities in a fraudulent manner;
- (b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made there under;
- (c) employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange;
- (d) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the rules and the regulations made there under:
  - (1) Without prejudice to the provisions of regulation 3, no person shall indulge in a manipulative, fraudulent or an unfair trade practice in securities markets.
  - (2) Dealing in securities shall be deemed to be a manipulative fraudulent or an unfair trade practice if it involves any of the following:-
    - (a) knowingly indulging in an act which creates false or misleading appearance of trading in the securities market;
    - (b) dealing in a security not intended to effect transfer of beneficial ownership but intended to operate only as a device to inflate, depress or cause fluctuations in the price of such security for wrongful gain or avoidance of loss;
    - (c) inducing any person to subscribe to an issue of the securities for fraudulently securing the minimum subscription to such issue of securities, by advancing or agreeing to advance any money to any other person or through any other means;
    - (d) inducing any person for dealing in any securities for artificially inflating, depressing, maintaining or causing fluctuation in the price of securities through any means including by paying, offering or agreeing to pay or offer any money or money's worth, directly or indirectly, to any person;
    - (e) any act or omission amounting to manipulation of the price of a security including, influencing or manipulating the reference price or bench mark price of any securities;
    - (f) knowingly publishing or causing to publish or reporting or causing to report by a person dealing in securities any information relating to securities, including financial results, financial statements, mergers and acquisitions, regulatory approvals, which is not true or which he does not believe to be true prior to or in the course of dealing in securities;
    - (g) entering into a transaction in securities without intention of performing it or without intention of change of ownership of such security;

- (h) selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities whether in physical or dematerialized form:

Provided that if:-

- (i) the person selling, dealing in or pledging stolen, counterfeit or fraudulently issued securities was a holder in due course; or
  - (ii) the stolen, counterfeit or fraudulently issued securities were previously traded on the market through a bonafide transaction,
  - (iii) such selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities shall not be considered as a manipulative, fraudulent, or unfair trade practice;
- (k) disseminating information or advice through any media, whether physical or digital, which the disseminator knows to be false or misleading and which is designed or likely to influence the decision of investors dealing in securities;
- (m) a market participant entering into transactions on behalf of client without knowledge of or instructions from client or misutilizing or diverting the funds or securities of the client held in fiduciary capacity”;
- (n) circular transactions in respect of a security entered into between persons including intermediaries to artificially] provide a false appearance of trading in such security or to inflate, depress or cause fluctuations in the price of such security;
- (o) fraudulent inducement of any person by a market participant to deal in securities with the objective of enhancing his brokerage or commission or income;
- (p) an intermediary predating or otherwise falsifying records including contract notes, client instructions, balance of securities statement, client account statements;
- (q) any order in securities placed by a person, while directly or indirectly in possession of information that is not publically available, regarding a substantial impending transaction in that securities, its underlying securities or its derivative;]
- (r) knowingly planting false or misleading news which may induce sale or purchase of securities. mis- selling of securities or services relating to securities market;
- (s) mis-selling of securities or services relating to securities market;

Explanation - For the purpose of this clause, “mis-selling” means sale of securities or services relating to securities market by any person, directly or indirectly, by—

- (i) knowingly making a false or misleading statement, or
  - (ii) knowingly concealing or omitting material facts, or
  - (iii) knowingly concealing the associated risk, or
  - (iv) not taking reasonable care to ensure suitability of the securities or service to the buyer:
- (t) illegal mobilization of funds by sponsoring or causing to be sponsored or carrying on or causing to be carried on any collective investment scheme by any person

### LESSON ROUND UP

- Fraud consists of some deceitful practice or willful device, resorted to with an intent to deprive another of his right, or in some manner to do him an injury. As distinguished from negligence, it is always positive, intentional.
- The term Fraud is not defined under the Indian Penal Code, 1860, however, it defines 'cheating'.
- Section 415 provides that whoever, by deceiving any person, fraudulently or dishonestly induces the person so deceived to deliver any property to any person, or to consent that any person shall retain any property, or intentionally induces the person so deceived to do or omit to do anything which he would not do or omit if he were not so deceived, and which act or omission causes or is likely to cause damage or harm to that person in body, mind, reputation or property, is said to "cheat".
- Whoever, being in any manner entrusted with property, or with any dominion over property, dishonestly misappropriates or converts to his own use that property, or dishonestly uses or disposes of that property in violation of any direction of law prescribing the mode in which such trust is to be discharged, or of any legal contract, express or implied, which he has made touching the discharge of such trust, or wilfully suffers any other person so to do, commits "criminal breach of trust".
- Whoever makes any false document or false electronic record or part of a document or electronic record, with intent to cause damage or injury, to the public or to any person, or to support any claim or title, or to cause any person to part with property, or to enter into any express or implied contract, or with intent to commit fraud or that fraud may be committed, commits forgery.

### TEST YOURSELF

*(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)*

1. "Intention is one of the essential ingredients to commit a fraud". Elaborate.
2. What are the essential ingredients of the offence of criminal breach of trust?
3. What are the main ingredients of cheating under Indian Penal Code, 1860?
4. An unintentional and mere accidental omission or commission generally will not stand the test of legal scrutiny in establishing a fraud. Comment.

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# Lesson 5

## Regulatory Action

### LESSON OUTLINE

- Introduction
- Investigation – Section 210 - 229
- Protection of Employees During Investigation (Section 218)
- Freezing of Assets of Company on Inquiry and Investigation (Section 221)
- Imposition of Restrictions upon Securities (Section 222)
- Inspector's Report (Section 223)
- Voluntary Winding Up of Company not to stop Investigation (Section 226)
- Legal Advisers and Bankers not to Disclose (Section 227)
- Penalty for False Statement etc. (Section 229)
- Preparation by a Company Secretary to Face Investigation
- Establishment of Serious Fraud Investigation Office (Section 211)
- Investigate into Affairs of a Company (Section 212)
- Investigations Procedure by SEBI
- Cease and Desist Proceedings
- SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003
- SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995
- Foreign Exchange Management Act, 1999
- Foreign Contribution (Regulation) Act, 2010
- Inspection, Search and Seizure
- Goods and Services Tax Act, 2017
- Income Tax Act, 1962
- Public Interest Cases
- LESSON ROUND UP
- TEST YOURSELF

### LEARNING OBJECTIVES

This lesson covers the detailed procedure regarding:

- Inspection, inquiry and investigation under Companies Act, 2013
- Establishment of SFIO
- Investigation procedures by SEBI
- Procedure for investigation of Fraudulent and Unfair Trade practices in Security Market
- Procedure for holding inquiry and imposition of penalty
- Competition Act, 2002
- Inspection Search, seizure under FEMA, FCRA, GST, Income Tax Act

**REGULATORY FRAMEWORK**

<b>Acts/Rules/Regulations</b>	<b>Relevant Sections</b>	<b>Contents</b>
Companies Act, 2013 and Rules made thereunder	Section 206	Power to call for information, inspect books and conduct inquiries
Companies Act, 2013 and Rules made thereunder	Section 207	Conduct of inspection and inquiry
Companies Act, 2013 and Rules made thereunder	Section 208	Report on inspection made
Companies Act, 2013 and Rules made thereunder	Section 209	Search and seizure
Companies Act, 2013 and Rules made thereunder	Section 211	Investigation into affairs of company
Companies Act, 2013 and Rules made thereunder	Section 211	Establishment of Serious Fraud Investigation Office
Companies Act, 2013 and Rules made thereunder	Section 212	Investigation into affairs of Company by Serious Fraud Investigation Office
Companies Act, 2013 and Rules made thereunder	Section 213	Investigation into company's affairs in other cases
Companies Act, 2013 and Rules made thereunder	Section 214	Security for payment of costs and expenses of investigation
Companies Act, 2013 and Rules made thereunder	Section 215	Firm, body corporate or association not to be appointed as inspector
Companies Act, 2013 and Rules made thereunder	Section 216	Investigation of ownership of company
Companies Act, 2013 and Rules made thereunder	Section 217	Procedure, powers, etc., of inspectors
Companies Act, 2013 and Rules made thereunder	Section 218	Protection of employees during investigation
Companies Act, 2013 and Rules made thereunder	Section 219	Power of inspector to conduct investigation into affairs of related companies, etc.
Companies Act, 2013 and Rules made thereunder	Section 220	Seizure of documents by inspector
Companies Act, 2013 and Rules made thereunder	Section 221	Freezing of assets of company on inquiry and investigation
Companies Act, 2013 and Rules made thereunder	Section 222	Imposition of restrictions upon securities
Companies Act, 2013 and Rules made thereunder	Section 223	Inspector's report
Companies Act, 2013 and Rules made thereunder	Section 224	Actions to be taken in pursuance of inspector's report

Companies Act, 2013 and Rules made thereunder	Section 225	Expenses of investigation
Companies Act, 2013 and Rules made thereunder	Section 226	Voluntary winding up of company, etc., not to stop investigation proceedings
Companies Act, 2013 and Rules made thereunder	Section 227	Legal advisers and bankers not to disclose certain information
Companies Act, 2013 and Rules made thereunder	Section 228	Investigation, etc., of foreign companies
Companies Act, 2013 and Rules made thereunder	Section 229	Penalty for furnishing false statement, mutilation, destruction of documents
SEBI Act, 1992	Section 11 C	Investigations and Procedure by SEBI
SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003	Regulation 3	Prohibition of certain dealings in securities
SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003	Regulation 4	Prohibition of manipulative, fraudulent and unfair trade practices
SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995	Rule 4	Procedure for Holding Inquiry and Imposing Penalties for the violations under SEBI Regulations
Competition Act, 2002	Section 19	Inquiry into certain agreements and dominant position of enterprise
Competition Act, 2002	Section 20	Inquiry into combination by Commission
Competition Act, 2002	Section 26	Procedure for inquiry under section 19
Factories Act, 1948	Section 9	Powers of Inspectors - Inspection, Search and Seizure
Foreign Exchange Management Act, 1999	Section 37	Power of search, seizure Inspection, Search and Seizure by the Director of Enforcement
Foreign Contribution (Regulation) Act, 2010	Section 43	Investigation into cases under the Act.
Goods and Services Tax Act, 2017	Section 67 (CGST Act, 2017)	Power of inspection, search and seizure
Income Tax Act, 1962	Section 132	Search and Seizure

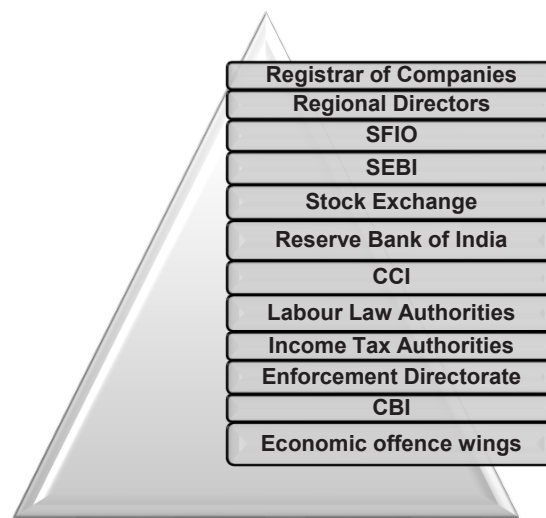
## INTRODUCTION

This takes a lot of efforts in drafting and making a law. In addition to that, the task of enforcing a law is the real challenge for any law making authority. Without enforcement of a law, there will be lesser compliance of the law. A law without regulatory or penal powers is a toothless tiger. Regulatory actions ensure proper compliance of the law.

A check on the performance and compliance of various applicable laws are generally exercised by the scrutiny of any document filed by the company with the Registrar of Companies or any other regulatory authority, who is empowered to call for information and explanation with respect to any matter to which such documents or any information purports to relate. The object of inspection is not only to keep a watch on the performance of companies but also to evaluate the level of efficiency in the conduct of the companies.

## REGULATORY AUTHORITIES

The agencies responsible for the enforcement of laws and regulations applicable to businesses are the following:



## The Companies Act, 2013

Chapter XIV of the Companies Act, 2013 contains Sections 206 to 229, which deals with the provisions relating to inspection, inquiry and investigation into the affairs of the Company.

The Companies Act, 2013 empowers the registrar of Companies to call for information, to order an enquiry, to enter and search the place or places where the books are kept. Further the act also empowers central government to order an investigation into the affairs of the company. The act also mandates constitution of Serious Fraud Investigation Office (SFIO) and assigns certain offenses to be investigated by SFIO, which has power to arrest in respect of certain offences.

In the Companies Act, 2013 or any other laws for that matter, requirement for registration, submission of various event based forms, annual filing and annual return, are basic examples of the regulatory compliances. Failure of such compliance, whether intentional or not, underline the requirement of the regulatory actions. In short, regulatory actions are tool to enforce regulatory compliances.

These regulatory actions may be:

- Call for information;
- Inspection;
- Investigation;
- Inquiry;
- Search and seizure;
- Litigation;
- Arrest;



- Penalty; and
- Punishment.

### Inspection, Inquiry and Investigation

Inspection, inquiry and investigation are three connected but different regulatory actions. These regulatory actions start with some information. We can understand this in a general example form a day to day public knowledge about criminal law.

The Police get some information about happening of something. The police officer, having jurisdiction, visits and inspect the place where the incident had happened. He receives all kind of information which might directly or indirectly, be related to the incident reported. After this, police file a formal first information report. Their after police do its own inquiry before filing its charge sheet in the court. The court order investigation in the matter, wherever required.

### Powers allotted under Companies Act, 2013

AUTHORITIES	SECTIONS	POWERS
Registrar of Companies	206, 207, 208 & 209	<ul style="list-style-type: none"> <li>• Call for Information, Inspect Books and Conduct Inquiries</li> <li>• Conduct of Inspection and enquiry</li> <li>• Report on Inspection Made</li> <li>• Search and Seizure</li> </ul>
Inspector	206, 207, 208 & 209, 216, 218 and 219	<ul style="list-style-type: none"> <li>• Call for Information, Inspect Books and Conduct Inquiries</li> <li>• Conduct of Inspection and enquiry</li> <li>• Report on Inspection Made</li> <li>• Search and Seizure</li> <li>• Procedure, Powers, etc., of Inspectors</li> <li>• To investigate on matters relating to the company, and its membership for determining ownership of the company</li> <li>• Power of Inspector to Conduct Investigation into Affairs of Related Companies</li> </ul>
Central Government	206, 210, 211, 212, 216 and 224	<ul style="list-style-type: none"> <li>• Authorise any statutory authority to carry out the inspection of books of account of a company or class of companies.</li> <li>• Direct any statutory authority appointed by it for the purpose to carry out the inquiry</li> <li>• Investigate into Affairs of Company</li> <li>• Establishment of Serious Fraud Investigation Office</li> <li>• Assign the investigation into the affairs of the company to the Serious Fraud Investigation Office</li> <li>• Appointment of inspector, to investigate on matters relating to the company, and its membership for determining ownership of the company</li> <li>• Actions to be Taken in Pursuance of Inspector's Report</li> </ul>

Regional Director	206	<ul style="list-style-type: none"> <li>Central government delegates power to appoint inspector for inspection of books and papers of a company</li> </ul>
Tribunal	213, 221, 222	<ul style="list-style-type: none"> <li>Freezing of Assets of Company on Inquiry and Investigation</li> <li>Imposition of Restrictions Upon Securities</li> </ul>

### Purpose of conducting Inspection

Section 206 does not specify the circumstances or pre conditions which must be satisfied to invoke these provisions. Some of the objectives of conducting such inspections may be thus:

1. To detect concealment of income by falsification of accounts.
2. To secure knowledge about the mismanagement of the business of a company and transactions entered into with an intent to defraud creditors, shareholders or otherwise for fraudulent or unlawful purposes.
3. To ascertain whether the statutory auditors have discharged their functions and duties in certifying the true and fair view of a company's accounts and their proper maintenance.
4. To enable the Government to ascertain the quantum of profits accrued but not adequately accounted for.
5. To detect misapplication of funds leading a company to a state of perpetual financial crisis.
6. To keep a watch on performance of a company.
7. To detect misuse of fiduciary responsibilities by the company's management for personal aggrandizement.

Inspection is intended to be a routine and not ad hoc or special affair. However, if sufficient evidence suggests that of the company's affairs are being mismanaged and/or managed in fraudulent way, then inspection can lead to orders for investigation into the affairs of the company.

In these paragraphs, we will discuss inspection, inquiry and investigation in context of the corporate law.

### Call for Information or Explanation {Sub-section (1) and (2) of Section 206}

The Registrar by a written notice issued under sub-section (1) of section 206 may require a company to:

- (a) furnish in writing information or explanation; or
- (b) to produce documents,

within a given reasonable specified time.

The Registrar may ask such information after framing his opinion:

- (a) on scrutiny of any document filed by the company; or
- (b) on any information received by him.

The registrar shall frame its opinion and record it while issuing the notice. His opinion shall be a reasoned opinion framed on the basis of the scrutiny of documents and information received by him.

The notice issued by the Registrar and the information or explanation submitted by the company shall be in writing.

### Duty of the company to furnish information

On receipt of the notice issued by the Registrar under sub-section (1), it shall be a duty of the company and of its officers:

- (a) to furnish the information or explanation to the best of their knowledge and power; and
- (b) to produce the documents within the specified or extended time.

#### ***Past employees to furnish information***

Where such information or explanation relates to any past period, the Registrar through a notice in writing may require the officers who were employees during that past period to furnish such information or explanation to the best of their knowledge.

Proviso to sub-section (2) of Section 206 has a relaxed provision for past officers. They are required to furnish information to the best of their knowledge. In case of present officers, they are required to furnish information to the best of their knowledge and power. Present officers need to do due diligence before furnishing any information.

#### **Inspection {Sub-section 3, 5 and 6 of Section 206}**

There are three circumstances, where inspection may be ordered:

- By registrar under sub- section (3) of section 206;
- By Regional Director under power delegated to it by Central Government under sub –section (5) of Section 206; and
- By Central Government by a general or special order.

#### ***Inspection ordered by the Registrar***

According to Section 206(3), Inspection may be ordered by the Registrar, where –

- If no information or explanation is furnished to the Registrar within the time specified under sub-section (1); or
- if the Registrar on an examination of the documents furnished is of the opinion that the information or explanation furnished is inadequate; or
- if the Registrar is satisfied on a scrutiny of the documents furnished that an unsatisfactory state of affairs exists in the company and does not disclose a full and fair statement of the information required.

The Registrar may by another written notice, call on the company to produce for his inspection such further books of accounts, books, papers and explanations as he may require at such place and at such time as specified in the notice.

In this written notice, the Registrar shall record his reason in writing for issuing the notice for inspection.

#### ***Inspection ordered by the Regional Director***

The Central Government may, on satisfaction that circumstance so warrant, direct inspection of books and papers of a company by an inspector appointed for the purpose. This power given under sub – section (5) to the Central Government has been delegated to jurisdictional Regional Directors.

#### ***Inspection ordered by the Central Government***

The Central Government may by general or special order authorize any statutory authority to carry out the inspection of books of account of a company or class of companies. While issuing such general or special order, the Central Government will give consideration to the circumstances.

This sub-section gives wide powers to the central government. Such inspection may be carried out by any statutory authority including SFIO, ICSI, ICAI, SEBI, IRDA, CCI, TRAI, etc. depending upon the circumstances of the case.

### **Inquiry {Sub-section (4) of Section 206}**

The Registrar may initiate inquiry under sub-section (4) of section 206, if the Registrar is satisfied that the business of the company is being carried on –

- for a fraudulent purpose;
- unlawful purpose; or
- not in compliance with the provision of this Act; or
- investors grievances not being addressed.

The Registrar shall satisfy itself before order of such inquiry on the basis of –

- information available with him; or
- information furnished to him; or
- on representation made to him by any person.

The order shall be made by the Registrar to carry out such inquiry as he deemed fit after giving the company a reasonable opportunity of being heard.

The Registrar shall order inquiry after informing the company of the allegation made against it by a written order. In this order the Registrar will call on the company in writing any information or explanation within specified time.

Further, the Central Government may, on satisfaction that circumstance so warrant, direct the Registrar or Inspector for the purpose to carry out the inquiry under this sub – section (4) of section 206.

Where business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud under Section 447.

### ***Meaning of Fraud***

Explanation (i) to Section 447 has defined fraud in relation to affairs of a company or anybody corporate to include, any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. ‘Wrongful gain’ in terms of Explanation (ii), means “the gain by unlawful means of property to which the person gaining is not entitled”.

On the other hand, explanation (iii) to section 447 has defined “wrongful loss” to mean the loss by unlawful means of any property to which the person losing is legally entitled”.

### **Enforcement of Section 206 {Sub-section (7) of Section 206}**

If a company fails to furnish any information or explanation or produce any document required under this section, the company and every officer of the company, who is in default shall be punishable with a fine which may extend to one lakh rupees and in the case of a continuing failure, with an additional fine which may extend to five hundred rupees for every day after the first during which the failure continues.

### **Conduct of Inspection and Inquiry {Section 207}**

Where a Registrar or inspector calls for the books of account or other books and papers, it shall be duty of every director, officer or other employee of the company to produce all these documents to the Registrar or inspector. It shall also be duty of these persons to furnish statements, information or explanation as the Registrar or inspector may require and shall render all assistance to the Registrar or inspector in connection with the inspection.

The Registrar or inspector making an inspection or inquiry may –

- (a) make or cause to be made copies of books of account or other books and papers; or
- (b) place or cause to be placed any mark of identification on such books in token of the inspection having made.

The Registrar or inspection making an inspection or inquiry shall have all powers of a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely–

- (a) the discovery and production of books of account and other documents;
- (b) summoning and enforcing the attendance of persons and examining them on oath; and
- (c) inspection of any books, registers and other documents of the company at any place.

### **Enforcement of Section 207**

If any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

If a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company.

### **Inspection Report (Section 208)**

The Registrar or inspector shall, after the inspection or an inquiry, submit a report in writing to the Central Government along with such documents, if any. The report may include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

### **Search and Seizure {Section 209}**

The Registrar or inspector may, after obtaining an order from the Special Court for the seizure of such books and papers, –

- (a) enter, with such assistance as may be required, and search, the place or places where such books or papers are kept; and
- (b) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

The Special court may order such seizure where, upon information in his possession or otherwise, has reasonable ground to believe that the books and papers of a company, or relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary, are likely to be destroyed, mutilated, altered, falsified or secreted.

The Register or inspector shall return the books and papers within one hundred and eighty days after such seizure to the company from whose custody or power such books or papers were seized. These books and papers may be called for by the Registrar or inspector for a further period of one hundred and eighty days ay an order in writing if they are needed again.

Registrar or inspector may, therefore returning such books and papers, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

The provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures shall apply, mutatis mutandis, to every search and seizure.

## INVESTIGATION – SECTION 210 - 229

Shareholders have been vested with various rights including the right to elect directors under the Companies Act, 2013. However, shareholders are often ill-equipped to exercise effective control over the affairs of companies, and, particularly in companies whose shareholders are widely scattered and the affairs of such companies are managed to all intents and purposes, by its Board of directors to the exclusion of a predominant majority of shareholders. Such a situation leads to abuse of power by persons in control of the affairs of company. It became, therefore, imperative for the Central Government to assume certain powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Sections 210 to 229 of the Companies Act, 2013, contain provisions relating to investigation of the affairs of company.

### KINDS OF INVESTIGATION

The Companies Act, 2013 provides for carrying out the following kinds of investigation:

1. Investigation of the affairs of the company if it is necessary to investigate into the affairs of the company in public interest (Section 210);
2. Investigation of the affairs of related companies (Section 219);
3. Investigation about the ownership of a Company (Section 216)
4. Investigation of foreign companies (Section 228)
5. Investigation by Serious Fraud Investigation Office directed by Central government under (section 212)
6. Investigation on the order of Tribunal. (Section 213)

### Investigation into Affairs of Company {Section 210}

Investigation into the affairs of the company may be ordered by the Central Government on grounds given in sub-section (1) of Section 210. The investigation shall be ordered by Central government, where an order of investigation was made by a court or the tribunal.

Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company,—

- (a) on the receipt of a report of the Registrar or inspector;
- (b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
- (c) in public interest,

it may order an investigation into the affairs of the company.

Where an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the affairs of that company.

For the purpose of investigation, the Central Government may appoint one or more inspectors to investigate the affairs of the company. These inspectors shall report on the affairs of the company in such manner as the central government may direct.

According to Rule 5 of the Companies (Inspection, Investigation and Inquiry) Rules 2014, the Central Government may before appointing an inspector under sub-section (3) of section 210, require the applicant to give a security not exceeding twenty-five thousand rupees for payment of the costs and expenses of investigation as per the criteria given below-

S. No.	Turnover as per previous year balance sheet (Rs.)	Amount of security (Rs.)
1	Turnover upto Rs. 50 crore	Rs. 10000
2	Turnover more than Rs. 50 crore and upto 200 crore	Rs. 15000
3	Turnover more than Rs. 200 crore	Rs. 25000

The security shall be refunded to the applicant if the investigation results in prosecution.

### **Investigation into the Company's Affairs on Application made by Members or other Persons (Section 213)**

The Tribunal may order after giving a reasonable opportunity of being heard to the parties concerned that affairs of a company ought to be investigated. Where such an order is passed, the Central Government shall appoint one or more competent persons as inspectors to investigate into the affairs of the company and to report thereupon.

The tribunal may make this order on an application made by –

- (a) not less one hundred members or members holding not less than one – tenth of the total voting power, in case of a company having a share capital; or
- (b) not less than one – fifth of the persons on the company's register of members, in case company having no share capital

and supported by evidence showing good reason for seeking and order for conducting an investigation into affairs of the company.

The Tribunal may also make such order on an application made to it by any other person or otherwise, if it is satisfied that the circumstance suggest that –

- (a) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose;
- (b) person concerned in the formation of the company or the management of its affairs have been guilty of fraud, misfeasance or other misconduct towards the company or towards its members; or
- (c) the members of the company have not been given all reasonable information including information relating to the calculation of commission payable to a managing or other director or the manager of the company.

If after investigation it is proved that –

- (a) the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or
- (b) any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud,

then, every officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs shall be punishable for fraud under Section 447.

### **Security for Payment of Cost and Expenses of Investigation (Section 214)**

Where an investigation is ordered by the Central Government in pursuance of clause (b) of sub-section (1)



of section 210, or in pursuance of an order made by the Tribunal under section 213, the Central Government may before appointing an inspector under subsection (3) of section 210 or clause (b) of section 213, require the applicant to give such security not exceeding twenty-five thousand rupees as may be prescribed, as it may think fit, for payment of the costs and expenses of the investigation and such security shall be refunded to the applicant if the investigation results in prosecution.

### **Investigation of Ownership of Company (Section 216)**

Investigation of the ownership of the company may be ordered by the Central Government on grounds given in sub-section (1) of Section 216. The investigation shall be ordered by Central government, where an order of investigation was made by a court or the tribunal under sub-section (2) of section 216.

Where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons –

- (a) who are or have been financially interested in the success or failure, whether real or apparent, of the company; or
- (b) who are or have been able to control or to materially influence the policy of the company; or
- (c) who have or had beneficial interest in shares of a company or who are or have been beneficial owners or significant beneficial owner of a company.

The Central Government shall appoint one or more inspectors under that sub-section, if the Tribunal, in the course of any proceeding before it, directs by an order that the affairs of the company ought to be investigated as regards the membership of the company and other matters relating financial control or material influence to the company.

The Central Government may define the scope of the investigation and may limit the investigation to particular shares or debentures.

The powers of inspector shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed in practice and which is relevant for the purposes of his investigation.

### **Power of Inspector to Conduct Investigation into Affairs of Related Companies (Section 219)**

An inspector shall subject to prior approval of the Central Government, investigate the affairs of –

- (a) Any other body corporate which is or has at any relevant time been the company's subsidiary company or holding company or a subsidiary of its holding company;
- (b) Any other body corporate which is or has any relevant time been managed by any person as managing director or as manager of the company;
- (c) Any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or
- (d) Any person who is or has at any relevant time been the company's managing director or manager or employee.

Such investigation should be in continuation of ongoing investigation under section 210s 212 and 213. Information, Inspection, Inquiries and Investigation of Foreign Company (Section 228)

The provisions of this Chapter XIV shall apply mutatis mutandis to inspection, inquiry or investigation in relation to foreign companies.



## **Procedure and Powers of Inspectors (Section 217)**

### ***Duty of Employees {sub-section (1) of Section 217}***

It shall be duty of all past and present officers, other employees and agents of a company or body corporate or a person under investigation –

- (a) To preserve and to produce to an inspector or any other authorized person all books and papers of the company or relating to the company or other body corporate or the person which are in their custody or power, and
- (b) Otherwise to give to the inspector all assistance in connection with the investigation which they are reasonable able to give.

### ***Duty of other Bodies Corporate {sub-section (2) of Section 217}***

The inspector may require any other body corporate to furnish such information to or produce such books and papers before him or any authorized person to furnish of information or produce books and papers relevant or necessary for the purpose of his investigation.

### ***Period for custody of books {sub-section (3) of Section 217}***

The inspector shall not keep books and papers for more than one hundred eighty days and returns the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced.

This initial period may be extended to one hundred and eighty days by an order in writing.

### ***Examination on oath {sub-section (4) of Section 217}***

An inspector may examine on oath –

- (a) Any past or present officer or employee,
- (b) With the prior approval of the Central Government, any other person,

In relation to the affairs of the company or other body corporate or person and for that purpose may require any of those persons to appear before him personally.

In case of investigation under Section 212, the prior approval of the Director of Serious Fraud Investigation Office shall be sufficient.

### ***Notes of examination {sub-section (7) of Section 217}***

The notes of any examination shall be taken down in writing and shall be read over to or by and signed by the person examined. Such notes may thereafter be used in evidence against said person.

### ***Power of Inspectors {sub-section (5) of Section 217}***

The inspector making an investigation shall have all the powers of civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of following matters, namely –

- (a) The discovery and production of books of account and other documents, at such place and time as may be specified by such person;
- (b) Summoning and enforcing the attendance of persons and examining them on oath; and
- (c) Inspection of any books, registers and other documents of the company at any place.

### ***Punishment for disobedys {sub-section (6) of Section 217}***

If any director or officer of the company disobeds the direction issued by the Registrar or the inspector, the

director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty – five thousand rupees but which may extend to one lakh rupees.

If a director or an officer has been convicted of an offence, the director or the officer shall on and from the date of conviction shall be deemed to have vacated his office and shall also be disqualified from holding an office in any company.

***Failure of a person {sub-section (8) of Section 217}***

If any person fails without reasonable or refuse –

- (a) To produce to an inspector or authorized person any book or paper which is his duty;
- (b) To furnish any information which is his duty to furnish;
- (c) To appear before the inspector personally when required to do so or to answer any question which is put to him by the inspector;
- (d) To sign the notes of any examination,

He shall be punishable with imprisonment for a term which may extend to six months and with fine which shall not be less than twenty five thousand rupees but may extend to one lakh rupees and also with a further fine which may extend to two thousand rupees for every day after the first during which the failure or refusal continues.

***Assistance to inspector by state authority {sub-section (9) of Section 217}***

The officers of the Central Government, State Government, police or statutory authority shall provide assistance to the inspector for the purpose of inspection, inquiry or investigation, which the inspector may with the prior approval of the Central Government require.

***Assistance by foreign government {sub-section (10) of Section 217}{sub-section (4) of Section 217}***

The Central Government may enter into an agreement with the Government of a foreign State for reciprocal arrangement to assist in any inspection, inquiry or investigation under this Act or under the corresponding law in force that State with which reciprocal arrangements have been made subject to such notification, exceptions, conditions and qualifications as may be deemed expedient for implementing the agreement with that State.

***Letter of Request from India {sub-section (11) of Section 217}***

On an application made by the inspector to the competent court in India, such court may issue a letter of request to a court or authority in such country of place, competent to deal with such request. Such application shall state that evidence is, or may be, available in that country or place outside India.

The letter of request shall ask the court in that country or place outside India –

- to examine orally, or otherwise, any person, supposed to be acquainted with the facts and circumstances of the case;
- to record his statement made in the course of such examination;
- to require such person or any other person to produce any document or thing, which may be in his possession pertaining to the case, and
- to forward all the evidence so taken or collected or the authenticated copies thereof or the things so collected to the court in India which had issued such letter of request

The letter of request shall be transmitted in such manner as the Central Government may specify in this behalf. According to Rule 6 of the Companies (inspection, Investigation and Inquiry) Rules 2014, the letter of request shall be transmitted in such manner as specified by the Ministry of Corporate Affairs.

Every statement recorded or document or thing received under this sub-section shall be deemed to be the evidence collected during the course of investigation.

***Letter of Request to India {sub-section (12) of Section 217}***

Upon receipt of a letter of request from a court or an authority in a country or place outside India, competent to issue such letter in that country or place for the examination of any person or production of any document or thing in relation to affairs of a company under investigation in that country or place, the Central Government may, if it thinks fit, forward such letter of request to the court concerned in India.

The court concern in India shall –

- summon the person before it and
- record his statement or
- cause any document or thing to be produced, or
- send the letter to any inspector for investigation, who shall thereupon investigate into the affairs of company in the same manner as the affairs of a company are investigated under this Act and the inspector shall submit the report to such court within thirty days or such extended time as the court may allow for further action.

The evidence taken or collected under this sub-section or authenticated copies thereof or the things so collected shall be forwarded by the court, to the Central Government for transmission, in such manner as the Central Government may deem fit, to the court or the authority in country or place outside India which had issued the letter of request.

## PROTECTION OF EMPLOYEES DURING INVESTIGATION (SECTION 218)

Section 218 provides protection to employees during investigation. During the course of any investigation and during pendency of any proceeding against any person concerned in the conduct and management of the affairs of a company, Such company, other body corporate or person shall not discharge or suspend or punish any employee without approval of the Tribunal. This protection is available to employees during the investigation of the affairs or other matters of or relating to a company, other body corporate or person or of the membership, ownership of shares or debentures.

Following action are not permitted without approval of the Tribunal -

- (a) To discharge or suspend any employee;
- (b) To punish any employee, whether by dismissal, removal, reduction in rank or otherwise; or
- (c) To change the terms of employment to his disadvantage.

If the applicant does not receive within thirty days of making of application the approval of the Tribunal, only then applicant concerned may proceed to take against the employee the action proposed.

If the applicant is dissatisfied with the objection raised by the tribunal it may within a period of thirty days of the receipt of the notice of the objection, prefer an appeal to the Appellate Tribunal. The decision of the Appellate Tribunal on such appeal shall be final and binding on the Parties concerned.

## SEIZURE OF DOCUMENTS BY INSPECTOR (SECTION 220)

In the course of an investigation, the inspector has reasonable grounds to believe that the books and papers of or relating to any company or other body corporate or managing director or manager of the company are likely to be destroyed, mutilated, altered, falsified or secreted. In such case, the inspector may –

- (a) Enter with such assistance as may be required, the place or places such books and papers are kept ; and
- (b) Seize books and papers as he considers necessary after allowing the company to take copies of or extract from such books and papers at list cost for the purpose of his investigation.

The inspector shall keep in his custody the books and papers seized up to the conclusion of the investigation as he considers necessary and thereafter shall return the same to the person from whose custody or power they were seized.

The inspector may before returning such books and papers, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in the manner as he considers necessary.

The provisions of the Code of Criminal Procedure, 1973 relating to searches or seizure shall apply mutatis mutandis to every search or seizure under this Section.

### **FREEZING OF ASSETS OF COMPANY ON INQUIRY AND INVESTIGATION (SECTION 221):**

The Tribunal,

- on a reference made to it by the Central Government;
- in connection with any inquiry or investigation into affairs of a company;
- on any complaint made by members under Section 244;
- a creditor having one lakh amount outstanding against the company; or
- any other person having a reasonable ground to believe;

it may by order direct that such transfer, removal or disposal shall not take place during a specified period not exceeding three years or may take place subject to such conditions and restrictions as it may deem fit.

The tribunal may make such order, where it appears to the tribunal that the removal, transfer or disposal of funds, assets, properties of the company is likely to take place prejudicial to the interests of the company or its shareholders or creditors or in public interest.

In case of contravention of this order, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

### **IMPOSITION OF RESTRICTIONS UPON SECURITIES (SECTION 222)**

The Tribunal may, by order, direct that the securities shall be subject to such restrictions as it may deem fit for such period not exceeding three years as may be specified in the order.

The Tribunal may pass such order where it appears to the Tribunal, in connection with any investigation or on a complaint made by any person in this behalf, that there is good reason to find out the relevant facts about any securities issued or to be issued by a company and the Tribunal is of the opinion that such facts cannot be found out unless certain restrictions, as it may deem fit, are imposed.

As per Section 222(2) - Where securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

### INSPECTOR'S REPORT (SECTION 223)

The report under Section 223 is different from the report made by SFIO under Section 212. In inspector shall submit all interim reports, if any, and final report to the Central Government. Every report shall be in writing or printed as per direction of the Central Government.

A copy of the report may be obtained by members, creditors or any other person whose interest is likely to be affected by making an application to the Central Government. The report of any inspector shall be authenticated either –

- (a) by the seal, if any of the company investigated; or
- (b) by a certificate of a public officer having the custody of the report.

After authentication such report shall be admissible in any legal proceeding as evidence.

### FOLLOW UP ACTIONS ON REPORT (SECTION 224)

#### Criminal Prosecution

The Central Government may prosecute any person appears to be guilty based on the report made by inspector under Section 223. It shall be duty of all officers and other employees of the company or body corporate to give the Central Government the necessary assistance in connection with the prosecution.

#### Winding up

On the basis of the report, the Central Government may cause to be present to the Tribunal –

- a. a petition for winding up of the company; or body corporate on the ground that it is just and equitable that it should be wound up; or
- b. under Section 241; or
- c. both.

#### Winding up proceeding for Recovery

The Central government may itself bring proceeding for winding up in the name of such company or body corporate –

- (a) for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation or the management of the affairs of such company or body corporate; or
- (b) for the recovery of any property of the company or body corporate which has been misapplied or wrongfully retained.

The Central Government may itself bring proceeding for winding up in the name of such company or body corporate.

The Central Government shall be indemnified by such company or body corporate against any cost or expenses incurred by it in or in connection with any proceedings of winding up.

#### Disgorgement

In case of fraud, undue advantage or benefit, the Central government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such assets, property, or cash. The Central Government may also file an application before the Tribunal for holding directors, key managerial personnel, officers or other person personally liable without any limitation of liability.

Disgorgement is the act of giving up something such as the profits obtained by illegal or unethical acts on demand or by legal compulsion. Court can order wrongdoers to pay back to prevent unjust enrichment. Disgorgement is a civil remedy and not a punishment or punitive civil action. The purpose of such a remedy, as in securities cases, is to deprive the wrongdoer of his or her ill-gotten gains and to deter violations of the law.

#### **EXPENSES OF INVESTIGATION (SECTION 225)**

The expenses of, and incidental to an investigation by an inspector other than expenses of inspection under Section 214 shall be defrayed in the first instance by the Central government. Such expenses incurred by Central Government but shall be reimbursed by the following person to the extent mentioned below, namely –

- (a) any person convicted on a prosecution instituted or who is ordered to pay damages or restore any property in proceedings to the extent that he may in the same proceedings be ordered to pay the said expenses as may be specified by the court convicting such person or ordering him to pay such damages or restore such property;
- (b) any company or body corporate in whose name proceedings are brought to the extent of the amount or value of any sums or property recovered by it as a result of such proceedings;
- (c) unless a prosecution is instituted under Section 224 –
  - (i) any company, body corporate, managing director or manager dealt with by the report of the inspector; and
  - (ii) the applicants for the investigation, where the inspector was appointed under section 213, to such extent as the Central Government may direct.

Any amount for which a company or body corporate is liable under clause (b) shall be a first charge in the sums or property mentioned.

#### **VOLUNTARY WINDING UP OF COMPANY NOT TO STOP INVESTIGATION (SECTION 226)**

An investigation may be initiated and no investigation shall be stopped or suspended by reason only of, the fact that –

- (a) an application has been made under section 241;
- (b) the company has passed a special resolution for voluntary winding up; or
- (c) any other proceeding for the winding up of the company is pending before the Tribunal.

Where a winding up order is passed by the Tribunal, the inspector shall inform the Tribunal about the pendency of the investigation proceeding before him and the Tribunal shall pass such order as it may deem fit.

Nothing in the winding up order shall absolve any director or other employee of the company from participating in the proceedings before the inspector or any liability as a result of the finding by the inspector.

#### **LEGAL ADVISERS AND BANKERS NOT TO DISCLOSE (SECTION 227)**

The Tribunal or Central Government or Registrar or inspector shall not require any disclosure –

- (a) by a legal advisors of any privileged communication except the name and address of his client; or
- (b) by the bankers of any company, body corporate, or other person, of any information as to the affairs of any of their customers, other than such company, body corporate, or person. [As per Section 227(b)]

#### **PENALTY FOR FALSE STATEMENT ETC (SECTION 229)**

Where a person who is required to provide an explanation or make a statement during the course of inspection,

inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation, –

- (a) destroys, mutilates or falsifies, or conceals or tampers or unauthorizedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorized removal of, documents relating to the property, assets or affairs of the company or the body corporate;
- (b) makes, or is a party to the making of, a false entry in any document concerning the company or body corporate; or
- (c) provides an explanation which is false or which he knows to be false, he shall be punishable for fraud in the manner as provided in section 447.

### **PREPARATION BY A COMPANY SECRETARY TO FACE INVESTIGATION**

Before an inspector commences investigation into the affairs of a company, it is advisable for the Secretary to prepare a report touching upon various aspects of the activities of his company particularly those transactions in respect of which fraud or misfeasance or mismanagement is alleged. This exercise will enable the secretary to handle the investigation into the affairs of his company with courage and confidence.

The aspects which should be considered by the company secretary include:

1. Basic information about the company – Name of the company; date of incorporation; location of the registered office, branches, factories and other offices; status of the company – public or private; objects of the company – capital structure; voting rights attached to the shares; shareholding pattern of the company.
2. Business activities – Nature of existing business, licensed and installed capacities, expansion programme and sources of finance, whether the company belongs to a particular group; if so the names of other companies falling within the same group.
3. Debentures, bank finance and deposits.
4. Foreign collaboration agreements.
5. Management—Brief history of past management set up; existing management set up; composition of Board of Directors; whether the terms and conditions of the appointment of managerial personnel are being adhered to; details regarding appointment of directors and their relatives to an office or place of profit.
6. Whether all the statutory registers including minute's books are being maintained up-to-date?
7. Whether the internal checks and internal control system is being properly followed?
8. Working results and financial position – General assessment of working of the company, evaluation of the level of performance and efficiency of the management, a review of the profits of the company, performance data, financial position of the company in the context of its working results for the last three years.
9. Compliance by the company and its officers with the provisions of the Companies Act, 1956/2013.
10. Compliance with the provisions of other Acts applicable to the company.
11. Whether the loans taken and loans advanced to Directors, the firms in which they are partners or companies in which they are Directors are in accordance with the provisions of the Act.
12. The investments made by the company.
13. Sole selling agency agreement.



14. Instance of mismanagement and other irregularities.
15. Acquisition/disposal of substantial assets.
16. A scrutiny of abnormal/heavy expenditure items.
17. Complaints, if any, against the company and its management and steps taken to redress them.
18. Brief particulars of the litigations against the company and the reasons thereof.
19. Management's relations with the employees and labour.
20. Shareholders—Instance of oppression of minority shareholders, allegations of non-receipt of dividend, notices of meetings, accounts, share certificates, etc.; illegal forfeiture of shares, etc. and steps taken to redress Investors, complaints.
21. Auditors—Name and address of Statutory auditors, Secretarial Auditor and Cost Auditor, compliance as per the provisions of Companies Act, 2013.

### WHO CANNOT BE INSPECTOR (SECTION 215)

No firm, body corporate or other association shall be appointed as an inspector.

### Brief History of Serious Fraud Investigation Office

The Serious Fraud Investigation Office was set-up by the Central Government in terms of the Government of India Resolution No. 45011/16/2003-Adm-I, dated the 2nd July, 2003.

The SFIO was established as a multi-disciplinary organization under Ministry of Corporate Affairs, consisting of experts in the field of accountancy, forensic auditing, law, information technology, investigation, company law, capital market and taxation for detecting and prosecuting or recommending for prosecution white-collar crimes/frauds.

The SFIO normally took up for investigation only such cases, which are characterized by:

- complexity and having inter-departmental and multi-disciplinary ramifications;
- substantial involvement of public interest to be judged by size, either in terms of monetary misappropriation or in terms of persons affected, and
- the possibility of investigation leading to or contributing towards a clear improvement in systems, laws or procedures. The SFIO shall investigate serious cases of fraud received from Department of company Affairs.

### ESTABLISHMENT OF SERIOUS FRAUD INVESTIGATION OFFICE (SECTION 211)

As per the Companies Act, 2013, Serious Fraud Investigation Office (SFIO) has been established through the Government of India vide Notification NO. S.O.2005(E) dated 21.07.2015. It is a multi-disciplinary organisation under the Ministry of Corporate Affairs, consisting of experts in the field of accountancy, forensic auditing, banking, law, information technology, investigation, company law, capital market and taxation etc. for detecting and prosecuting or recommending for prosecution white collar crimes/frauds.

The office shall be headed by a Director and consist of experts of following fields:

- (a) Banking,
- (b) Corporate Affairs,
- (c) Taxation,

- (d) Forensic auditing,
- (e) Capital Market,
- (f) Information Technology,
- (g) Law, or
- (h) Other fields.

According to Rule 3, the Central Government may appoint persons having expertise in the fields of investigations, cyber forensics, financial accounting, management accounting, cost accounting and any other fields as may be necessary for the efficient discharge of Serious Fraud Investigation Office (SFIO) functions under the Act.

The Director shall be an officer not below to the rank of a Joint Secretary having knowledge and experience in dealing with matters relating to corporate affairs.

The Central Government may appoint such experts and other officers and employees in the Serious Fraud Investigation Office as it considers necessary for the efficient discharge of its functions under this Act.

The terms and conditions of service of Director, experts, and other officers and employees of the Serious Fraud Investigation Office shall be such as may be prescribed.

According to Rule 4 of the Companies (Inspection, Investigation and Inquiry) Rules, 2014, the terms and conditions of service of Director, experts and other officers and employees of the Serious Fraud Investigation Office under sub-section (5) of section 211 shall be as under-

- (a) the terms and conditions of appointment of Director shall be governed by the deputation rules under the Central Staffing Scheme of Government of India;
- (b) the terms and conditions of service of experts from the Central Government or the State Government or Union territory Government, Public Sector Undertaking, Autonomous Bodies and such other organizations shall be as per the recruitment rules which may be duly notified by the Central Government under article 309 of the Constitution of India;
- (c) the terms and conditions of service of other officers and employees from the Central Government or the State Government or Union territory Government, Public Sector Undertaking, Autonomous Bodies and such other organizations shall be as per the recruitment rules which may be duly notified by the Central Government under article 309 of the Constitution of India;
- (d) the Central Government may appoint experts or consultants or other professionals or professional firms on contractual basis as per the scheme of engagement of experts or consultants which may be duly approved by the Central Government.

### **INVESTIGATE INTO AFFAIRS OF A COMPANY (SECTION 212)**

The provision of investigation under section 212 is in addition of the provision of investigation under Section 210.

The Central Government may by order assign investigation into the affairs of a company –

- (a) On receipt of a report of the Registrar or inspector under Section 208;
- (b) On intimation of a Special Resolution passed by a company that its affairs are required to be investigated;
- (c) In the public interest, or
- (d) On request from any department of Central Government or State Government.

According to sub-section (2), Once, a case has been assigned to the Serious Fraud Investigation Office, the

case shall not be investigated by any other department of Central Government or State Government and all existing investigation shall also be transferred to the Serious Fraud Investigation Office.

Where the investigation into the affairs of a company has been assigned by the Central Government to Serious Fraud Investigation Office, it shall conduct the investigation in the manner and follow the procedure provided in this Chapter. The SFIO shall submit its report to the Central Government within such period as may be specified in the order.

According to sub-section (4), the Investigation Officer (IO) of the Serious Fraud Investigation Office has power of inspector under Section 217.

The company and its officers and employees, who are or have been in employment of the company shall under sub-section (5), be responsible to provide all information, explanation, documents and assistance to the Investigating Officer as he may require for conduct of the investigation.

Section 212(6) states that notwithstanding anything contained in the Code of Criminal Procedure, 1973, offence covered under Section 447 of the Companies Act, 2013 shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless –

- (i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and
- (ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

A person, who, is under the age of sixteen years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs.

The Special court shall not take cognizance of any offence except only upon a complaint in writing made by –

- (a) The Director, Serious Fraud Investigation Office; or
- (b) Any officer of the Central Government authorized by a general or special order in writing in this behalf.

The limitation on granting of bail specified in sub-section (6) is in addition to the limitations under the Code of Criminal Procedure, 1973 or any other law for the time being in force on granting of bail.

In sub-section (6), for the words, brackets and figures “the offences covered under sub-sections (5) and (6) of section 7, section 34, section 36, sub-section (1) of section 38, sub-section (5) of section 46, sub-section (7) of section 56, sub-section (10) of section 66, sub-section (5) of section 140, sub-section (4) of section 206, section 213, section 229, sub-section (1) of section 251, sub-section (3) of section 339 and section 448 which attract the punishment for fraud provided in section 447”, the words and figures “offence covered under section 447” shall be substituted.

### **Process of Investigation by Serious Fraud Investigation Office (SFIO)**

As per Section 212(8), If any officer not below the rank of Assistant Director of Serious Fraud Investigation Office authorised in this behalf by the Central Government by general or special order, has on the basis of material in his possession reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of any offence punishable under sections referred to in section 212(6), he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest.

As per Section 212(9), the officer authorised under section 212 (8) shall, immediately after arrest of such person under such sub-section, forward a copy of the order, along with the material in his possession, referred to in

that sub-section, to the Serious Fraud Investigation Office in a sealed envelope, in such manner as may be prescribed and the Serious Fraud Investigation Office shall keep such order and material for such period as may be prescribed.

Every person arrested shall within twenty-four hours, be taken to a Special Court or Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction. The period of twenty-four hours shall exclude the time necessary for the journey from the place of arrest to the Special Court or Magistrate's court.

On completion of investigation, the Serious Fraud Investigation office shall submit the investigation report to the Central Government. Where Central Government direct to submit an interim report, then such interim report shall also be submitted to the Central Government.

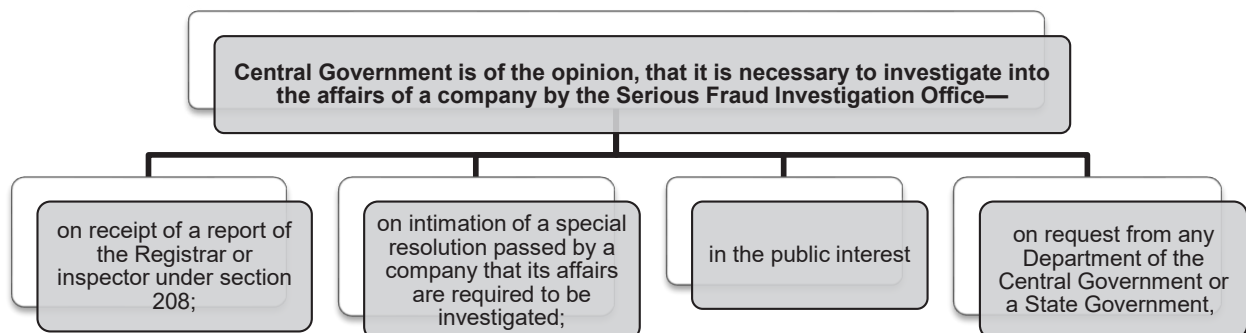
A copy of the investigation report may be obtained by any person concerned by making an application in this regard to the court.

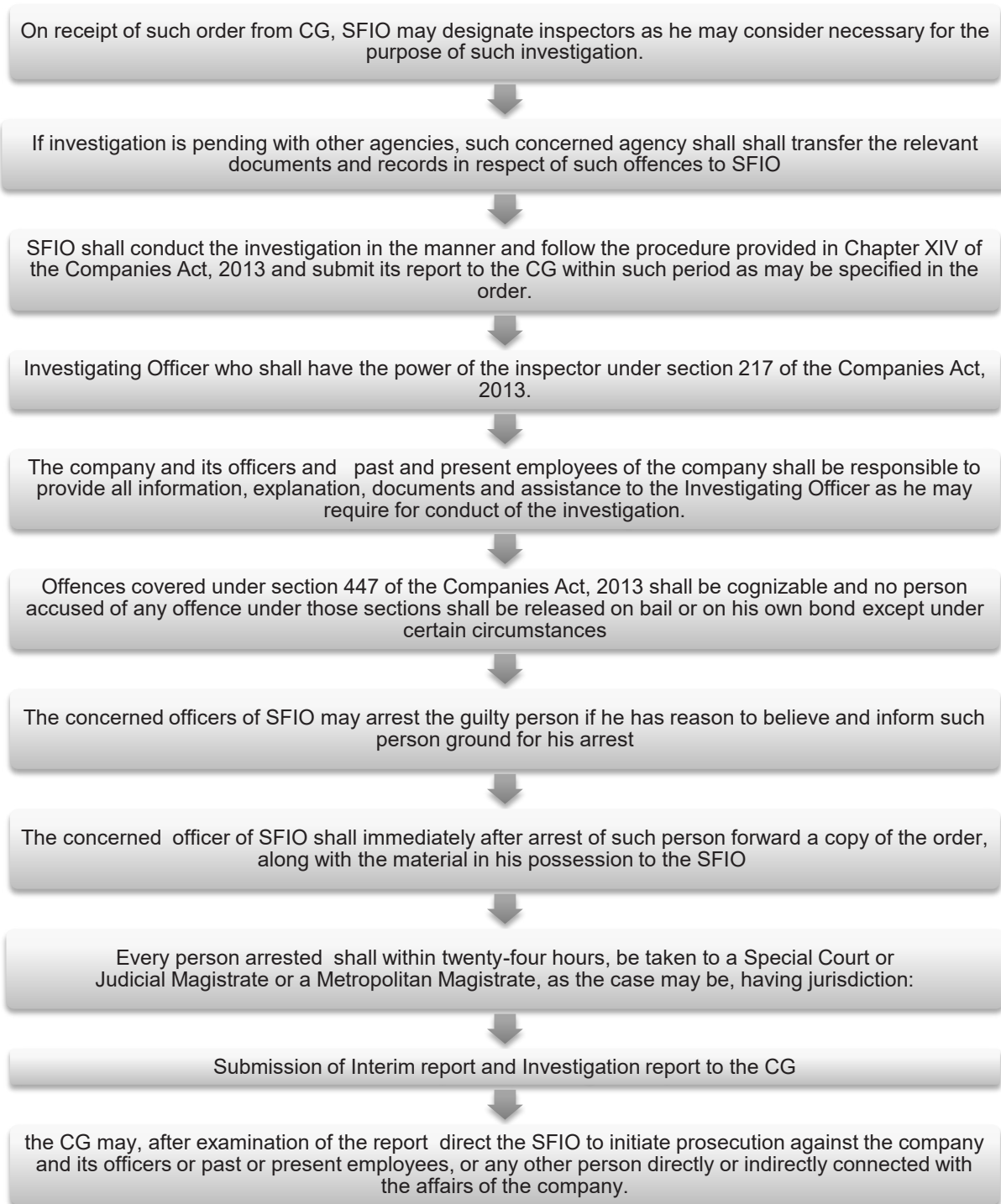
On receipt of the investigation report, the central government may after examination of the report (and after taking such legal advice, as it may think fit) direct the Serious Fraud Investigation office to initiate prosecution against the company and its past or present officers or employees or any other person directly or indirectly connected with the affairs of the company.

Where the report states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property or cash and also for holding such director, key managerial personnel, other officer or any other person liable personally without any limitation of liability.

The investigation report filed with the Special Court for framing of charge shall be deemed to be a report filed by a police officer under Section 173 of the Code of Criminal Procedure 1973.

All other investigating agencies, State Government, police authority or income tax authority shall share relevant or useful information or documents in respect of such offence with SFIO. Similarly, The Serious Fraud Investigation Office shall share any information or documents available with it, with any investigating agency, State Government, police authority or income tax authorities, which may be relevant or useful for such investigating agency, State Government, police authority or income-tax authorities in respect of any offence or matter being investigated or examined by it under any other law.





In the case of *Serious Fraud Investigation Office and Ors. (Appellants) v. Rahul Modi and Ors. (Respondents)* (Criminal Appeal Nos. 538-539 of 2019 (Arising out of Special Leave Petition (Criminal) Nos. 94-95 of 2019) and Transfer Petition (Crl.) No. 35 of 2019) (Supreme Court of India)

**Facts of the case:** In exercise of powers, the Central Government directed investigation into the affairs of one Group of Companies and LLPs by Officers of Serious Fraud Investigation (SFIO) as nominated by Director, SFIO.

The SFIO shall investigate into following areas in addition to any other issues that it may come across during the investigation.

- (i) To ascertain and unearth rotation of funds or identification of quantum of diversion of funds of siphoning including beneficiaries thereof;
- (ii) To identify instances of mismanagement, negligence or fraud;
- (iii) To ascertain the role of auditors, KMPs or independent directors or any other person in the alleged fraud;
- (iv) To examine role of any other entity used as conduit in the alleged fraud;
- (v) To identify non-compliance of the statutory provisions of the Act and its impact on Corporate Governance.

That the Inspector(s) so appointed shall exercise all powers available to them Under Section 217 of the Companies Act, 2013 and Chapter IX of LLP Act, 2008. The inspector(s) shall complete their investigation and submit their report to the Central Government within a period of 03 (Three) months from the date of issue of this order.

Accused were accordingly arrested and Judicial Magistrate granted remand and directed they be produced before Special Court. Thereafter, the Accused were produced before the Special Court with a fresh application for remand. The prayer for extension of custody was opposed by the Accused inter alia on the grounds that the period of completion of investigation as stipulated in the order had expired and as such all further proceedings were illegal. The Special Court found that the application seeking further remand was justified and extended the police custody of the Accused. Writ Petition were filed by accused persons in the High Court. It was submitted that with the expiry of period within which the investigation had to be completed in terms of order, all further proceedings including the arrest of the Respondents were illegal and without any authority of law. The High Court directed release of accused persons on interim bail, during the pendency of the writ petitions, on their furnishing personal bond. Appellants challenged the correctness of the common interim order passed by Delhi High Court in the Supreme Court.

**Held:** The Supreme court held that, It could not be said that the prescription of period within which a report was to be submitted by SFIO under Sub-section (3) of Section 212 was for completion of period of investigation and on the expiry of that period the mandate in favour of SFIO must come to an end. If it was to come to an end, the legislation would have contemplated certain results including re-transfer of investigation back to the original Investigating Agencies which were directed to transfer the entire record under Sub-section (2) of Section 212. In the absence of any clear stipulation, an interpretation that with the expiry of the period, the mandate in favour of SFIO must come to an end, would cause great violence to the scheme of legislation.

If such interpretation was accepted, with the transfer of investigation in terms of Sub-section (2) of Section 212 the original Investigating Agencies would be denuded of power to investigate and with the expiry of mandate SFIO would also be powerless which would lead to an incongruous situation that serious frauds would remain beyond investigation. That could never have been the idea. The only construction which was, possible therefore, was that the prescription of period within which a report had to be submitted to the Central Government under Sub-section (3) of Section 212 was purely directory. Even after the expiry of such stipulated period, the mandate in favour of the SFIO and the assignment of investigation under Sub-section (1) would not come to an end. The only logical end as contemplated was after completion of investigation when a final report or investigation report was submitted in terms of Sub-section (12) of Section 212. It could not therefore be said that in the instant case the mandate came to an end and the arrest effected under the orders passed by Director, SFIO was in any way illegal or unauthorised by law. In any case, extension was granted in the present case by the Central Government. But that was completely besides the point since the original arrest itself was not in any way illegal. The High Court completely erred in proceeding on that premise and in passing the order under appeal.

If the submission of the Respondents (writ Petitioners) that the compliance of Sub-section (3) of Section 212 of the Act in relation to the submission of the report be held mandatory was accepted, the very purpose of enacting Section 212 of the Act would get defeated and would become nugatory. It was held that Sub-section (3) of Section 212 of the Act was directory in nature, it serves the legislative intent for which Chapter XXIX was enacted.

### Judicial Pronouncements

Judicial pronouncements of the relevant provision of the erstwhile Companies Act, 1956. (Corresponding to Section 210 of Companies Act 2013)

In the case of *Mrs U.A. Sumathy and Anr. v. Dig Vijay Chit Fund (P) Ltd.*, [1983 53 Comp Cas 493 (Ker)] which held that Section 235 does not lay down what precise circumstances are to be proved so as to trigger an investigation but in the least the materials on record to be examined must be such as to satisfy the court that a deeper probe into the company affairs are desirable in the interest of the company.

In *Modi Industries Ltd. v. Union of India* ([1982] 52 Comp. Cas. 589), the Delhi High Court has observed that in order to order an investigation there may be some circumstances which would lead to the inference that there has been some fraud, misfeasance, breach of trust or misconduct which requires investigation. It is not necessary that the persons concerned should be actually guilty but at least there should seem to be some circumstances which could lead to the inference.

In the matter of *Rohtas Industries v. S.D. Agarwal and Ors.*, ((1969) 139 Comp Cas 781 (SC), CO.A.(SB) 39/2013 Page 13 of 20) wherein the Hon'ble Supreme Court set aside a impugned order of the High Court and held that in cases of allegations of fraud on the part of the directorsof a company, an investigation must be carried out if there is prima facie evidence of any intent to defraud, fraudulent or unlawful activities, or instances of misconduct.

However, in the case of *Andhra Pradesh State Civil Supply Corpn. Ltd. v. Delta Oils & Fats Ltd.* ([1999] 96 Comp. Cas. 303 1 (CLB)) to show "a mere statement of facts based on the auditor's report without any corroborative evidence will not assist the Company Law Board in framing the requisite opinion for directing investigation into the affairs of the company under Section 235 of the Companies Act, 1956.

In another matter of *Delhi Flour Milk Co. Ltd.*, ([1975] 45 Comp. Cas. 33) in which Delhi High Court held that unless there is material to show that fall in profit was due to mismanagement and that there was something which was not apparently visible to the naked eye, an order of investigation cannot be made.



The CLB also held in *Hotel Sweta (P.) Ltd.* (5 case), a petition under Section 235 that ‘an order of investigation is not an end by itself, but only a means to find out the full facts of the acts complained. It is nothing, but exploratory measure to be proved or disproved with reference to facts later on ascertained’

In the Gujarat High Court judgment *Alembic Glass Industries Ltd.’s case* (supra) the scope and jurisdiction of Sections 235 and 237(b) have been defined as under :

“The language of Section 237(a) is clear and unambiguous and admits of no construction by which any letter or limit can be put on the jurisdiction of this Court to entertain a petition for giving a direction to the Central Government to appoint an inspector to investigate the affairs of the company. Once the Court makes an order, it is obligatory upon the Central Government to appoint an inspector. There are three distinct methods by which a party desirous of getting the affairs of a company investigated may get an inspector appointed by the Central Government. If the requisite number of members are available, application can be made under Section 235. Any one who is unable to collect the requisite number of members may bring to the notice of the Central Government various malpractices committed in the administration of the affairs of a company and the Central Government may act suo motu under Section 237(b). In the aforementioned two cases the question of appointment of an inspector is within the discretion of the Central Government. But there is a third mode legislatively recognized and mandatory in character by which an inspector can be got appointed by the Central Government and that is where the special resolution to that effect is adopted by the company or where the court makes an order to that effect”.

In the case of *Binod Kumar Kasera v. Nandlall & Sons Tea Industries (P.) Ltd.* ([2010] 175 (CLB - New Delhi)), which held that object of investigation under Section 235(2) is to discover something which is not apparently visible to the naked eye and where a petition discloses merely facts which are apparent from the balance sheet of the company, an investigation will not be ordered

In *J.P. Srivastava & Sons (P.) Ltd. v. Gwalior Sugar Co. Ltd.* ([2005] 1 SCC 172), to contend that the legislative intent behind restricting the filing of petitions under Sections 235 and 397 is to prevent frivolous litigation. They argue that the requisite shareholding for filing petitions shall not be permitted to be used as a protective shield by wrongdoers who mismanage and play frauds on companies. According to the appellants, what is required is that there must be enough material on record so as to raise a doubt regarding instances of foul play in the management of the affairs of the company and that, as also observed by the CLB, this is present within these set of facts.

Calcutta High Court in *Mayank Kocher v. Transport & Handling Equipments MFG. Co. P. Ltd.*, ((2008) 143 Comp Cas 601 (CLB)). While discussing Section 235 of the Companies Act, 1956 (Corresponding Section to Section 210 of the Companies Act, 2013) order records that: “Under this Section directing an investigation is only analogous to the issue of a fact-finding commission by a civil court for looking into accounts or making an investigation and does not amount to a judgment, so as to enable an aggrieved party to appeal.”

## INVESTIGATIONS PROCEDURE BY SEBI UNDER SEBI ACT, 1992

Section 11C of the Act provides that where SEBI has reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by SEBI thereunder, it may, at any time by order in writing, direct any person specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to SEBI.

It is the duty of every manager, managing director, officer and other employee of the company and every intermediary or every person associated with the securities market to preserve and to produce to the Investigating Authority or any person authorized by it in this behalf, all the books, registers, other documents and record of,

or relating to the company or, as the case may be, of or relating to the intermediary or such person, which are in their custody or power.

The Investigating Authority may require any intermediary or any person associated with securities market in any manner to furnish such information to, or produce such books, or registers, or other documents, or record before it or any person authorized by it in this behalf as it may consider necessary if the furnishing of such information or the production of such books, or registers, or other documents, or record is relevant or necessary for the purposes of its investigation. The Investigating Authority may keep in its custody any books, registers, other documents and record produced for six months and thereafter shall return the same to any intermediary or any person associated with securities market by whom or on whose behalf the books, registers, other documents and record are produced.

The Investigating Authority may call for any book, or register, other document and record if they are needed again.

Further, if the person on whose behalf the books, registers, other documents and record are produced requires certified copies of the books, registers, other documents and record produced before the Investigating Authority, it shall give certified copies of such books, registers, other documents and record to such person or on whose behalf the books, registers, other documents and record were produced.

Any person, directed to make an investigation may, examine on oath, any manager, managing director, officer and other employee of any intermediary or any person associated with securities market in any manner, in relation to the affairs of his business and may administer an oath accordingly and for that purpose may require any of those persons to appear before it personally.

If any person fails without reasonable cause or refuses to produce to the Investigating Authority or any person authorized by it in this behalf any book, register, other document and record which is his duty to produce; or to furnish any information which it is his duty to furnish; or to appear before the Investigating Authority personally when required to do so or to answer any question which is put to him by the Investigating Authority; or to sign the notes of any examination, he shall be punishable with imprisonment for a term which may extend to one year, or with fine, which may extend to one crore rupees, or with both, and also with a further fine which may extend to five lakh rupees for every day after the first during which the failure or refusal continues.

Sub-section 7 lays down that notes of any examination shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

Sub-section 8 lays down that where in the course of an investigation, the Investigating Authority has reasonable ground to believe that the books, registers, other documents and record of, or relating to any, any intermediary or any person associated with securities market in any manner may be destroyed, mutilated, altered, falsified or secreted, the Investigating Authority may make an application to the Magistrate or Judge of such during noted court in Mumbai, as may be notified by the Central Government for an order for the seizure of such books, registers, other documents and records.

Sub-section 8A stipulates that the authorized officer may requisition the services of any police officer or any office of the Central Government, or of both, to assist him for all or any of the purposes specified above and it shall be the duty of every such officer to comply with such requisition.

Sub-section (9) provides that after considering the application and hearing the Investigating Authority, if necessary, the Magistrate or Judge of the Designed Court, by order, authorize the investigating authority –

- (a) to enter, with such assistance, as may be required, the place or places where such books, registers, other documents and record are kept.
- (b) to search that place or those places in the manner specified in the order and.

- (c) to seize books, registers and other documents and records, if it considers necessary for the purpose of the investigation.

However, the Magistrate or Judge of the Designated Court shall not authorize seizure of books, registers, other documents and record of any listed public company or a public company (not being the intermediary specified under section (12) which intends to get its securities listed on any recognized stock exchange unless such company indulges in insider trading or market manipulation.

Sub-section 10 provides that the Investigating Authority shall keep in its custody the books, registers, other documents and record seized under this section for such period not later than the conclusion of the investigation as it considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person, from whose custody or power they were seized and inform the Magistrate or Judge of the Designated Court of such return. The Investigating Authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof. Every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures made under that Code.

### **CEASE AND DESIST PROCEEDINGS**

Section 11D deals with the cease and desist powers of SEBI. If SEBI finds, after causing an inquiry to be made, that any person has violated, or is likely to violate any provisions of this Act, or any rules or regulations made thereunder, it may pass an order requiring such person to cease and desist from committing or causing such violation. SEBI shall not pass such order in respect of any listed public company or a public company (other than the intermediaries specified under section 12) which intends to get its securities listed on any recognized stock exchange unless SEBI has reasonable grounds to believe that such company has indulged in insider trading or market manipulation.

### **SEBI (PROHIBITION OF FRAUDULENT AND UNFAIR TRADE PRACTICES RELATING TO SECURITIES MARKET) REGULATIONS, 2003**

A person shall not directly or indirectly –

- (a) buy, sell or otherwise deal in securities in a fraudulent manner;
- (b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made there under;
- (c) employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange;
- (d) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the rules and the regulations made there under.

A PERSON SHALL NOT INDULGE IN A MANIPULATIVE, FRAUDULENT OR AN UNFAIR TRADE PRACTICE IN SECURITIES MARKETS.

### **Power of the Board to order investigation (Regulation 5)**

Where the Board, the Chairman, the member or the Executive Director (hereinafter referred to as “appointing authority”) has reasonable ground to believe that –

- (a) the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market in violation of these regulations;
- (b) any intermediary or any person associated with the securities market has violated any of the provisions of the Act or the rules or the regulations, it may, at any time by order in writing, direct any person (hereinafter referred to as the "Investigating Authority") specified in the order to investigate the affairs of such intermediary or persons associated with the securities market or any other person and to report thereon to the Board in the manner provided in section 11C of the Act.

### **Powers of Investigating Authority (Regulation 6)**

Without prejudice to the powers conferred under the Act, the Investigating Authority shall have the following powers for the conduct of investigation, namely:—

- (1) to call for information or records from any person specified in section 11(2)(i) of the Act;
- (2) to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in section 12 of the Act) which intends to get its securities listed on any recognized stock exchange where the Investigating Authority has reasonable grounds to believe that such company has been conducting in violation of these regulations;
- (3) to require any intermediary or any person associated with securities market in any manner to furnish such information to, or produce such books, or registers, or other documents, or record before him or any person authorized by him in this behalf as he may consider necessary if the furnishing of such information or the production of such books, or registers, or other documents, or record is relevant or necessary for the purposes of the investigation;
- (4) to keep in his custody any books, registers, other documents and record produced under this regulation for a maximum period of one month which may be extended up to a period of six months by the Board:

However, the Investigating Authority may call for any book, register, other document or record if the same is needed again :

If the person on whose behalf the books, registers, other documents and record are produced requires certified copies of the books, registers, other documents and record produced before the Investigating Authority, he shall give certified copies of such books, registers, other documents and record to such person or on whose behalf the books, registers, other documents and record were produced;

- (5) to examine orally and to record the statement of the person concerned or any director, partner, member or employee of such person and to take notes of such oral examination to be used as an evidence against such person :

However, said notes shall be read over to, or by, and signed by, the person so examined;

- (6) to examine on oath any manager, managing director, officer or other employee of any intermediary or any person associated with securities market in any manner in relation to the affairs of his business and may administer an oath accordingly and for that purpose may require any of those persons to appear before him personally.

### **Power of the Investigating Authority to be exercised with prior approval (Regulation 7)**

The Investigating Authority may, after obtaining specific approval from the Chairman or Member also exercise all or any of the following powers, namely :—

- (1) to call for information and record from any bank or any other authority or board or corporation established

or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which are under investigation;

- (2) to make an application to the Judicial Magistrate of the first class having jurisdiction for an order for the seizure of any books, registers, other documents and record, if in the course of investigation, the Investigating Authority has reasonable ground to believe that such books, registers, other documents and record of, or relating to, any intermediary or any person associated with securities market in any manner may be destroyed, mutilated, altered, falsified or secreted;
- (3) to keep in his custody the books, registers, other documents and record seized under these regulations for such period not later than the conclusion of the investigation as he considers necessary and thereafter to return the same to the person, the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person from whose custody or power they were seized :

However, the Investigating Authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof;

- (4) save as otherwise provided in this regulation, every search or seizure made under this regulation shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973 (2 of 1974) relating to searches or seizures made under that Code.

#### **Duty to co-operate, etc. (Regulation 8)**

(1) It shall be the duty of every person in respect of whom an investigation has been ordered under regulation 7 –

- (a) to produce to the Investigating Authority or any person authorized by him such books, accounts and other documents and record in his custody or control and to furnish such statements and information as the Investigating Authority or the person so authorized by him may reasonably require for the purposes of the investigation;
- (b) to appear before the Investigating Authority personally when required to do so by him under regulation 6 or regulation 7 to answer any question which is put to him by the Investigating Authority in pursuance of the powers under the said regulations.

(2) Without prejudice to the provisions of the Companies Act, 2013, it shall be the duty of every manager, managing director, officer and other employee of the company and every intermediary referred to in section 12 of the Act or every person associated with the securities market to preserve and to produce to the Investigating Authority or any person authorized by him in this behalf, all the books, registers, other documents and record of, or relating to, the company or, as the case may be, of or relating to, the intermediary or such person, which are in their custody or power.

(3) Without prejudice to the generality of the provisions of sub-regulations (1) and (2), such person shall –

- (a) allow the Investigating Authority to have access to the premises occupied by such person at all reasonable times for the purpose of investigation;
- (b) extend to the Investigating Authority reasonable facilities for examining any books, accounts and other documents in his custody or control (whether kept manually or in computer or in any other form) reasonably required for the purposes of the investigation;
- (c) provide to such Investigating Authority any such books, accounts and records which, in the opinion of the Investigating Authority, are relevant to the investigation or, as the case may be, allow him to take out computer out-prints thereof.

### **Submission of report to the Board (Regulation 9)**

The Investigating Authority shall, on completion of investigation, after taking into account all relevant facts, submit a report to the appointing authority:

Provided that the Investigating Authority may submit an interim report pending completion of investigations if he considers necessary in the interest of investors and the securities market or as directed by the appointing authority.

### **Enforcement by the Board (Regulation 10)**

The Board may, after consideration of the report referred to in regulation 9, if satisfied that there is a violation of these regulations and after giving a reasonable opportunity of hearing to the persons concerned, issue such directions or take such action as mentioned in regulation 11 and regulation 12:

Provided that the Board may, in the interest of investors and the securities market, pending the receipt of the report of the investigating authority referred to in regulation 9, issue directions under regulation 11:

Provided further that the Board may, in the interest of investors and securities market, dispense with the opportunity of pre-decisional hearing by recording reasons in writing and shall give an opportunity of post-decisional hearing to the persons concerned as expeditiously as possible.

### **Actions which may be taken by the board (Regulation 11)**

(1) The Board may, without prejudice to the provisions contained in sub-sections (1), (2), (2A) and (3) of section 11 and section 11B of the Act, by an order, for reasons to be recorded in writing, in the interests of investors and securities market, issue or take any of the following actions or directions, either pending investigation or enquiry or on completion of such investigation or enquiry, namely: –

- (a) suspend the trading of the security found to be or prima facie found to be involved in fraudulent and unfair trade practice in a recognized stock exchange;
- (b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities;
- (c) suspend any office-bearer of any stock exchange or self-regulatory organization from holding such position;
- (d) impound and retain the proceeds or securities in respect of any transaction which is in violation or prima facie in violation of these regulations;
- (e) direct and intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of a fraudulent and unfair transaction;
- (f) require the person concerned to call upon any of its officers, other employees or representatives to refrain from dealing in securities in any particular manner;
- (g) prohibit the person concerned from disposing of any of the securities acquired in contravention of these regulations;
- (h) direct the person concerned to dispose of any such securities acquired in contravention of these regulations, in such manner as the Board may deem fit, for restoring the status quo ante;

(2) The Board shall issue a press release in respect of any final order passed under sub regulation (1) in at least two newspapers of which one shall have nationwide circulation and shall also put the order on the website of the Board.



In the case of *Securities and Exchange Board of India (Appellant) v. Shri Kanaiyalal Baldevbhai Patel* (Respondent) (Civil Appeal no. 2595 of 2013, dated 20th September, 2017 (Supreme Court of India).

This case revolves round the legality of 'non-intermediary front running' in security market under the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (FUTP 2003)

**Fact of the case:** SEBI investigated into the activities of Shri Kanaiyalal Baldevbhai Patel [herein after 'KB' for brevity] an individual trader. During the investigation, it was found that KB was putting orders ahead of orders placed by Passport India Investment (Mauritius) Ltd. [herein after 'PII' for brevity]. One Dipak Patel, was the portfolio manager of PII, who also happens to be a cousin of KB and one Shri Anandkumar Baldevbhai Patel [herein after 'AB' for brevity]. It was alleged that Dipak Patel provided information to KB and AB regarding forthcoming trading activity of the PII. It is to be noted that trades were executed using the telephone number registered in the name of AB at the common residential address of KB and AB. Taking advantage of the information received from Dipak Patel, KB had indulged in trading before the PII and consequently squared off the position when the order of PII were placed in the market. It was estimated that the KB earned a total profit of Rs. 1,56,32,364.01/- from the alleged trades.

**Held:** The object and purpose of FUTP 2003 is to curb "market manipulations". Market manipulation is normally regarded as an "unwarranted" interference in the operation of ordinary market forces of supply and demand and thus undermines the "integrity" and efficiency of the market.

The law of confidentiality has a bearing on this case instant. "Confidential information acquired or compiled by a corporation in the course and conduct of its business is a species of property to which the corporation has the exclusive right and benefit, and which a court of equity will protect through the injunctive process or other appropriate remedy." The information of possible trades that the company is going to undertake is the confidential information of the company concerned, which it has absolute liberty to deal with. Therefore, a person conveying confidential information to another person (tippee) breaches his duty prescribed by law and if the recipient of such information knows of the breach and trades, and there is an inducement to bring about an inequitable result, then the recipient tippee may be said to have committed the fraud.

In order to establish charges against tippee, under regulations 3 (a), (b), (c) and (d) and 4 (1) of FUTP 2003, one needs to prove that a person who had provided the tip was under a duty to keep the non-public information under confidence, further such breach of duty was known to the tippee and he still trades thereby defrauding the person, whose orders were front-run, by inducing him to deal at the price he did.

**Conclusion:** Concerned parties to the transaction were involved in an apparent fraudulent practice violating market integrity. The parting of information with regard to an imminent bulk purchase and the subsequent transaction thereto are so intrinsically connected that no other conclusion but one of joint liability of both the initiator of the fraudulent practice and the other party who had knowingly aided in the same is possible.

### SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995

In exercise of the powers conferred by clause (da) and clause (f) of sub-section (2) of section 29 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Central Government hereby made these rules for holding inquiry for the purpose of imposing penalty under Chapter VI-A of the said Act.

#### Appointment of adjudicating officer for holding inquiry (Rule 3)

Whenever the Board is of the opinion that there are grounds for adjudging under any of the provisions in Chapter



VI-A of the Act, it may appoint any of its officers not below the rank of Division Chief to be an adjudicating officer for holding an inquiry for the said purpose.

#### **Holding of Inquiry (Rule 4)**

- (1) In holding an inquiry for the purpose of adjudging under sections 15A, 15B, 15C, 15D, 15E, 15EA, 15EB], 15F, 15G, 15HA and 15HB whether any person has committed contraventions as specified in any of sections 15A, 15B, 15C, 15D, 15E, 15EA, 15EB, 15F, 15G, 15HA and 15HB the Board or the adjudicating officer shall, in the first instance, issue a notice to such person requiring him to show cause within such period as may be specified in the notice (being not less than fourteen days from the date of service thereof) why an inquiry should not be held against him.
- (2) Every notice under sub-rule (1) to any such person shall indicate the nature of offence alleged to have been committed by him.
- (3) If, after considering the cause, if any, shown by such person, the Board or the adjudicating officer is of the opinion that an inquiry should be held, he shall issue a notice fixing a date for the appearance of that person either personally or through his lawyer or other authorized representative
- (4) On the date fixed, the Board or the adjudicating officer shall explain to the person proceeded against or his lawyer or authorized representative, the offence, alleged to have been committed by such person indicating the provisions of the Act, rules or regulations in respect of which contravention is alleged to have taken place.
- (5) The Board or the adjudicating officer shall then give an opportunity to such person to produce such documents or evidence as he may consider relevant to the inquiry and if necessary the hearing may be adjourned to a future date and in taking such evidence the Board or the adjudicating officer shall not be bound to observe the provisions of the Evidence Act, 1872 (11 of 1872) :

Provided that the notice referred to in sub-rule (3), and the personal hearing referred to in sub-rules (3), (4) and (5) may, at the request of the person concerned, be waived.

- (5A) The Board may appoint a presenting officer in an inquiry under this rule.
- (6) While holding an inquiry under this rule the Board or the adjudicating officer shall have the power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which, in the opinion of the Board or the adjudicating officer, may be useful for or relevant to, the subject-matter of the inquiry.
- (7) If any person fails, neglects or refuses to appear as required by sub-rule (3) before the Board or the adjudicating officer, the Board or the adjudicating officer may proceed with the inquiry in the absence of such person after recording the reasons for doing so.

#### **Order of the Board or the Adjudicating Officer (Rule 5)**

(1) If, upon consideration of the evidence produced before the Board or the adjudicating officer, the Board or the adjudicating officer is satisfied that the person has become liable to penalty under any of the sections specified in sub-section (1) of sub-section (4A) of section 11 or sub-section (2) of section 11B or section 15-I of the Act, he may, by order in writing, impose such penalty as he thinks fit in accordance with the provisions of the relevant section or sections specified in sub-section (4A) of section 11 or sub-section (2) of section 11B or section 15-I of the Act.

(2) While adjudging the quantum of penalty under sub-section (4A) of section 11 or sub-section (2) of section 11B or section 15-I of the Act], the Board or the adjudicating officer shall have due regard to the following factors, namely:—

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default ;
- (b) the amount of loss caused to an investor or group of investors as a result of the default ;
- (c) the repetitive nature of the default.

(3) Every order made under sub-rule (1) shall specify the provisions of the Act in respect of which default has taken place and shall contain brief reasons for such decisions.

(4) Every such order shall be dated and signed by the Board or the adjudicating officer.

(5) The Board or the adjudicating officer who has passed an order, may rectify any error apparent on the face of record on such order, either on its own motion or where such error is brought to his notice by the affected person within a period of fifteen days from the date of such order.

*Explanation :* For the purpose of this rule, “error apparent on the face of record” shall mean any typographical errors that creep in inadvertently into the order and includes such other errors that do not require a long drawn out reasoning process to ascertain such a mistake.

### Copy of the Order (Rule 6)

The Board or the adjudicating officer shall send a copy of every order made under rules by it to the person concerned and to the Board.

### Service of notices and orders (Rule 7)

A notice or an order issued under these rules shall be served on the person in the following manner, that is to say, –

- (a) by delivering or tendering it to that person or his duly authorized agent ;
- (b) by sending it to the person by fax or electronic mail or courier or speed post with acknowledgement due or registered post with acknowledgement due to the address of his place of residence or his last known place of residence or the place where he carried on, or last carried on, business or personally works, or last worked, for gain:

Provided that a notice sent by Fax shall bear a note that the same is being sent by fax and in case the document contains annexure, the number of pages being sent shall also be mentioned;

Provided further that a notice sent through electronic mail shall be digitally signed by the competent authority and bouncing of the electronic mail shall not constitute valid service;

- (c) if it cannot be served under clause (a) or clause (b), by affixing it on the outer door or some other conspicuous part of the premises in which that person resides or is known to have last resided, or carried on business or personally works or last worked for gain and that written report thereof should be witnessed by two persons; or
- (d) if it cannot be affixed on the outer door as per clause (c), by publishing the notice in at least two newspapers, one in a English daily newspaper having nationwide circulation and another in a newspaper having wide circulation published in the language of the region where that person was last known to have resided or carried on business or personally worked for gain.

### Power of Inspection of RBI

According to Section 45N(1) of the Reserve Bank of India Act, 1934, the Reserve Bank may, at any time, cause an inspection to be made by one or more of its officers or employees or other persons (hereafter in this section referred to as the inspecting authority)-

- (i) of any non-banking institution, including a financial institution, for the purpose of verifying the correctness or completeness of any statement, information or particulars furnished to the Bank or for the purpose of obtaining any information or particulars; which the non-banking institution has failed to furnish on being called upon to do so; or
- (ii) of any non-banking institution being a financial institution, if the Bank considers it necessary or expedient to inspect that institution.

### **Duty of Director and Officers**

According to section 45N(1), it shall be the duty of every director or member of any committee or other body for the time being vested with the management of the affairs of the non-banking institution or other officer or employee thereof to produce to the inspecting authority all such books, accounts and other documents in his custody or power and to furnish that authority with any statements and information relating to the business of the institution as that authority may require of him, within such time as may be specified by that authority.

### **Power of Inspecting Authority**

According to Section 45N(3), the inspecting authority may examine on oath any director or member of any committee or body for the time being vested with the management of the affairs of the non-banking institution or other officer or employee thereof, in relation to its business and may administer an oath accordingly.

## **FOREIGN EXCHANGE MANAGEMENT ACT, 1999**

### **Directorate of Enforcement**

According to Section 36(1), the Central Government shall establish a Directorate of Enforcement with a Director and such other officers or class of officers as it thinks fit, who shall be called officers of Enforcement, for the purposes of this Act.

### **Power of Search, Seizure, etc.**

According to Section 37(1), the Director of Enforcement and other officers of Enforcement, not below the rank of an Assistant Director, shall take up for investigation the contravention referred to in section 13.

According to Section 37(2), the Central Government may also, by notification, authorize any officer or class of officers in the Central Government, State Government or the Reserve Bank, not below the rank of an Under Secretary to the Government of India to investigate any contravention referred to in section 13.

### **Powers of these officers**

According to Section 37(3), the officers referred to in sub-section (1) shall exercise the like powers which are conferred on income-tax authorities under the Income-tax Act, 1961 (43 of 1961) and shall exercise such powers, subject to such limitations laid down under that Act.

Section 37 of the Act empowers the Director of Enforcement and other officers below the rank of an Assistant Director to take up for investigation the contravention referred to in Section 13 of the Act. In addition, the Central Government may also authorize any officer or class of officers in the Central Government, State Government, Reserve Bank of India, not below the rank of Under Secretary to Government of India, to investigate any contravention under Section 13 of the Act. The officers so appointed shall exercise the like powers which are conferred on income tax authorities under the Income Tax Act, 1961, subject to such conditions and limitations as laid down under that Act.

In this context, Foreign Exchange Management (Encashment of Draft, Cheque Instrument and Payment of Interest) Rules, 2000 provides that where investigation referred to in Section 37 of the Act is being taken up into

any alleged contravention of any provisions of the Act or rule, regulation, direction or order or violation of any condition subject to which Reserve Bank of India gives authorisation, and any draft, cheque or other instrument relevant for such investigation, such officer shall send such draft, cheque or other instrument to the Reserve Bank of India or to an authorized person as the officer may specify for encashment. The Reserve Bank of India or the authorized person is required to take steps without delay for encashment of the draft, cheque or other instrument and to credit the proceeds of such encashment (less any commission and expenses incurred for such encashment) to a separate account in the name of the Directorate of Enforcement.

The Central Government is required to indemnify the Reserve Bank of India or an authorized person against any liability which may incur by reason of or in connection with the encashment of the draft, cheque or other instrument delivered to it.

### **Empowering other Officers**

According to Section 38(1), the Central Government may, by order and subject to such conditions and limitations as it thinks fit to impose, authorize any officer of customs or any central excise officer or any police officer or any other officer of the Central Government or a State Government to exercise such of the powers and discharge such of the duties of the Director of Enforcement or any other officer of Enforcement under this Act as may be stated in the order.

According to Section 38(2), the officers referred to in sub-section (1) shall exercise the like powers which are conferred on the income-tax authorities under the Income-tax Act, 1961 (43 of 1961), subject to such conditions and limitations as the Central Government may impose.

### **Presumption as to Documents in Certain Cases**

According to Section 39, where any document –

- (i) is produced or furnished by any person or has been seized from the custody or control of any person, in either case, under this Act or under any other law; or
- (ii) has been received from any place outside India (duly authenticated by such authority or person and in such manner as may be prescribed) in the course of investigation of any contravention under this Act alleged to have been committed by any person, and such document is tendered in any proceeding under this Act in evidence against him, or against him and any other person who is proceeded against jointly with him, the court or the Adjudicating Authority, as the case may be, shall –
  - (a) presume, unless the contrary is proved, that the signature and every other part of such document which purports to be in the handwriting of any particular person or which the court may reasonably assume to have been signed by, or to be in the handwriting of, any particular person, is in that person's handwriting, and in the case of a document executed or attested, that it was executed or attested by the person by whom it purports to have been so executed or attested;
  - (b) admit the document in evidence notwithstanding that it is not duly stamped, if such document is otherwise admissible in evidence;
  - (c) in a case falling under clause (i), also presume, unless the contrary is proved, the truth of the contents of such document.

### **Contravention by Companies**

According to Section 42(1), where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time the contravention

was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention took place without his knowledge or that he exercised due diligence to prevent such contravention.

According to Section 42(2), where a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

For the purposes of this section –

- (i) Company means anybody corporate and includes a firm or other association of individuals; and
- (ii) Director, in relation to a firm, means a partner in the firm.

Section 42 of the Act deals with contravention of the provisions of the Act by the Companies and provides that where the person committing the contravention of the Act or Rules happened to be a company, every person who at the time the contravention was committed, was in charge of and was responsible to the company for the conduct of the business of the company shall be deemed to be guilty of the contravention and liable to be proceeded against and punished accordingly. However, no such persons shall be deemed to be guilty of committing any offence if he proves that such contravention took place without his knowledge or that he exercised adequate steps to prevent such contravention.

In case the contravention is committed by a company and it is proved that such contravention is committed with the knowledge, consent and connivance or is attributed to the neglect on the part of any director, manager or secretary or other officer of the company, they will also be deemed to be guilty of contravention and liable to be proceeded against and punished accordingly.

In the case of *Suborno Bose (Appellant) v. Enforcement Directorate and Anr. (Respondents)* Civil Appeal No. 6267 of 2020), dated 05th March, 2020 (Supreme Court of India)

**Facts of the case:** A show-cause notice was issued to the Appellant, stating that the Adjudicating Authority was satisfied that there was a prima facie contravention of Section 10(6) of the FEMA Act read with Sections 46 and 47 of the said Act and the Foreign Exchange Manual in the complaint filed against the company of which, the Appellant was the Managing Director. The reply to the show-cause notice filed on behalf of the Company including for the Appellant and the submissions made before the Adjudicating Authority were duly considered by the Adjudicating Authority. The Adjudicating Authority concluded that the noticee Company and the Appellant had violated the provisions of Section 10(6) of the FEMA Act read with Sections 46 and 47 of the said Act read with the Foreign Exchange Manual having found that the goods had arrived in India, but the Company failed to submit Bill of Entry and did not take delivery of the goods. The import formalities would have been completed only after submission of Bill of Entry. Thus, though the goods for which foreign exchange was remitted had reached the destination of the users, but the same were not released and as such kept in bonded warehouse. That resulted in contravention warranting issuance of show-cause notice to the Company and the Appellant. Resultantly, the Adjudicating Authority imposed penalty on Appellant and the company. The Company, as well as, the Appellant carried the matter in appeal before the Special Director (Appeals), FEMA and Commissioner of Income-Tax. The Appellate Authority dismissed both the appeals and was pleased to uphold the decision of the Adjudicating Authority. Being aggrieved, the Company, as well as the Appellant carried the matter before the High Court. Both appeals were dismissed by the High Court.

**Supreme Court Held:**

(i) The contravention referred to in Section 10(6) of the FEMA Act is a continuing actionable offence. If so, the Company and the persons managing the affairs of the Company remain liable to take corrective measures in right earnest. Considering the admitted fact that the Appellant took over the management of the Company and was fully alive to the default committed by the Company, yet failed to take corrective steps in right earnest. Notably, being conscious of such contravention, the Appellant had sought indulgence of the authorities for more time. It must follow that the Appellant cannot now be heard to contend that no liability could be fastened on him individually. Indeed, Regulation 6 of the FEMA Regulations provides for the period within which the foreign exchange ought to be surrendered if the Company was not wanting to take delivery of the goods imported. That, however, does not mean that the contravention ceased to exist beyond the specified period. On the other hand, after the specified period had expired, it would be a case of deemed contravention until rectified.

(ii) It was not the case of the Appellant that he was not an officer or a person in charge of and responsible to the Company for the conduct of the business of the Company, as well as, the Company on or after he took charge of company. Considering the fact that the Appellant admittedly became aware of the contravention yet failed to take corrective measures until the action to impose penalty for such contravention was initiated, he could not be permitted to invoke the only defence available in terms of proviso to Sub-Section (1) of Section 42 of the FEMA Act that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention. In the reply filed to the show-cause notice by the Appellant, no such specific plea had been taken.

(iii) Therefore, no error had been committed by the Adjudicating Authority in finding that the Appellant was also liable to be proceeded with for the contravention by the Company of which he became the Managing Director and for penalty therefor as prescribed for the contravention of Section 10(6) read with Sections 46 and 47 of the FEMA Act read with the Foreign Exchange Manual. The First Appellate Authority and the High Court justly affirmed the view so taken by the Adjudicating Authority.

## FOREIGN CONTRIBUTION (REGULATION) ACT, 2010

The Foreign Contribution (Regulation) Act, 2010 has come into effect from May 1, 2011. The Ministry of Home Affairs has issued the necessary Gazette Notification vide S.O. 999 (E) dated the 29th April, 2011 in this regard.

The Ministry of Home Affairs has also issued a Gazette Notification vide G.S.R. 349 (E) dated the 29th April, 2011 notifying the Foreign Contribution (Regulation) Rules, 2011 made under section 48 of FCRA, 2010. The FCR Rules, 2011 have come into force simultaneously with FCRA, 2010.

## INSPECTION, SEARCH AND SEIZURE

### Inspection of accounts or records

According to Section 23, if the Central Government has, for any reason, to be recorded in writing, any ground to suspect that any provision of this Act has been or is being, contravened by –

- (a) any political party; or
- (b) any person; or
- (c) any organization; or
- (d) any association,

it may, by general or special order, authorize such Gazetted Officer, holding a Group A post under the Central Government or such other officer or authority or organization, as it may think fit (hereinafter referred to as the



inspecting officer), to inspect any account or record maintained by such political party, person, organization or association, as the case may be, and thereupon every such inspecting officer shall have the right to enter in or upon any premises at any reasonable hour, before sunset and after sunrise, for the purpose of inspecting the said account or record.

Section 23 provides that if the Central Government has, for any reason, to be recorded in writing, any ground to suspect that any provision of this Act has been or is being, contravened by any political party; or any person; or any organization; or any association, it may, by general or special order, authorize such gazetted officer, holding a Group A post under the Central Government or such other officer or authority or organization, as it may think fit, to inspect any account or record maintained by such political party, person, organization or association, as the case may be, and thereupon every such inspecting officer shall have the right to enter in or upon any premises at any reasonable hour, before sunset and after sunrise, for the purpose of inspecting the said account or record.

### **Seizure of accounts or records**

According to Section 24, if, after inspection of an account or record referred to in section 23, the inspecting officer has any reasonable cause to believe that any provision of this Act or of any other law relating to foreign exchange has been, or is being, contravened, he may seize such account or record and produce the same before the court, authority or Tribunal in which any proceeding is brought for such contravention.

The authorized officer shall return such account or record to the person from whom it was seized if no proceeding is brought within six months from the date of such seizure for the contravention disclosed by such account or record.

Section 24 provides that if, after inspection of an account or record, the inspecting officer has any reasonable cause to believe that any provision of the Act or of any other law relating to foreign exchange has been, or is being, contravened, he may seize such account or record and produce the same before the court, authority or tribunal in which any proceeding is brought for such contravention. Further, the authorized officer shall return such account or record to the person from whom it was seized if no proceeding is brought within six months from the date of such seizure for the contravention disclosed by such account or record.

### **Seizure of Article or Currency or Security received in contravention of the Act**

According to Section 25, if any Gazetted Officer, authorized in this behalf by the Central Government by general or special order, has any reason to believe that any person has in his possession or control any article exceeding the value specified in sub-clause (i) of clause (h) of sub-section (1) of section 2 or currency or security whether Indian or foreign, in relation to which any provision of this Act has been or is being, contravened, he may seize such article or currency or security.

### **Disposal of Seized Article or Currency or Security**

According to Section 26(1), the Central Government, may, having regard to the value of article or currency or security, their vulnerability to theft or any relevant consideration, by notification, specify such article or currency or security which shall, as soon as may be after their seizure, be disposed of by such officer and in such manner, as the Central Government may, from time to time, determine after following the procedure hereinafter specified.

According to Section 26(2), the article or currency or security seized shall be forwarded without unnecessary delay to such officer as may be specified.

According to Section 26(3), Where any article or currency or security has been seized and forwarded to such officer, the officer referred to in sub-section (1), shall prepare an inventory of such article or currency or security containing such details relating to their description, value or such other identifying particulars as the officer



referred to in that sub-section may consider relevant to the identity of the article or the currency or security and make an application to any Magistrate for the purposes of certifying the correctness of the inventory so prepared.

According to Section 26 (4), where an application is made under sub-section (2), the Magistrate shall, as soon as may be, allow the application.

According to Section 26 (5) notwithstanding anything contained in the Indian Evidence Act, 1872 (1 of 1872) or the Code of Criminal Procedure, 1973 (2 of 1974), every court trying an offence under this Act, shall treat the inventory, as certified by the Magistrate, as primary evidence in respect of such offence.

According to Section 26 (6) every officer acting under sub-section (3) shall forthwith report the seizure to the Court of Session or Assistant Sessions Judge having jurisdiction for adjudging the confiscation under section 29.

### **Seizure to be made in accordance with Act**

According to Section 27, the provisions of the Code of Criminal Procedure, 1973 (2 of 1974) shall apply insofar as they are not inconsistent with the provisions of this Act to all seizures made under this Act.

Procedure of search in Criminal Procedure detailed as follows:

- a. At least two respectable witnesses of the locality shall be asked to be present at a search.
- b. The search shall be conducted in their presence and the list of things seized should be signed by witnesses.
- c. The occupant of the place or his representative shall be allowed to be present during the search and a copy of the search list signed by the witnesses shall be given to him.
- d. When any person is searched under sub-section (3) of Section 100 of the Code of Criminal Procedure, a copy of the list of things taken possession of shall be given to him.
- e. Before the commencement of the search, the person of the Police officer and the witnesses should be searched, so that there may not be suspicion of something extraneous being planted in the house or the place to be searched.
- f. The law does not require a search under the Code of Criminal Procedure to be made only by daylight, but, normally, daylight should be awaited. If information is received after dusk necessitating the immediate search of house and if it is apprehended that delay till daybreak might result in evidence being concealed or destroyed, the house should be sealed and guarded and if that is not possible, search should be conducted during the night itself.
- g. Before entering the premises to be searched, the exterior of the place shall be inspected to see whether facilities exist for introducing property from outside.
- h. Search must be systematic and thorough.
  - i. Women should be allowed to withdraw.
  - j. Indiscriminate search and damage to property should be avoided.
- k. A search list shall be prepared on the completion of the search in quadruplicate, all the copies being signed by the Police officer making the search and the witnesses to the search. One copy will be handed over to the owner or occupant of the house, the second copy should be sent to the Magistrate and the third copy should be sent with the case diary to the superior officer to whom case diaries are sent. The fourth copy will form the station record. If blank paper has unavoidably to be used, four copies of the list should be made and dealt with as above affixing the fourth copy to search list book, on return to the station.

### **Confiscation of article or currency or security obtained in contravention of the Act**

According to Section 28, any article or currency or security which is seized under section 25 shall be liable to confiscation if such article or currency or security has been adjudged under section 29 to have been received or obtained in contravention of this Act.

### **Adjudication of confiscation**

According to Section 29(1), any confiscation referred to in section 28 may be adjudged –

- (a) without limit, by the Court of Session within the local limits of whose jurisdiction the seizure was made; and
- (b) subject to such limits as may be prescribed, by such officer, not below the rank of an Assistant Sessions Judge, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

According to Section 29(2) When an adjudication under sub-section (1) is concluded by the Court of Session or Assistant Sessions Judge, as the case may be, the Sessions Judge or Assistant Sessions Judge may make such order as he thinks fit for the disposal by confiscation or delivery of seized article or currency or security, as the case may be, to any person claiming to be entitled to possession thereof or otherwise, or which has been used for the commission of any offence under this Act.

Section 29 dealing with adjudication of confiscation, provides that any confiscation article or currency or security which is seized may be adjudged without limit, by the Court of Session within the local limits of whose jurisdiction the seizure was made; and subject to such limits as may be prescribed, by such officer, not below the rank of an Assistant Sessions Judge, as the Central Government may, by notification in the Official Gazette.

Section 30 provides that no order of adjudication of confiscation shall be made unless a reasonable opportunity of making a representation against such confiscation has been given to the person from whom any article or currency or security has been seized.

### **Appeal**

Section 31 deals with appeals and provides that any person aggrieved by any order made under section 29 may prefer an appeal, where the order has been made by the Court of Session, to the High Court to which such Court is subordinate; or where the order has been made by any officer specified, to the Court of Session within the local limits of whose jurisdiction such order of adjudication of confiscation was made, within one month from the date of communication to such person of the order.

Further the appellate court may, if it is satisfied that the appellant was prevented by sufficient cause from preferring the appeal within the said period of one month, allow such appeal to be preferred within a further period of one month, but not thereafter.

Every appeal preferred under this section shall be deemed to be an appeal from an original decree and the provisions of Order XLI of the First Schedule to the Code of Civil Procedure, 1908, shall, as far as may be, apply thereto as they apply to an appeal from an original decree.

### **Penalty and Punishment**

Section 34 prescribes for penalty on any person, on whom any prohibitory order has been served under section 10, pays, delivers, transfers or otherwise deals with, in any manner whatsoever, any article or currency or security, whether Indian or foreign, in contravention of such prohibitory order, he shall be punished with imprisonment for a term which may extend to three years, or with fine, or with both. The court trying such contravention may also impose on the person convicted an additional fine equivalent to the market value of the article or the amount of the currency or security in respect of which the prohibitory order has been contravened by him or such part thereof as the court may deem fit.

Section 35 provides for punishment with imprisonment for a term which may extend to five years, or with fine, or with both for accepting, or assisting any person, political party or organization in accepting, any foreign contribution or any currency or security from a foreign source, in contravention of any provision of this Act or any rule or order made thereunder.

### Offences by Companies

Section 39 deals with offences by companies and provides that where an offence has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, such person shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Further in the case an offence has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

### Composition of certain Offences

Section 41 (1) provides that any offence punishable under this Act (whether committed by an individual or association or any officer or employee thereof), not being an offence punishable with imprisonment only, may, before the institution of any prosecution, be compounded by such officers or authorities and for such sums as the Central Government may, by notification in the Official Gazette, specify in this behalf.

Section 41(2) provides that any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence. Every officer of authority shall exercise the powers to compound an offence, subject to the direction, control and supervision of the Central Government. Every application for the compounding of an offence shall be made to the officer or authority referred to in sub-section (1) in such form and manner along with such fee as may be prescribed. Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, against the offender in relation to whom the offence is so compounded.

Every officer or authority while dealing with an application for the compounding of an offence for a default in compliance with any provision of this Act which requires by an individual or association or its officer or other employee to obtain permission or file or register with, or deliver or send to, the Central Government or any prescribed authority any return, account or other document, may, direct, by order, if he or it thinks fit to do so, any individual or association or its officer or other employee to file or register with, such return, account or other document within such time as may be specified in the order.

## COMPETITION ACT, 2002

### Inquiry by Competition Commission of India

According to Section 19(1) of the Competition Act, 2002, the Commission may inquire into any alleged contravention of the provisions contained in sub-section (1) of section 3 or sub-section (1) of section 4 either on its own motion or on –

- (a) receipt of any information, in such manner and accompanied by such fee as may be determined by regulations, from any person, consumer or their association or trade association; or
- (b) a reference made to it by the Central Government or a State Government or a statutory authority.

### Anti-Competitive Agreement

According to Section 3(1) of the Act, no enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.

### Prohibition of Abuse of Dominant Position

According to Section 4(1), no enterprise or group shall abuse its dominant position.

In the case of *M/s Adani Gas Limited (Appellant) v. Competition Commission of India and Ors. (Respondents)* (TA(AT) (Competition) No. 33 of 2017) (Old Appeal No. 50 of 2014), dated 5th March, 2020 (The National Company Law Appellate Tribunal)

**Fact of the case :** The Adani Gas Limited' (AGL) has preferred the instant appeal being passed by the Competition Commission of India (Commission) in Case (*Faridabad Industries Association v. Adani Gas Limited*) under Section 27 of 'the Competition Act, 2002' (Act) holding that the Appellant has contravened the provisions of Section 4(2)(a)(i) of the Act by imposing unfair conditions upon the buyers under 'Gas Supply Agreement' (GSA).

The Commission, apart from directing the Appellant to cease and desist from indulging in conduct found to be in contravention of the provisions of the Act in terms of the impugned order, directed the Appellant to modify the GSA's in the light of observations and findings recorded in the impugned order and imposed a penalty on Adani Gas Limited @ 4% of the average turnover of the last three years quantified at Rs.2567.2764 Lakh.

The Informant (Faridabad Industries Association' (FIA)) alleged that AGL, by grossly abusing its dominant position in the relevant market of supply and distribution of natural gas in Faridabad, has put unconscionable terms and conditions in GSA which are unilateral and lopsided besides being heavily tilted in favor of AGL. Thus, AGL was alleged to have imposed its diktat upon the buyers of natural gas (Members of FIA) under the garb of executing GSA. It was further alleged that the terms of GSA have been drafted unilaterally by AGL leaving no scope for Members of FIA, who are solely dependent on supplies upon AGL. Referring to various clauses of GSA, the Informant alleged that the said clauses and conduct of AGL clearly demonstrated abuse of dominant position by AGL in imposing unfair and discriminatory conditions in GSA's executed by it with the Members of FIA. Informant complained of contravention of provisions of Section 4 of the Act, seeking various reliefs including the direction to AGL to discontinue such abuse of dominant position, direct modification of offending clauses in GSA by providing fair and non-discriminatory terms and the imposition of the exemplary penalty within the ambit of Section 27(b) of the Act.

Held: The NCLAT observed that the Gas Supply Agreements (GSAs) that had been revised by AGL during the course of investigation and inquiry before the Commission came up for further revision of the contravening clauses to make them more consumer-friendly and to protect the interests of Industrial Consumers by removing the disparity as regards the revision of gas prices, payment obligation in case of shutdown of supply and for complete or partial off-take of gas, etc. which came about in compliance to the suggestions put forth by this Appellate Tribunal. The Tribunal also observed that the modifications which in effect eliminated discrimination qua Industrial Consumers and the subsequent emergence of competitors of natural gas on the scene coupled with the fact that AGL not only came up with a voluntary revision of GSAs even before the conclusion of inquiry by the Commission and was amenable to the advice/ suggestions falling from this Appellate Tribunal resulting in the incorporation of the consumer-friendly clauses substituting the contravening provisions in the GSAs, in our considered opinion carve out mitigating factors/ extenuating circumstances in favor of AGL outweighing the only aggravating factor i.e. abuse of dominant position.

The NCLAT further opined that reducing the penalty imposed on Adani Gas Limited from 4% of the average annual turnover of the relevant three years to 1% would be commensurate with and proportionate to the level of proved abusive conduct of AGL and also opined that this reduction would meet the ends of justice and achieve the desired object of the statute in the peculiar facts and circumstances of the case.

### **Additional Powers relating to Inquiry for CCI**

According to Section 19(2), the powers and functions of the Commission shall include the powers and functions specified in sub-sections (3) to (7).

### **Determining whether an agreement has an appreciable adverse effect**

According to Section 19(3), the Commission shall, while determining whether an agreement has an appreciable adverse effect on competition under section 3, have due regard to all or any of the following factors, namely: –

- (a) creation of barriers to new entrants in the market;
- (b) driving existing competitors out of the market;
- (c) foreclosure of competition by hindering entry into the market;
- (d) accrual of benefits to consumers;
- (e) improvements in production or distribution of goods or provision of services; or
- (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

### **Factors determining Dominant Position**

According to Section 19(4), the Commission shall, while inquiring whether an enterprise enjoys a dominant position or not under section 4, have due regard to all or any of the following factors, namely:—

- (a) market share of the enterprise;
- (b) size and resources of the enterprise;
- (c) size and importance of the competitors;
- (d) economic power of the enterprise including commercial advantages over competitors;
- (e) vertical integration of the enterprises or sale or service network of such enterprises;
- (f) dependence of consumers on the enterprise;
- (g) monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;
- (h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;
- (i) countervailing buying power;
- (j) market structure and size of market;
- (k) social obligations and social costs;
- (l) relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;

- (m) any other factor which the Commission may consider relevant for the inquiry.

### **Relevant Market**

According to section 19(5), for determining whether a market constitutes a “relevant market” for the purposes of this Act, the Commission shall have due regard to the “relevant geographic market” and “relevant product market”.

### **Relevant Geographic Market**

The Commission shall, while determining the “relevant geographic market”, have due regard to all or any of the following factors, namely: –

- (a) regulatory trade barriers;
- (b) local specification requirements;
- (c) national procurement policies;
- (d) adequate distribution facilities;
- (e) transport costs;
- (f) language;
- (g) consumer preferences; and
- (h) need for secure or regular supplies or rapid after-sales services.

### **Relevant Product Market**

The Commission shall, while determining the “relevant product market”, have due regard to all or any of the following factors, namely: –

- (a) physical characteristics or end-use of goods;
- (b) price of goods or service;
- (c) consumer preferences;
- (d) exclusion of in-house production;
- (e) existence of specialised producers; and
- (f) classification of industrial products.

### **Inquiry into Combination by Commission**

According to Section 20(1), the Commission may, upon its own knowledge or information relating to acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of section 5 or merger or amalgamation referred to in clause (c) of that section, inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India.

This inquiry under sub-section (1) of section 20 is optional. To initiate inquiry under this sub –section the commission must have an opinion that such a combination has caused or is likely to cause an appreciable adverse effect on competition in India.

According to Section 20(2), the Commission shall, on receipt of a notice under sub-section (2) of section 6, inquire whether a combination referred to in that notice or reference has caused or is likely to cause an appreciable adverse effect on competition in India.



### Limitation on inquiry into combination

According to Proviso to Section 20(1), the Commission shall not initiate any inquiry under this subsection after the expiry of one year from the date on which such combination has taken effect.

### Determining an Appreciable Adverse Effect

For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission shall have due regard to all or any of the following factors, namely: –

- (a) actual and potential level of competition through imports in the market
- (b) extent of barriers to entry into the market;
- (c) level of combination in the market;
- (d) degree of countervailing power in the market;
- (e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
- (f) extent of effective competition likely to sustain in a market;
- (g) extent to which substitutes are available or are likely to be available in the market;
- (h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
- (i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
- (j) nature and extent of vertical integration in the market;
- (k) possibility of a failing business;
- (l) nature and extent of innovation;
- (m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;
- (n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

### DUTIES OF DIRECTOR GENERAL TO INVESTIGATE CONTRAVENTION

According to Section 41(1), the Director General shall, when so directed by the Commission, assist the Commission in investigating into any contravention of the provisions of this Act or any rules or regulations made thereunder.

### Powers of Director General

According to Section 41(2), the Director General shall have all the powers as are conferred upon the Commission under subsection (2) of section 36.

### Powers of Civil Court

According to Section 36(2), the Commission shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit, in respect of the following matters, namely:-



- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavit;
- (d) issuing commissions for the examination of witnesses or documents;
- (e) requisitioning, subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), any public record or document or copy of such record or document from any office.

### **THE FACTORIES ACT, 1948**

According to Section 9 of the Factories Act, 1948, an Inspector may exercise any of the following powers within the local limits for which he is appointed:

1. He can enter any place which is used or which, he has reasons to believe, is used as a factory.
2. He can make examination of the premises, plant, machinery, article or substance. Inquire into any accident or dangerous occurrence whether resulting in bodily injury, disability or not, and take on the spot or otherwise statements of any person which he may consider necessary for such inquiry.
3. Require the production of any prescribed register or any other document relating to the factory. Seize, or take copies of any register, record of other document or any portion thereof.
4. Take measurement and photographs and make such recordings as he considers necessary for the purpose of any examination.
5. In case of any article or substance found in any premises, being an article or substance which appears to him as having caused or is likely to cause danger to the health or safety of the workers, direct it to be dismantled or subject it to any process or test (but not so as to damage or destroy it unless the same is in the circumstances necessary, for carrying out the purposes of this Act) and take possession of any such article or substance or a part thereof, and detain it for so long as is necessary for such examination.

### **Production of Documents**

The Factories Act requires the maintenance of certain registers and records. Inspectors have been empowered to ask for the production of any such documents maintained under law, and the non-compliance of this has been made an offence.

### **Power of Central Government to appoint Inquiry Committee**

According to Section 41D(1) of the Act, the Central Government may, in event of the occurrence of an extraordinary situation involving a factory engaged in a hazardous process, appoint an Inquiry Committee to inquire into the standards of health and safety observed in the factory with a view to finding out the causes of any failure or neglect in the adoption of any measures or standards prescribed for the health and safety of the workers employed in the factory or the general public affected, or likely to be affected, due to such failure or neglect and for the prevention and recurrence of such extraordinary situations in future in such factory or elsewhere.

(2) The Committee appointed under sub-section (1) shall consist of a Chairman and two other members and the terms of reference of the Committee and the tenure of office of its members shall be such as may be determined by the Central Government according to the requirements of the situation.

(3) The recommendations of the Committee shall be advisory in nature.

## **GOODS AND SERVICES TAX ACT, 2017**

### **Power of Inspection, Search and Seizure**

#### **Power of Inspection**

According to Section 67(1) of the CGST Act, (1) where the proper officer, not below the rank of Joint Commissioner, has reasons to believe that –

- (a) a taxable person
  - a. has suppressed any transaction relating to supply of goods or services or both or the stock of goods in hand, or
  - b. has claimed input tax credit in excess of his entitlement under this Act or
  - c. has indulged in contravention of any of the provisions of this Act or the rules made thereunder to evade tax under this Act; or
- (b) any person engaged in the business of transporting goods or an owner or operator of a warehouse or a godown or any other place –
  - a. is keeping goods which have escaped payment of tax or has kept his accounts or
  - b. goods in such a manner as is likely to cause evasion of tax payable under this Act,

he may authorize in writing any other officer of central tax to inspect any places of business of the taxable person or the persons engaged in the business of transporting goods or the owner or the operator of warehouse or godown or any other place.

### **Power to Search and Seizure**

According to Section 67(1), where the proper officer, not below the rank of Joint Commissioner, either pursuant to an inspection carried out under sub-section (1) or otherwise, has reasons to believe that any goods liable to confiscation or any documents or books or things, which in his opinion shall be useful for or relevant to any proceedings under this Act, are secreted in any place, he may authorize in writing any other officer of central tax to search and seize or may himself search and seize such goods, documents or books or things.

### **Order not to remove**

According to first proviso to Section 67(2), where it is not practicable to seize any such goods, the proper officer, or any officer authorized by him, may serve on the owner or the custodian of the goods an order that he shall not remove, part with, or otherwise deal with the goods except with the previous permission of such officer.

### **Duration of Seizure**

According to Second Proviso to Section 67(2), the documents or books or things so seized shall be retained by such officer only for so long as may be necessary for their examination and for any inquiry or proceedings under this Act.

### **Return of documents not relied upon**

The documents, books or things referred to in sub-section (2) or any other documents, books or things produced by a taxable person or any other person, which have not been relied upon for the issue of notice under this Act

or the rules made thereunder, shall be returned to such person within a period not exceeding thirty days of the issue of the said notice.

### **Power to Seal**

According to Section 67(4), the officer authorized under sub-section (2) shall have the power to seal or break open the door of any premises or to break open any almirah, electronic devices, box, receptacle in which any goods, accounts, registers or documents of the person are suspected to be concealed, where access to such premises, almirah, electronic devices, box or receptacle is denied.

### **Right to keep copies**

According to section 67(5), the person from whose custody any documents are seized under sub-section (2) shall be entitled to make copies thereof or take extracts therefrom in the presence of an authorized officer at such place and time as such officer may indicate in this behalf except where making such copies or taking such extracts may, in the opinion of the proper officer, prejudicially affect the investigation.

### **Release on Bond**

According to Section 67(6), the goods so seized under sub-section (2) shall be released, on a provisional basis, upon execution of a bond and furnishing of a security, in such manner and of such quantum, respectively, as may be prescribed or on payment of applicable tax, interest and penalty payable, as the case may be.

### **Return when no notice issued**

According to Section 67(7), where any goods are seized under sub-section (2) and no notice in respect thereof is given within six months of the seizure of the goods, the goods shall be returned to the person from whose possession they were seized.

The period of six months may, on sufficient cause being shown, be extended by the proper officer for a further period not exceeding six months.

### **Goods of perishable or hazardous nature**

According to section 67(8), the Government may, having regard to the perishable or hazardous nature of any goods, depreciation in the value of the goods with the passage of time, constraints of storage space for the goods or any other relevant considerations, by notification, specify the goods or class of goods which shall, as soon as may be after its seizure under sub-section (2), be disposed of by the proper officer.

According to Section 67(9), where any goods, being goods specified under sub-section (8), have been seized by a proper officer, or any officer authorized by him under sub-section (2), he shall prepare an inventory of such goods.

### **Applicability of Code of Criminal Procedure, 1973**

According to Section 67(10), the provisions of the Code of Criminal Procedure, 1973, relating to search and seizure, shall, so far as may be, apply to search and seizure under this section subject to the modification that sub-section (5) of section 165 of the said Code shall have effect as if for the word "Magistrate", wherever it occurs, the word "Commissioner" were substituted.

### **Seize the accounts, registers or documents**

According to Section 67(11), where the proper officer has reasons to believe that any person has evaded or is attempting to evade the payment of any tax, he may, for reasons to be recorded in writing, seize the accounts, registers or documents of such person produced before him and shall grant a receipt for the same, and shall

retain the same for so long as may be necessary in connection with any proceedings under this Act or the rules made thereunder for prosecution.

### **Purchase to check issue of tax invoice**

The Commissioner or an officer authorized by him may cause purchase of any goods or services or both by any person authorized by him from the business premises of any taxable person, to check the issue of tax invoices or bills of supply by such taxable person, and on return of goods so purchased by such officer, such taxable person or any person in charge of the business premises shall refund the amount so paid towards the goods after cancelling any tax invoice or bill of supply issued earlier.

### **Inspection of Goods in Movement**

According to Section 68(1), the Government may require the person in charge of a conveyance carrying any consignment of goods of value exceeding such amount as may be specified to carry with him such documents and such devices.

According to Section 68(2), the details of documents required to be carried under sub-section (1) shall be validated in such manner.

According to Section 68(3), where any conveyance referred to in sub-section (1) is intercepted by the proper officer at any place, he may require the person in charge of the said conveyance to produce the documents prescribed under the said sub-section and devices for verification, and the said person shall be liable to produce the documents and devices and also allow the inspection of goods.

### **Power to Arrest**

According to Section 69(1), where the Commissioner has reasons to believe that a person has committed any offence specified in clause (a) or clause (b) or clause (c) or clause (d) of sub-section (1) of section 132 which is punishable under clause (i) or (ii) of sub-section (1), or sub-section (2) of the said section, he may, by order, authorize any officer of central tax to arrest such person.

According to section 69(2), where a person is arrested under sub-section (1) for an offence specified under subsection (5) of section 132, the officer authorized to arrest the person shall inform such person of the grounds of arrest and produce him before a Magistrate within twenty-four hours.

### **Bail of arrested person**

According to Section 69(3), subject to the provisions of the Code of Criminal Procedure, 1973, –

- (a) where a person is arrested under sub-section (1) for any offence specified under sub-section (4) of section 132, he shall be admitted to bail or in default of bail, forwarded to the custody of the Magistrate;
- (b) in the case of a non-cognizable and bailable offence, the Deputy Commissioner or the Assistant Commissioner shall, for the purpose of releasing an arrested person on bail or otherwise, have the same powers and be subject to the same provisions as an officer-in-charge of a police station.

### **Power to summon a person**

According to Section 70(1), the proper officer under this Act shall have power to summon any person whose attendance he considers necessary either to give evidence or to produce a document or any other thing in any inquiry in the same manner, as provided in the case of a civil court under the provisions of the Code of Civil Procedure, 1908.

According to Section 70(2), every such inquiry referred to in sub-section (1) shall be deemed to be a “judicial proceedings” within the meaning of section 193 and section 228 of the Indian Penal Code.

### **Access to business premises**

According to section 71(1), Any officer under this Act, authorized by the proper officer not below the rank of Joint Commissioner, shall have access to any place of business of a registered person to inspect books of account, documents, computers, computer programs, computer software whether installed in a computer or otherwise and such other things as he may require and which may be available at such place, for the purposes of carrying out any audit, scrutiny, verification and checks as may be necessary to safeguard the interest of revenue.

### **Duty of person in charge**

Every person in charge of place referred to in sub-section (1) shall, on demand, make available to the officer authorized under sub-section (1) or the audit party deputed by the proper officer or a cost accountant or chartered accountant nominated under section 66 –

- (i) such records as prepared or maintained by the registered person and declared to the proper officer in such manner as may be prescribed;
- (ii) trial balance or its equivalent;
- (iii) statements of annual financial accounts, duly audited, wherever required;
- (iv) cost audit report, if any, under section 148 of the Companies Act, 2013;
- (v) the income-tax audit report, if any, under section 44AB of the Income-tax Act, 1961; and
- (vi) any other relevant record,

for the scrutiny by the officer or audit party or the chartered accountant or cost accountant within a period not exceeding fifteen working days from the day when such demand is made, or such further period as may be allowed by the said officer or the audit party or the chartered accountant or cost accountant.

### **Officers required to assist CGST/SGST officers**

According to Section 72(1), all officers of Police, Railways, Customs, and those officers engaged in the collection of land revenue, including village officers, officers of State tax and officers of Union territory tax shall assist the proper officers in the implementation of this Act.

According to Section 72(2), The Government may, by notification, empower and require any other class of officers to assist the proper officers in the implementation of this Act when called upon to do so by the Commissioner.

## **INCOME TAX ACT, 1962**

### **Power regarding discovery, production of evidence, etc.**

According to Section 131(1), the Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeals), Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and the Dispute Resolution Panel referred to in clause (a) of sub-section (15) of section 144C shall, for the purposes of this Act, have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (5 of 1908), when trying a suit in respect of the following matters, namely :—

- (a) discovery and inspection;
- (b) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

- (c) compelling the production of books of account and other documents; and
- (d) issuing commissions.

According to Section 131(1A), If the Principal Director General or Director General or Principal Director or Director or Joint Director or Assistant Director or Deputy Director, or the authorized officer referred to in sub-section (1) of section 132 before he takes action under clauses (i) to (v) of that sub-section, has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, then, for the purposes of making any enquiry or investigation relating thereto, it shall be competent for him to exercise the powers conferred under sub-section (1) on the income-tax authorities referred to in that sub-section, notwithstanding that no proceedings with respect to such person or class of persons are pending before him or any other income-tax authority.

According to Section 131(2), for the purpose of making an inquiry or investigation in respect of any person or class of persons in relation to an agreement referred to in section 90 or section 90A, it shall be competent for any income-tax authority not below the rank of Assistant Commissioner of Income-tax, as may be notified by the Board in this behalf, to exercise the powers conferred under sub-section (1) on the income-tax authorities referred to in that sub-section, notwithstanding that no proceedings with respect to such person or class of persons are pending before it or any other income-tax authority.

According to Section 131(3), Subject to any rules made in this behalf, any authority referred to in sub-section (1) or sub-section (1A) or sub-section (2) may impound and retain in its custody for such period as it thinks fit any books of account or other documents produced before it in any proceeding under this Act.

According to Proviso to Section 131(3), an Assessing Officer or an Assistant Director or Deputy Director shall not –

- (a) impound any books of account or other documents without recording his reasons for so doing, or
- (b) retain in his custody any such books or documents for a period exceeding fifteen days (exclusive of holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner or Principal Director or Director therefor, as the case may be.

### Search and seizure

According to Section 132(1), search and seizure may take place where the Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner or Additional Director or Additional Commissioner or Joint Director or Joint Commissioner in consequence of information in his possession, has reason to believe that –

- (a) any person to whom a summons under sub-section (1) of section 37 of the Indian Income Tax Act, 1922 (11 of 1922), or under sub-section (1) of section 131 of this Act, or a notice under sub-section (4) of section 22 of the Indian Income-tax Act, 1922, or under sub-section (1) of section 142 of this Act was issued to produce, or cause to be produced, any books of account or other documents has omitted or failed to produce, or cause to be produced, such books of account or other documents as required by such summons or notice, or
- (b) any person to whom a summons or notice as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, any books of account or other documents which will be useful for, or relevant to, any proceeding under the Indian Income-tax Act, 1922 (11 of 1922), or under this Act, or
- (c) any person is in possession of any money, bullion, jewellery or other valuable article or thing and such money, bullion, jewellery or other valuable article or thing represents either wholly or partly income

or property which has not been, or would not be, disclosed for the purposes of the Indian Income-tax Act, 1922 (11 of 1922), or this Act (hereinafter in this section referred to as the undisclosed income or property).

Section 132 authorizes –

- (A) the Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, as the case may be, may authorize any Additional Director or Additional Commissioner or Joint Director, Joint Commissioner, Assistant Director or Deputy Director, Assistant Commissioner or Deputy Commissioner or Income-tax Officer, or
- (B) such Additional Director or Additional Commissioner or Joint Director, or Joint Commissioner, as the case may be, may authorize any Assistant Director or Deputy Director, Assistant Commissioner or Deputy Commissioner or Income-tax Officer,

(the officer so authorized in all cases being hereinafter referred to as the authorized officer) to do search and seizure.

These officers may –

- (i) enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such books of account, other documents, money, bullion, jewellery or other valuable article or thing are kept;
- (ii) break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred by clause (i) where the keys thereof are not available;
- (iia) search any person who has got out of, or is about to get into, or is in, the building, place, vessel, vehicle or aircraft, if the authorized officer has reason to suspect that such person has secreted about his person any such books of account, other documents, money, bullion, jewellery or other valuable article or thing;
- (iib) require any person who is found to be in possession or control of any books of account or other documents maintained in the form of electronic record as defined in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000), to afford the authorized officer the necessary facility to inspect such books of account or other documents;
- (iii) seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search, except bullion, jewellery or other valuable article or thing, being stock-in-trade of the business after making a note of inventory;
- (iv) place marks of identification on any books of account or other documents or make or cause to be made extracts or copies therefrom;
- (v) make a note or an inventory of any such money, bullion, jewellery or other valuable article or thing.

### **Extension of Jurisdiction**

According to proviso to Section 132(1), where any building, place, vessel, vehicle or aircraft referred to in clause (i) is within the area of jurisdiction of any Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, but such Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner has no jurisdiction over the person referred to in clause (a) or clause (b) or clause (c), then, notwithstanding anything contained in section 120, it shall be competent for him to exercise the powers under this sub-section in all cases where he has reason to believe that any delay in getting the authorisation from the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner having jurisdiction over such person may be prejudicial to the interests of the revenue.



**Order not to remove etc.**

According to second Proviso to Section 132(1), where it is not possible or practicable to take physical possession of any valuable article or thing and remove it to a safe place due to its volume, weight or other physical characteristics or due to its being of a dangerous nature, the authorized officer may serve an order on the owner or the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it, except with the previous permission of such authorized officer and such action of the authorized officer shall be deemed to be seizure of such valuable article or thing. Nothing contained in the second proviso shall apply in case of any valuable article or thing, being stock-in-trade of the business.

According to Section 132(3) the authorized officer may, where it is not practicable to seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing, for reasons other than those mentioned in the second proviso to sub-section (1), serve an order on the owner or the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such officer and such officer may take such steps as may be necessary for ensuring compliance with this sub-section.

Serving of an order as aforesaid under this sub-section shall not be deemed to be seizure of such books of account, other documents, money, bullion, jewellery or other valuable article or thing under clause (iii) of sub-section (1).

According to Section 132(8A), an order under sub-section (3) shall not be in force for a period exceeding sixty days from the date of the order.

**Services of any police officer or of any officer**

According to Section 132(2), the authorized officer may requisition the services of any police officer or of any officer of the Central Government, or of both, to assist him for all or any of the purposes specified in sub-section (1) or sub-section (1A) and it shall be the duty of every such officer to comply with such requisition.

**Examine on oath**

According to Section 132(4), the authorized officer may, during the course of the search or seizure, examine on oath any person who is found to be in possession or control of any books of account, documents, money, bullion, jewellery or other valuable article or thing and any statement made by such person during such examination may thereafter be used in evidence in any proceeding under the Indian Income-tax Act, 1922 (11 of 1922), or under this Act.

The examination of any person under this sub-section may be not merely in respect of any books of account, other documents or assets found as a result of the search, but also in respect of all matters relevant for the purposes of any investigation connected with any proceeding under the Indian Income-tax Act, 1922 (11 of 1922), or under this Act.

**Presumption about books**

According to Section 132(4A), where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search, it may be presumed –

- (i) that such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;
- (ii) that the contents of such books of account and other documents are true ; and
- (iii) that the signature and every other part of such books of account and other documents which purport

to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting, and in the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

### **Period for such retention**

According to Section 132(8), the books of account or other documents seized under sub-section (1) or sub-section (1A) shall not be retained by the authorized officer for a period exceeding thirty days from the date of the order of assessment under section 153A or clause (c) of section 158BC unless the reasons for retaining the same are recorded by him in writing and the approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director for such retention is obtained :

The Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director shall not authorize the retention of the books of account and other documents for a period exceeding thirty days after all the proceedings under the Indian Income Tax Act, 1922 (11 of 1922), or in respect of the years for which the books of account or other documents are relevant are completed.

### **Right to have copies of documents**

According to Section 132(9), the person from whose custody any books of account or other documents are seized under sub-section (1) or sub-section (1A) may make copies thereof, or take extracts therefrom, in the presence of the authorized officer or any other person empowered by him in this behalf, at such place and time as the authorized officer may appoint in this behalf.

### **Handling over to officer having jurisdiction**

According to Section 132(9A), Where the authorized officer has no jurisdiction over the person referred to in clause (a) or clause (b) or clause (c) of sub-section (1), the books of account or other documents, or any money, bullion, jewellery or other valuable article or thing (hereafter in this section and in sections 132A and 132B referred to as the assets) seized under that sub-section shall be handed over by the authorized officer to the Assessing Officer having jurisdiction over such person within a period of sixty days from the date on which the last of the authorisations for search was executed and thereupon the powers exercisable by the authorized officer under sub-section (8) or sub-section (9) shall be exercisable by such Assessing Officer.

### **Provisional Attachment of property**

According to Section 132(9B), where, during the course of the search or seizure or within a period of sixty days from the date on which the last of the authorisations for search was executed, the authorized officer, for reasons to be recorded in writing, is satisfied that for the purpose of protecting the interest of revenue, it is necessary so to do, he may with the previous approval of the Principal Director General or Director General or the Principal Director or Director, by order in writing, attach provisionally any property belonging to the assessee, and for the said purposes, the provisions of the Second Schedule shall, mutatis mutandis, apply.

According to Section 132(9C), every provisional attachment made under sub-section (9B) shall cease to have effect after the expiry of a period of six months from the date of the order referred to in sub-section (9B).

### **Fair Market Value**

According to section 132(9D), the authorized officer may, during the course of the search or seizure or within

a period of sixty days from the date on which the last of the authorisations for search was executed, make a reference to a Valuation Officer referred to in section 142A, who shall estimate the fair market value of the property in the manner provided under that section and submit a report of the estimate to the said officer within a period of sixty days from the date of receipt of such reference.

### Objections

According to section 132(10), If a person legally entitled to the books of account or other documents seized under sub-section (1) or sub-section (1A) objects for any reason to the approval given by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director under sub-section (8), he may make an application to the Board stating therein the reasons for such objection and requesting for the return of the books of account or other documents and the Board may, after giving the applicant an opportunity of being heard, pass such orders as it thinks fit.

### Application of Code of Criminal Procedure, 1973

According to Section 132(13), the provisions of the Code of Criminal Procedure, 1973 (2 of 1974), relating to searches and seizure shall apply, so far as may be, to searches and seizure under sub-section (1) or sub-section (1A).

### Powers to requisition books of account, etc

According to Section 132A, where the Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, in consequence of information in his possession, has reason to believe that –

- (a) any person to whom a summons under sub-section (1) of section 37 of the Indian Income-tax Act, 1922 (11 of 1922), or under sub-section (1) of section 131 of this Act, or a notice under sub-section (4) of section 22 of the Indian Income-tax Act, 1922, or under sub-section (1) of section 142 of this Act was issued to produce, or cause to be produced, any books of account or other documents has omitted or failed to produce, or cause to be produced, such books of account or other documents, as required by such summons or notice and the said books of account or other documents have been taken into custody by any officer or authority under any other law for the time being in force, or
- (b) any books of account or other documents will be useful for, or relevant to, any proceeding under the Indian Income-tax Act, 1922 (11 of 1922), or under this Act and any person to whom a summons or notice as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, such books of account or other documents on the return of such books of account or other documents by any officer or authority by whom or which such books of account or other documents have been taken into custody under any other law for the time being in force, or
- (c) any assets represent either wholly or partly income or property which has not been, or would not have been, disclosed for the purposes of the Indian Income-tax Act, 1922 (11 of 1922), or this Act by any person from whose possession or control such assets have been taken into custody by any officer or authority under any other law for the time being in force,

then, the Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may authorize any Additional Director, Additional Commissioner, Joint Director, Joint Commissioner, Assistant Director or Deputy Director, Assistant Commissioner or Deputy Commissioner or Income-tax Officer (hereafter in this section and in sub-section (2) of section 278D referred to as the requisitioning officer) to require the officer or authority referred to in clause (a) or clause (b) or clause (c), as the case may be, to deliver such books of account, other documents or assets to the requisitioning officer.

The reason to believe, as recorded by the income-tax authority under this sub-section, shall not be disclosed to any person or any authority or the Appellate Tribunal.

According to Section 132A(2), on a requisition being made under sub-section (1), the officer or authority referred to in clause (a) or clause (b) or clause (c), as the case may be, of that sub-section shall deliver the books of account, other documents or assets to the requisitioning officer either forthwith or when such officer or authority is of the opinion that it is no longer necessary to retain the same in his or its custody.

According to Section 132A(3), where any books of account, other documents or assets have been delivered to the requisitioning officer, the provisions of sub-sections (4A) to (14) (both inclusive) of section 132 and section 132B shall, so far as may be, apply as if such books of account, other documents or assets had been seized under sub-section (1) of section 132 by the requisitioning officer from the custody of the person referred to in clause (a) or clause (b) or clause (c), as the case may be, of sub-section (1) of this section and as if for the words "the authorized officer" occurring in any of the aforesaid sub-sections (4A) to (14), the words "the requisitioning officer" were substituted.

### **Application of seized or requisitioned assets**

According to Section 132B,

The assets seized under section 132 or requisitioned under section 132A may be dealt with in the following manner, namely: –

- (i) the amount of any existing liability under this Act, the Wealth-tax Act, 1957 (27 of 1957), the Expenditure-tax Act, 1987 (35 of 1987), the Gift-tax Act, 1958 (18 of 1958) and the Interest-tax Act, 1974 (45 of 1974), and the amount of the liability determined on completion of the assessment under section 153A and the assessment of the year relevant to the previous year in which search is initiated or requisition is made, or the amount of liability determined on completion of the assessment under Chapter XIV-B for the block period, as the case may be (including any penalty levied or interest payable in connection with such assessment) and in respect of which such person is in default or is deemed to be in default, or the amount of liability arising on an application made before the Settlement Commission under sub-section (1) of section 245C, may be recovered out of such assets :

Provided that where the person concerned makes an application to the Assessing Officer within thirty days from the end of the month in which the asset was seized, for release of asset and the nature and source of acquisition of any such asset is explained to the satisfaction of the Assessing Officer, the amount of any existing liability referred to in this clause may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, to the person from whose custody the assets were seized:

Provided further that such asset or any portion thereof as is referred to in the first proviso shall be released within a period of one hundred and twenty days from the date on which the last of the authorisations for search under section 132 or for requisition under section 132A, as the case may be, was executed;

- (ii) if the assets consist solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to in clause (i) and the assessee shall be discharged of such liability to the extent of the money so applied;
- (iii) the assets other than money may also be applied for the discharge of any such liability referred to in clause (i) as remains undischarged and for this purpose such assets shall be deemed to be under distraint as if such distraint was effected by the Assessing Officer or, as the case may be, the Tax Recovery Officer under authorisation from the Principal Chief Commissioner or Chief Commissioner

or Principal Commissioner or Commissioner under sub-section (5) of section 226 and the Assessing Officer or, as the case may be, the Tax Recovery Officer may recover the amount of such liabilities by the sale of such assets and such sale shall be effected in the manner laid down in the Third Schedule.

### **Preclude the recovery**

According to Section 132B(2) Nothing contained in sub-section (1) shall preclude the recovery of the amount of liabilities aforesaid by any other mode laid down in this Act.

### **Made over or paid to the persons from whom property seized**

According to Section 132B(3), any assets or proceeds thereof which remain after the liabilities referred to in clause (i) of sub-section (1) are discharged shall be forthwith made over or paid to the persons from whose custody the assets were seized.

### **Interest on asserts ceased**

According to Section 132B(4), the Central Government shall pay simple interest at the rate of one-half per cent for every month or part of a month on the amount by which the aggregate amount of money seized under section 132 or requisitioned under section 132A, as reduced by the amount of money, if any, released under the first proviso to clause (i) of sub-section (1), and of the proceeds, if any, of the assets sold towards the discharge of the existing liability referred to in clause (i) of sub-section (1), exceeds the aggregate of the amount required to meet the liabilities referred to in clause (i) of sub-section (1) of this section.

Such interest shall run from the date immediately following the expiry of the period of one hundred and twenty days from the date on which the last of the authorisations for search under section 132 or requisition under section 132A was executed to the date of completion of the assessment under section 153A or under Chapter XIV-B.

### **Power to call for information**

According to Section 133, the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals) may, for the purposes of this Act,—

- (1) require any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares;
- (2) require any Hindu undivided family to furnish him with a return of the names and addresses of the manager and the members of the family;
- (3) require any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names of the persons for or of whom he is trustee, guardian or agent, and of their addresses;
- (4) require any assessee to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage, or any annuity, not being any annuity taxable under the head “Salaries” amounting to more than one thousand rupees, or such higher amount as may be prescribed, together with particulars of all such payments made;
- (5) require any dealer, broker or agent or any person concerned in the management of a stock or commodity exchange to furnish a statement of the names and addresses of all persons to whom he or the exchange has paid any sum in connection with the transfer, whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the exchange has received any such sum, together with particulars of all such payments and receipts ;
- (6) require any person, including a banking company or any officer thereof, to furnish information in relation

to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), will be useful for, or relevant to, any enquiry or proceeding under this Act

### **Power of survey**

According to Section 133A, an income-tax authority may enter –

- (a) any place within the limits of the area assigned to him, or
- (b) any place occupied by any person in respect of whom he exercises jurisdiction, or
- (c) any place in respect of which he is authorized for the purposes of this section by such income-tax authority, who is assigned the area within which such place is situated or who exercises jurisdiction in respect of any person occupying such place,

at which a business or profession or an activity for charitable purpose is carried on, whether such place be the principal place or not of such business or profession or of such activity for charitable purpose, and require any proprietor, trustee, employee or any other person who may at that time and place be attending in any manner to, or helping in, the carrying on of such business or profession or such activity for charitable purpose—

- (i) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place,
- (ii) to afford him the necessary facility to check or verify the cash, stock or other valuable article or thing which may be found therein, and
- (iii) to furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceeding under this Act.

A place where a business or profession or activity for charitable purpose is carried on shall also include any other place, whether any business or profession or activity for charitable purpose is carried on therein or not, in which the person carrying on the business or profession or activity for charitable purpose states that any of his books of account or other documents or any part of his cash or stock or other valuable article or thing relating to his business or profession or activity for charitable purpose] are or is kept.

### **Time for survey**

According to Section 133A(2), an income-tax authority may enter any place of business or profession referred to in sub-section (1) only during the hours at which such place is open for the conduct of business or profession and, in the case of any other place, only after sunrise and before sunset.

According to Section 133A(2A), without prejudice to the provisions of sub-section (1), an income-tax authority acting under this sub-section may for the purpose of verifying that tax has been deducted or collected at source in accordance with the provisions under sub-heading B of Chapter XVII or under sub-heading BB of Chapter XVII, as the case may be, enter, after sunrise and before sunset, any office, or any other place where business or profession is carried on, within the limits of the area assigned to him, or any place in respect of which he is authorized for the purposes of this section by such income-tax authority who is assigned the area within which such place is situated, where books of account or documents are kept and require the deductor or the collector or any other person who may at that time and place be attending in any manner to such work,—

- (i) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place, and



- (ii) to furnish such information as he may require in relation to such matter.

### **Manner of survey**

According to Section 133A(3), An income-tax authority acting under this section may, –

- (i) if he so deems necessary, place marks of identification on the books of account or other documents inspected by him and make or cause to be made extracts or copies therefrom,
- (ia) impound and retain in his custody for such period as he thinks fit any books of account or other documents inspected by him.

Such income-tax authority shall not –

- (a) impound any books of account or other documents except after recording his reasons for so doing; or
- (b) retain in his custody any such books of account or other documents for a period exceeding fifteen days (exclusive of holidays) without obtaining the approval of the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General or the Principal Commissioner or the Commissioner or the Principal Director or the Director therefor, as the case may be,
- (ii) make an inventory of any cash, stock or other valuable article or thing checked or verified by him,
- (iii) record the statement of any person which may be useful for, or relevant to, any proceeding under this Act

According to Section 133A(4), An income-tax authority acting under this section shall, on no account, remove or cause to be removed from the place wherein he has entered, any cash, stock or other valuable article or thing.

According to Section 133A(5), Where, having regard to the nature and scale of expenditure incurred by an assessee, in connection with any function, ceremony or event, the income-tax authority is of the opinion that it is necessary or expedient so to do, he may, at any time after such function, ceremony or event, require the assessee by whom such expenditure has been incurred or any person who, in the opinion of the income-tax authority, is likely to possess information as respects the expenditure incurred, to furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceeding under this Act and may have the statements of the assessee or any other person recorded and any statement so recorded may thereafter be used in evidence in any proceeding under this Act.

According to Section 133A(6), if a person under this section is required to afford facility to the income-tax authority to inspect books of account or other documents or to check or verify any cash, stock or other valuable article or thing or to furnish any information or to have his statement recorded either refuses or evades to do so, the income-tax authority shall have all the powers under sub-section (1) of section 131 for enforcing compliance with the requirement made.

No action under sub-section (1) shall be taken by an Assistant Director or a Deputy Director or an Assessing Officer or a Tax Recovery Officer or an Inspector of Income-tax without obtaining the approval of the Joint Director or the Joint Commissioner, as the case may be.

### **Power to collect certain information**

According to Section 133B(1), an income-tax authority may, for the purpose of collecting any information which may be useful for, or relevant to, the purposes of this Act, enter –

- (a) any building or place within the limits of the area assigned to such authority ; or
- (b) any building or place occupied by any person in respect of whom he exercises jurisdiction,



at which a business or profession is carried on, whether such place be the principal place or not of such business or profession, and require any proprietor, employee or any other person who may at that time and place be attending in any manner to, or helping in, the carrying on of such business or profession to furnish such information.

According to Section 133B(2), an income-tax authority may enter any place of business or profession referred to in sub-section (1) only during the hours at which such place is open for the conduct of business or profession.

#### **Power to call for information by prescribed income-tax authority**

According to Section 133C(1) the prescribed income-tax authority may, for the purposes of verification of information in its possession relating to any person, issue a notice to such person requiring him, on or before a date to be specified therein, to furnish information or documents verified in the manner specified therein, which may be useful for, or relevant to, any inquiry or proceeding under this Act.

According to Section 133C(2), where any information or document has been received in response to a notice issued under sub-section (1), the prescribed income-tax authority may process such information or document and make available the outcome of such processing to the Assessing Officer.

According to Section 133C(3), the Board may make a scheme for centralized issuance of notice and for processing of information or documents and making available the outcome of the processing to the Assessing Officer.

#### **Power to inspect registers of companies**

According to Section 134, the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), or any person subordinate to him authorized in writing in this behalf by the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), may inspect, and if necessary, take copies, or cause copies to be taken, of any register of the members, debenture holders or mortgagees of any company or of any entry in such register.

#### **Power to make inquiry**

According to Section 135, The Principal Director General or Director General or Principal Director or Director, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and the Joint Commissioner shall be competent to make any enquiry under this Act, and for this purpose shall have all the powers that an Assessing Officer has under this Act in relation to the making of enquiries.

#### **Proceedings before Income Tax Authorities to be judicial proceedings**

According to Section 136, Any proceeding under this Act before an income-tax authority shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 and for the purposes of section 196 of the Indian Penal Code (45 of 1860) and every income-tax authority shall be deemed to be a Civil Court for the purposes of section 195, but not for the purposes of Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974).

#### **Disclosure of information respecting assesses**

According to Section 138(1)(a), The Board or any other income-tax authority specified by it by a general or special order in this behalf may furnish or cause to be furnished to –

- (i) any officer, authority or body performing any functions under any law relating to the imposition of any tax, duty or cess, or to dealings in foreign exchange as defined in clause (n) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999); or

- (ii) such officer, authority or body performing functions under any other law as the Central Government may, if in its opinion it is necessary so to do in the public interest, specify by notification in the Official Gazette in this behalf,

any such information received or obtained by any income-tax authority in the performance of his functions under this Act, as may, in the opinion of the Board or other income-tax authority, be necessary for the purpose of enabling the officer, authority or body to perform his or its functions under that law.

According to Section 138(1)(b) where a person makes an application to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in the prescribed form for any information relating to any assessee received or obtained by any income-tax authority in the performance of his functions under this Act, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may, if he is satisfied that it is in the public interest so to do, furnish or cause to be furnished the information asked for and his decision in this behalf shall be final and shall not be called in question in any court of law.

According to Section 138(2), the Central Government may, having regard to the practices and usages customary or any other relevant factors, by order notified in the Official Gazette, direct that no information or document shall be furnished or produced by a public servant in respect of such matters relating to such class of assessee or except to such authorities as may be specified in the order.

## THE CENTRAL BUREAU OF INVESTIGATION

The Central Bureau of Investigation is an organization established under the Delhi Special Police Establishment Act, 1946.

According to section 2 of the DSPE Act, CBI can *suo-moto* take up investigation of offences notified in section 3 only in the Union Territories.

Its basic jurisdiction is for Delhi and other Union Territories. However, in practice it investigates matters all over India on request or by extension of jurisdiction under Section 5.

Taking up investigation by CBI in the boundaries of a State requires prior consent of that State as per Section 6 of the DSPE Act. The Central Government can authorize CBI to investigate such a crime in a State but only with the consent of the concerned State Government. The Supreme Court and High Courts, however, can order CBI to investigate such a crime anywhere in the country without the consent of the State.

## Type of Investigation

CBI has grown into a multidisciplinary investigation agency over a period of time. Today it has the following three divisions for investigation of crime –

- (i) Anti-Corruption Division - for investigation of cases under the Prevention of Corruption Act, 1988 against Public officials and the employees of Central Government, Public Sector Undertakings, Corporations or Bodies owned or controlled by the Government of India - it is the largest division having presence almost in all the States of India.
- (ii) Economic Offences Division - for investigation of major financial scams and serious economic frauds, including crimes relating to Fake Indian Currency Notes, Bank Frauds and Cyber Crime.
- (iii) Special Crimes Division - for investigation of serious, sensational and organized crime under the Indian Penal Code and other laws on the requests of State Governments or on the orders of the Supreme Court and High Courts.

The laws under which CBI can investigate Crime are notified by the Central Government under section 3 of the DSPE Act. According to Section 3, The Central Government may, by notification in the Official Gazette, specify the offences or classes of offences which are to be investigated by the Delhi Special Police Establishment.

### Economic Offence Wing

Economic Offence Wings are specialized wings of state police to handle investigation of economic offences. In many state police department, the Economic Offence Wing is part of its Criminal Investigation Department (CID). Cyber Cell usually part of economic offence wing in many states.

The purpose of the Economic Offences Wing (EOW) is to prevent, detect and investigate cases of economic, cyber and Intellectual Property related crimes to ensure prompt justice and desired relief to the victims.

Economic and financial offences cover fraud, forgery and counterfeiting, offences against the legislation governing cheques (in particular forgery or use of stolen cheques), forgery or use of credit cards, undeclared employment, and offences against companies (such as misuse of company assets).

Being a specialized wing of the state Police to deal with important cases concerning multi-level-marketing frauds, share market frauds, multi-victim frauds, foreign trade related frauds, land and building rackets, offences of forgery, cheating by individuals and Non-Banking Financial Companies, cyber-crimes, offences related to Intellectual Property Rights and such like cases.

### PROFESSIONAL AND MODERN METHODS

The EOW strive to achieve excellence in the investigation of cases of economic crimes by adopting professional and modern methods by equipping ourselves with state-of-the-art knowledge and by being cognizant of the emerging trends in the field.

### PUBLIC INTEREST CASES

The EOW is sensitive towards the victims of such cases where a large number of people get duped by fraudsters and cheats and pursue such cases with vigor and zeal. We educate the public about the various modus operandi adopted by such criminals so that they don't fall prey to their evil designs.

### CYBER CRIMES

The Cyber Crime Cell of EOW strives to be pro-active in adopting modern methods of investigation by continuously upgrading its capabilities to face the challenge of ever-increasing cyber-crimes. It creates awareness amongst students and general public about such crimes.

### LESSON ROUND UP

- An investigation refers to an exploration into the affairs of a company. The main aim of such investigations is to obtain any evidence or facts regarding any malpractice in the course of business.
- Investigations may also be undertaken to identify the profits and losses of a business, the assets and liabilities and so on.
- Under the Companies Act, 2013, inspection may be ordered by registrar under sub-section (3) of section 206, by Regional Director under power delegated to it by Central Government under sub-section (5) of Section 206, and by Central Government by a general or special order.
- The Companies Act, 2013 provides for carrying out the following kinds of investigation:
  1. Investigation of the affairs of the company if it is necessary to investigate into the affairs of the company in public interest (Section 210);
  2. Investigation of the affairs of related companies (Section 219);
  3. Investigation about the ownership of a Company (Section 216)
  4. Investigation of foreign companies (Section 228)

5. Investigation by Serious Fraud Investigation Office directed by Central government under (section 212)
6. Investigation on the order of Tribunal. (Section 213)

## TEST YOURSELF

*(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)*

1. What are the objective for conducting inspection and under what circumstances the inspection can be ordered by the Registrar of Companies?
2. Describe the provisions relating to Search and Seizure under the Companies Act, 2013
3. Under what circumstances the tribunal makes order for the investigation in to the affairs of the company.
4. What are the preparatory steps for the company secretary to face investigation?
5. What are the power of the Investigation authority under the SEBI (Prohibition of Fraudulent And Unfair Trade Practices relating to Securities Market) Regulations, 2003.
6. What is the distinction in law between 'Seizure' and 'Detention' under GST Laws?

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# Lesson 6

## Adjudication, Prosecutions, Offences and Penalties

### LESSON OUTLINE

- Introduction
- Penalties under the Act
- Permission of the Special Court
- Adjudication
- The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974
- Attachment, Adjudication and Confiscation under Prevention of Money Laundering Act (PMLA), 2002
- Summons, Searches and Seizures under PMLA
- Appellate Tribunal under PMLA
- Special Courts under PMLA
- LESSON ROUND UP
- TEST YOURSELF

### LEARNING OBJECTIVES

In this chapter, students will learn and analyze:

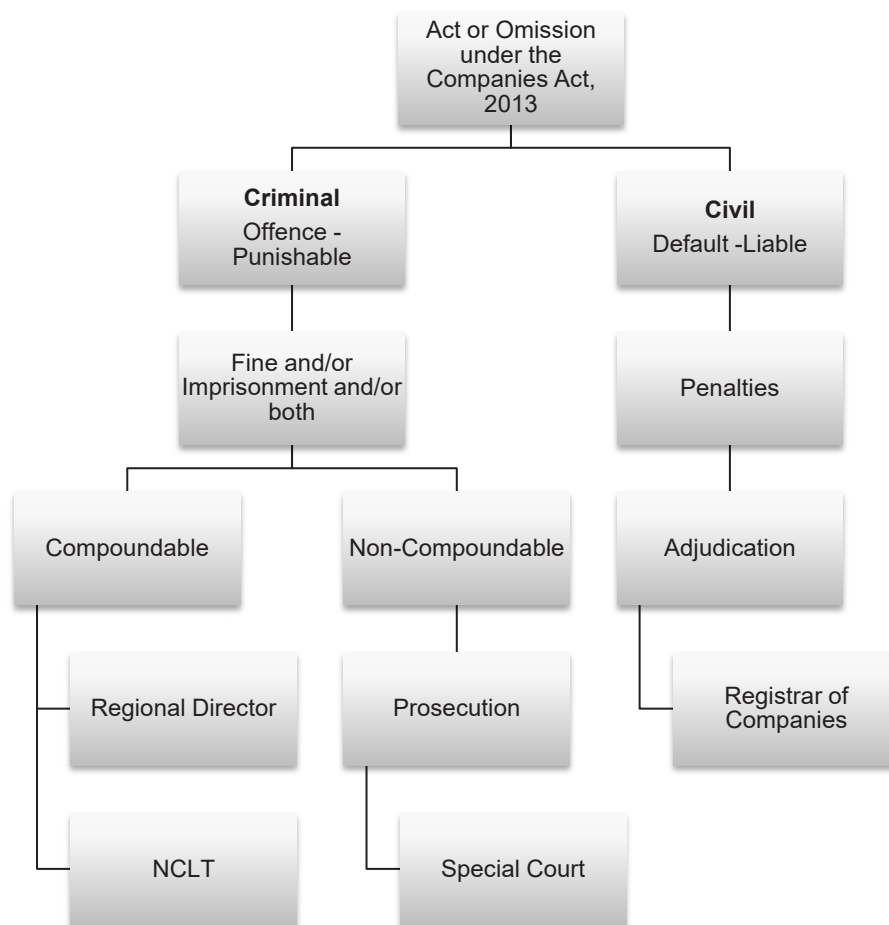
- To understand the concept of better corporate compliance, ensured the Companies Act, 2013 by promulgation of the Companies (Amendment) Act, 2019 to reclassify and decriminalize certain procedural or technical non-compliances.
- To learn upon the substantive provisions of the various corporate laws (concerning the offences and defaults by the companies and officers in default)
- To know and analyse the Adjudication mechanism under the respective Act.

## INTRODUCTION

Before we analyse the provisions of the Act, let us first understand the meaning of terms - civil law and criminal law. A civil law is that branch of law which deals with private disputes or defaults with an objective to resolve or redress and to make good the loss or damages suffered by one party on account of any act or omission by other party. On the other hand, a criminal law is that branch of law which deals with offences with an objective to punish the offender and is reflection of the public policy of a country. An offence is an act or omission made punishable by any law, whereas a default is a non-compliance of any provision of law whether it be an omission to act or failure to act within the time. The nature of any act or omission, its gravity and its impact on general public or affected persons are some of the key factors which a legislature will take into consideration before classifying any act or omission as an offence or as a default.

Whether the Companies Act, 2013 ("**Act**") is a civil law or criminal law? The answer is - its mixture of both civil as well as criminal provisions with majority being criminal. The civil and criminal provisions under the Act can be identified by observing the language used by Act for consequences of non-compliances/contravention of its provisions. The words "**liable to penalties**" denote civil nature of non-compliances whereas the words "**punishable with fine and/or imprisonment and/or both**" denote criminal nature of non-compliances.

The Act has clearly laid down the mechanism and the forum for speedy and smooth administration of judicial activities under the Act. The power of adjudication of civil non-compliances (defaults liable for penalties) is being vested with the ROC and the power of adjudication of criminal non-compliances (offences punishable with fine/imprisonment) is being vested with the special courts with sub-delegation of power of compounding of offences to Regional Director and NCLT. The broad judicial structure of the Act is depicted herein below:





## PENALTIES UNDER THE ACT

Considering the non-compliance being procedural or technical or minor in nature, the Act has classified 35 instances of non-compliance as civil defaults liable for prescribed amount of penalties. These 35 instances include 16 instances which have recently been decriminalized pursuant to Companies (Amendment) Act, 2019

Pursuant to provisions of section 454A of the Act, the amount of penalty payable for any second or subsequent defaults shall be twice the amount prescribed under the Act in case the same default has been committed again within a period of 3 years from the date of order imposing penalty for the first or earlier default.

Further, in addition to imposing of penalties, the Act also contains certain provisions providing for civil liability of making good the loss or damages suffered by any person on account of any action or omission. For e.g. section 35 - civil liability for misstatement in prospectus, section 147(3) - civil liability of auditors for misleading statement in audit reports etc.

It is important to note that the default or non-compliances of provisions of the Act also attracts restrictions, ineligibility or withdrawal of benefits provided under the Act in addition to liability to pay penalties. For e.g. default or failure in compliance with the provisions of section 92 (Annual Return) and/or 137(filing of financial statements) will, depending upon the period of default or failure, result into a) withdrawal of exemptions available to a private company, b) company becoming ineligible to undertake buy-back of its equity shares or other specified securities, c) disqualification of directors, and d) company being classified into an inactive company.

### Adjudication of penalties

Section 454 of the Act read with the Companies (Adjudication of Penalties) Rules, 2014 deals with the manner and procedure of adjudication of penalties. The Registrar of Companies (ROC) has been shouldered with the responsibility of adjudicating officer for their respective jurisdiction. The Act envisages a natural justice based mechanism of adjudication of penalties whereby the ROC has been mandated to provide reasonable opportunity of being heard to the Company and Officer in default before imposing any penalty. In case any person is aggrieved by order of the ROC imposing penalties, he may prefer an appeal to the concerned regional director within a period of 60 days and the decision of regional director on the matter shall be final and binding.

Although the Act has provided the ROC with the power to adjudicate the penalties, yet a question still revolves around such power of the ROC, i.e., whether the power of the ROC under section 454 is subject to any period of limitation and whether the provisions of Limitation Act, 1963 will be applicable to the action of the ROC?

### Adjudication of Penalties [Section 454]

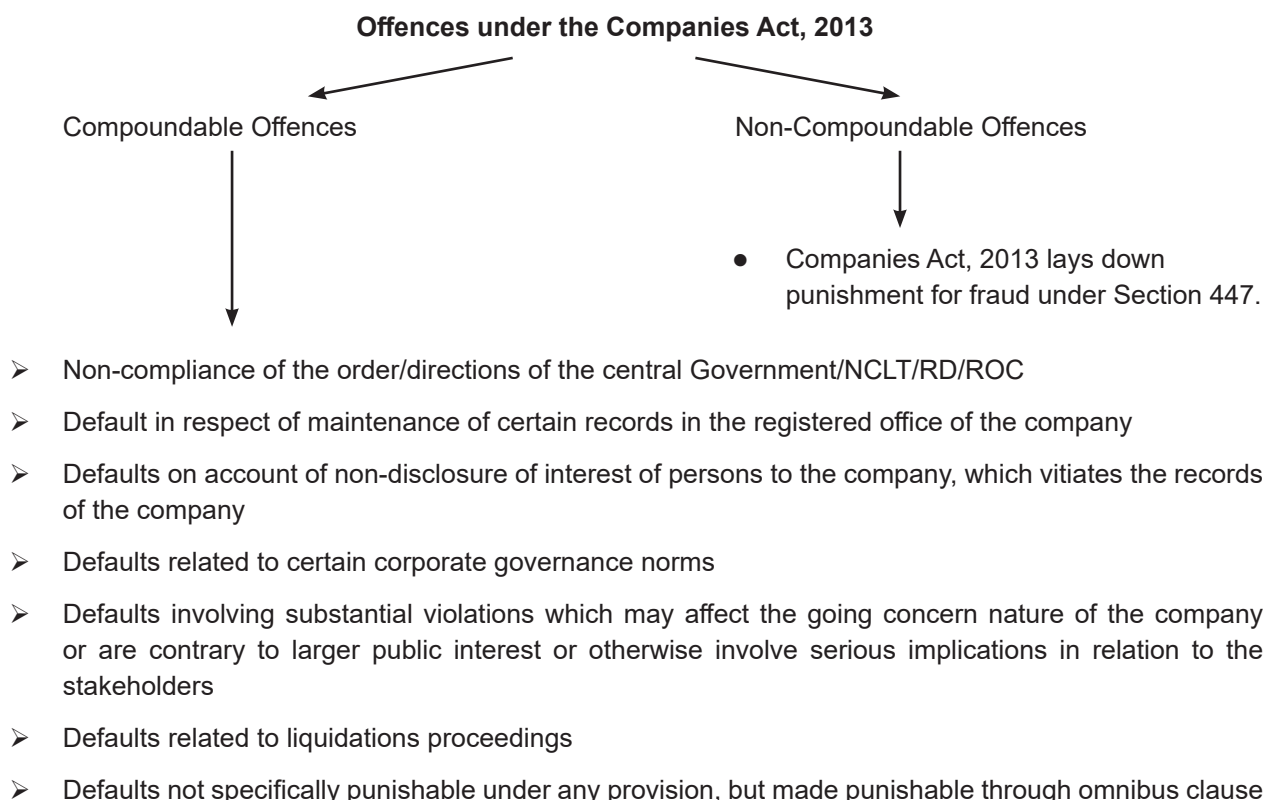
- The Central Government may appoint as many officers of the Central Government not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of this Act in the manner as may be prescribed.
- The adjudicating officer may, by an order-
  - (a) impose the penalty on the company, the officer who is in default, or any other person, as the case may be, stating therein any non-compliance or default under the relevant provisions of this Act; and
  - (b) direct such company, or officer who is in default, or any other person, as the case may be, to rectify the default, wherever he considers fit.
- The adjudicating officer shall, before imposing any penalty, give a reasonable opportunity of being heard to such company, the officer who is in default or any other person

- Any person aggrieved by an order made by the adjudicating officer may prefer an appeal to the Regional Director having jurisdiction in the matter.
- Every appeal shall be filed within sixty days from the date on which the copy of the order made by the adjudicating officer is received by the aggrieved person and shall be in such form, manner and be accompanied by such fees as may be prescribed.
- The Regional Director may, after giving the parties to the appeal an opportunity of being heard, pass such order as he thinks fit, confirming, modifying or setting aside the order appealed against.
- Where company fails to comply with the order within a period of ninety days from the date of the receipt of the copy of the order, the company shall be punishable with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees.
- Where an officer of a company or any other person who is in default fails to comply with the order within a period of ninety days from the date of the receipt of the copy of the order, such officer shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

### Penalties for Repeated Default [Section 454A]

Where a company or an officer of a company or any other person having already been subjected to penalty for default under any provisions of this Act, again commits such default within a period of three years from the date of order imposing such penalty passed by the adjudicating officer or the Regional Director, as the case may be, it or he shall be liable for the second or subsequent defaults for an amount equal to twice the amount of penalty provided for such default under the relevant provisions of this Act.

### Offences under the Act



**Section 439(1) provides that every offence under Companies Act, 2013 except the offences referred to in sub-section (6) of section 212 shall be deemed to be non-cognizable within the meaning of the said Code.**

(2) No court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder or a member of the company, or of a person authorised by the Central Government in that behalf:

Provided that the court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorised by the Securities and Exchange Board of India:

Provided further that nothing in this sub-section shall apply to a prosecution by a company of any of its officers.]

(3) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, where the complainant under sub-section (2) is the Registrar or a person authorised by the Central Government, the presence of such officer before the Court trying the offences shall not be necessary unless the court requires his personal attendance at the trial.

(4) The provisions of sub-section (2) shall not apply to any action taken by the liquidator of a company in respect of any offence alleged to have been committed in respect of any of the matters in Chapter XX or in any other provision of this Act relating to winding up of companies.

*Explanation.* – The liquidator of a company shall not be deemed to be an officer of the company within the meaning of sub-section (2).

**Section 440 provides that** any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be tried by a Court of Session or the Court of Metropolitan Magistrate or a Judicial Magistrate of the First Class, as the case may be exercising jurisdiction over the area, notwithstanding anything contained in the Code of Criminal Procedure, 1973:

Provided that nothing contained in this section shall affect the powers of the High Court under section 407 of the Code to transfer any case or class of cases taken cognizance by a Court of Session or the Court of Metropolitan Magistrate or a Judicial Magistrate of the First Class, as the case may be under this section.

### **Offences to be Cognizable and Non-Bailable under Companies Act, 2013**

Notwithstanding anything in the Code of Criminal Procedure, 1973, every offence under the Companies Act, 2013 except the offences referred to in sub-section (6) of section 212 shall be deemed to be non-cognizable within the meaning of the said Code

Section 212(6) provide, offence covered under section 447 of Companies Act ,2013 shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless-

- (i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and
- (ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail:

Provided that a person, who, is under the age of sixteen years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs:

Provided further that the Special Court shall not take cognizance of any offence referred to this sub-section except upon a complaint in writing made by –

- (i) the Director, Serious Fraud Investigation Office; or

- (ii) any officer of the Central Government authorized, by a general or special order in writing in this behalf by that Government.

Except for 35 instances of defaults listed herein, all other acts or omissions under the Act have been classified as offences punishable with a) fine only, or b) fine or imprisonment, or c) fine or imprisonment or both, or d) imprisonment only or e) fine and imprisonment as may be prescribed under the relevant sections. Further, wherever any section of the Act is silent on quantum of punishment or penalty for non-compliances of such section, section 450 of the Act comes into play and makes all such non-compliances punishable with fine which may extend to Rs. 10,000 and in case of continuous contravention, a further fine of which may extend to Rs. 1,000 per day after the first during which the contravention continues. Consequently, the general character of the Act remains criminal.

Broadly the offences under the Act are classified, for the purpose of punishment, into two categories, namely, –

- a) offences involving frauds and b) other offences. The offences involving frauds are subject to punishment prescribed under section 447 of the Act. There are 17 sections under the Act which refer to section 447 for punishing fraudulent conduct (Source: Report of Offence Review Committee). The other offences are punishable with such quantum of fine and/or imprisonment as prescribed under the respective sections.

Further, the offences under Act are also classified into a) compoundable offences and b) non-compoundable offence. In accordance with section 441(6) of the Act, an offence punishable under the Act with imprisonment only or with imprisonment and also with fine is a non-compoundable offence. Accordingly, all other offences, i.e., offences punishable with a) fine only, or b) fine or imprisonment and c) fine or imprisonment or both are compoundable offences under the Act.

### **Section 447 – Punishment for frauds**

Fraud in relation to affairs of a company or any body corporate, includes:-

- (i) any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;
- (ii) “wrongful gain” means the gain by unlawful means of property to which the person gaining is not legally entitled;
- (iii) “wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.

**Section 447** stipulates that without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud 1[involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower] shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

However where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

However where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to 4[3[2[fifty lakh rupees]]] or with both.]

The punishment of offences involving frauds is briefly outlined below:

Material Frauds not involving public interest	Imprisonment for a term which shall not be less than 6 months but which may extend to 10 years and fine which shall not be less than the amount involved the fraud, but which may extend to three times the amount involved in the frauds.
Material Frauds involving public interest	Imprisonment for a term which shall not be less than 3 years but which may extend to 10 years and fine which shall not be less than the amount involved the fraud, but which may extend to three times the amount involved in the frauds.
Other Frauds not involving public interest	Imprisonment for a term which may extend to five years or fine which may extend to 50 lakh* rupees or both.

**Note:** *Material Frauds means the fraud involving an amount of at least 10 lakh rupees or 1% of the turnover the company, whichever is lower.*

It is important to note that pursuant to provisions of section 441 of the Act, the offences involving material frauds are non-compoundable offences and pursuant to provisions of section 439 of the Act, all the offences involving frauds are cognizable offences within the meaning of Code of Criminal Procedure, 1973.

#### Section 448 – Punishment for False Statement

If in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement,—

- (a) which is false in any material particulars, knowing it to be false; or
- (b) which omits any material fact, knowing it to be material,

**He shall be liable under Section 447.**

#### Section 449 – Punishment for False Evidence

If any person intentionally gives false evidence –

- (a) upon any examination on oath or solemn affirmation, authorized under this Act; or
- (b) in any affidavit, deposition or solemn affirmation, in or about the winding up of any company under this Act, or otherwise in or about any matter arising under this Act,

**He shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to seven years and with fine which may extend to ten lakh rupees.**

#### Section 450 – Punishment where No specific Penalty or Punishment is Provided

If a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made thereunder, or any condition, limitation or restriction subject to which any approval, sanction, consent, confirmation, recognition, direction or exemption in relation to any matter has been accorded, given or granted, and for which no penalty or punishment is provided elsewhere in this Act, the company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to ten thousand rupees, and where the contravention is continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the contravention continues.

### **Section 451 – Punishment in case of Repeated Default**

If a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.

### **Section 452 – Punishment for wrongful withholding of property**

If any officer or employee of a company –

- (a) wrongfully obtains possession of any property, including cash of the company; or
- (b) having any such property including cash in his possession, wrongfully withholds it or knowingly applies it for the purposes other than those expressed or directed in the articles and authorised by this Act,

he shall, on the complaint of the company or of any member or creditor or contributory thereof, be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

The Court trying an offence under sub-section (1) may also order such officer or employee to deliver up or refund, within a time to be fixed by it, any such property or cash wrongfully obtained or wrongfully withheld or knowingly misapplied, the benefits that have been derived from such property or cash or in default, to undergo imprisonment for a term which may extend to two years.

### **Section 453 – Punishment for Improper use of “Limited” or “Private Limited”**

If any person or persons trade or carry on business under any name or title, of which the word “Limited” or the words “Private Limited” or any contraction or imitation thereof is or are the last word or words, that person or each of those persons shall, unless duly incorporated with limited liability, or unless duly incorporated as a private company with limited liability, as the case may be, punishable with fine which shall not be less than five hundred rupees but may extend to two thousand rupees for every day for which that name or title has been used.

### **Judicial structure for dealing with Offences under the Act**

Pursuant to section 435 of the Act, the special courts established or designated by the central government have only been given power to prosecute and try offences punishable under the Act. However, in order to avoid lengthy and time consuming prosecution, the Act has envisaged the mechanism for compounding of offences under section 441 of the Act and has empowered the regional directors and NCLTs to exercise such compounding power. The brief judicial structure of the Act concerning offences is depicted below:

**Section 435(1)** stipulates that the Central Government for the purpose of providing speedy trial of offences may establish or designate as many Special Courts as may be necessary by notification.

(2) A Special Court shall consist of –

- (a) a single judge holding office as Session Judge or Additional Session Judge, in case of offences punishable under this Act with imprisonment of two years or more; and
- (b) a Metropolitan Magistrate or a Judicial Magistrate of the First Class, in the case of other offences,

who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

**Section 436(1)** states that notwithstanding anything contained in the Code of Criminal Procedure, 1973, –

- (a) all offences specified under sub-section (1) of section 435 shall be triable only by the Special Court established for the area in which the registered office of the company in relation to which the offence is



committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned;

- (b) where a person accused of, or suspected of the commission of, an offence under this Act is forwarded to a Magistrate under sub-section (2) or sub-section (2A) of section 167 of the Code of Criminal Procedure, 1973, such Magistrate may authorise the detention of such person in such custody as he thinks fit for a period not exceeding fifteen days in the whole where such Magistrate is a Judicial Magistrate and seven days in the whole where such Magistrate is an Executive Magistrate:

Provided that where such Magistrate considers that the detention of such person upon or before the expiry of the period of detention is unnecessary, he shall order such person to be forwarded to the Special Court having jurisdiction;

- (c) the Special Court may exercise, in relation to the person forwarded to it under clause (b), the same power which a Magistrate having jurisdiction to try a case may exercise under section 167 of the Code of Criminal Procedure, 1973 in relation to an accused person who has been forwarded to him under that section; and
- (d) a Special Court may, upon perusal of the police report of the facts constituting an offence under this Act or upon a complaint in that behalf, take cognizance of that offence without the accused being committed to it for trial.

(2) When trying an offence under this Act, a Special Court may also try an offence other than an offence under this Act with which the accused may, under the Code of Criminal Procedure, 1973 be charged at the same trial.

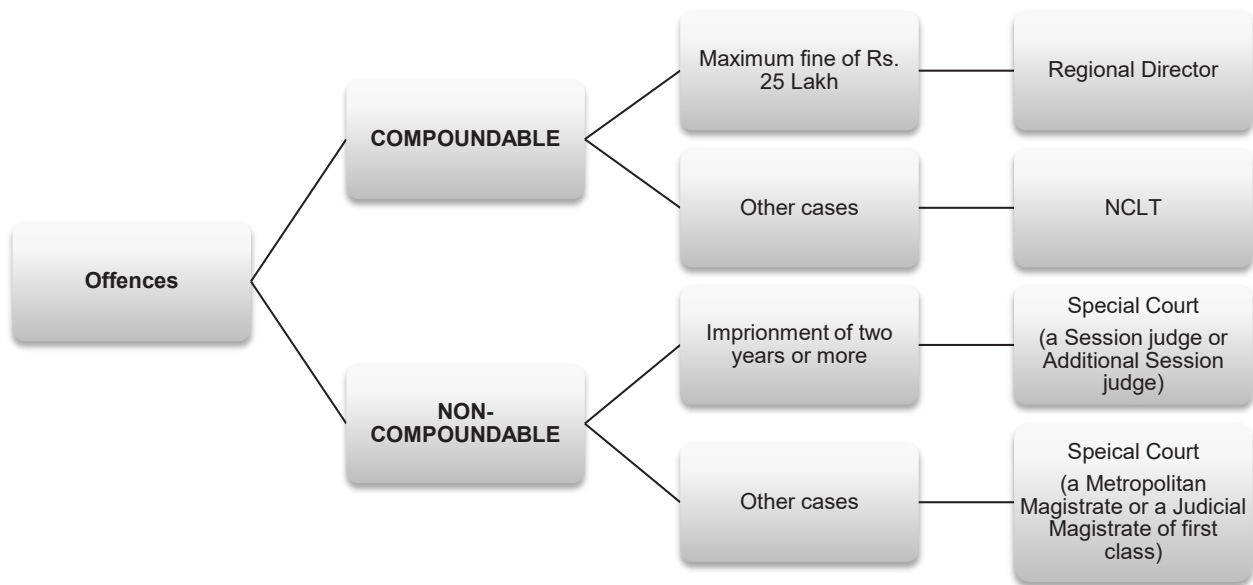
(3) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Special Court may, if it thinks fit, try in a summary way any offence under this Act which is punishable with imprisonment for a term not exceeding three years:

Provided that in the case of any conviction in a summary trial, no sentence of imprisonment for a term exceeding one year shall be passed:

Provided further that when at the commencement of, or in the course of, a summary trial, it appears to the Special Court that the nature of the case is such that the sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Special Court shall, after hearing the parties, record an order to that effect and thereafter recall any witnesses who may have been examined and proceed to hear or rehear the case in accordance with the procedure for the regular trial.

- The High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX of the Code of Criminal Procedure, 1973 on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.
- The provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session or the court of Metropolitan Magistrate or a Judicial Magistrate of the First Class, as the case may be] and the person conducting a prosecution before a Special Court shall be deemed to be a Public Prosecutor.





### Section 403 – Be cautious!!

Any document, required to be submitted, filed, registered or recorded, or any fact or information required or authorised to be registered shall be submitted, filed, registered or recorded within the time specified in the relevant provision on payment of such fee as may be prescribed.

However where any document, fact or information required to be submitted, filed, registered or recorded, as the case may be, under section 92 or 137 is not submitted, filed, registered or recorded, as the case may be, within the period provided in those sections, without prejudice to any other legal action or liability under this Act, it may be submitted, filed, registered or recorded, as the case may be, after expiry of the period so provided in those sections, on payment of such additional fee as may be prescribed, which shall not be less than one hundred rupees per day and different amounts may be prescribed for different classes of companies.

However where the document, fact or information, as the case may be, in cases other than referred as above is not submitted, filed, registered or recorded, as the case may be, within the period provided in the relevant section, it may, without prejudice to any other legal action or liability under this Act, be submitted, filed, registered or recorded as the case may be, on payment of such additional fee as may be prescribed and different fees may be prescribed for different classes of companies.

However where there is default on two or more occasions in submitting, filing, registering or recording of the document, fact or information, it may, without prejudice to any other legal action or liability under this Act, be submitted, filed, registered or recorded, as the case may be, on payment of a higher additional fee, as may be prescribed and which shall not be lesser than twice the additional fee provided under the first or the second proviso as applicable.

Where a company fails or commits any default to submit, file, register or record any document, fact or information as above before the expiry of the period specified in the relevant section, the company and the officers of the company who are in default, shall, without prejudice to the liability for the payment of fee and additional fee, be liable for the penalty or punishment provided under this Act for such failure or default.

One of the significant changes brought in by the Companies (Amendment) Act, 2017 is the amendment in section 403 of the Companies Act, 2013. Pursuant to said amendment, the non-offence period of 270 days has been omitted from the Companies Act, 2013 and the filing of forms, returns or documents within the time prescribed under the relevant provision has been made mandatory. Accordingly, the non-filing of forms, returns or documents within the time prescribed under relevant provision (for e.g., Form AOC-4 within 30 days of date

of AGM) is now considered as a default or failure and the payment of additional fees does not absolve the Company from the liability of penalty or any other action under the Act for such default or failure.

This provision has far reaching impact on the level of compliances of Indian corporates. It is noteworthy, specifically for private companies, as default in compliance with the provisions of section 92 or section 137 will take away the exemption benefits available to such private companies besides any other action for such default.

### **Role of Company Secretary**

The Company Secretary has a vital role to play in the event of invocation any action under the Act. The current regulatory scenario demands the Company Secretary be more vigilant and diligent specifically about the applicability of multiple laws and timely compliances there under. The role which a Company Secretary can play is briefly discussed below:

1. To ensure timely compliances of the provisions of the Act to avoid any action for default or failure;
2. To represent the Company before the ROC, RD or NCLT, in the event of any action for default or failure;
3. To develop a robust internal compliance system which generates the details of compliances undertaken and any compliance lapses in a timely manner;
4. To initiate the compounding procedure in the event of any non-compliance(s) comes to light and to avoid recurrence of such non-compliances in future,
5. To ensure timely and appropriate disclosure pertaining to penalties or compounding offences or action by any authorities.

Further, since the Practicing Company Secretaries are also covered under section 447 of the Act, they should ensure that they are not certifying any returns or issuing any report which contains any false certification or information or omits any material information or facts.

### **Companies (Amendment) Act, 2019**

After the coming into force of the Companies (Amendment) Act, 2019, the Companies Act, 2013 has undergone a major change in the manner of dealing with the offences and penalties and the introduction of e-adjudication will begin a new chapter in the history of Indian corporate world and will speed up the disposal of ongoing and upcoming cases. To further promote the drive of the ease of doing business in India, the concept of “settlement of civil matters” as is currently existing under the securities law may also be introduced under the Companies Act, 2013 enabling the companies and officer in default to voluntarily accept the occurrence of defaults and to settle the same in accordance with the settlement term agreed between the companies/officer in default and the ROC.

The amendment brought in by the Companies (Amendment) Act, 2017 and the Companies (Amendment) Act, 2019 has struck a proper balance between the object of promoting ease of doing business in India by decriminalizing procedural or technical defaults, reducing penalties for One person company and Small Company to half of the amount payable by normal companies, expanding the jurisdiction of regional director for entertaining compounding applications and the object of ensuring better corporate compliance by mandating the timely compliance of the Act and disallowing benefits to defaulting companies and the Company Secretary will have to play a crucial role in achieving these objectives. The Companies (Amendment) Act, 2019 has re-categorized the 16 offence out of 81 which are in the category of the compoundable offence to an in house adjudication framework wherein the defaults are subject to a penalty levied by an adjudicating officer. Some of the provision attracting the penalties are listed hereunder:

**List of Defaults/ Failure Attracting Civil Penalties**

Sr. No.	Section	Subject Matter/nature of default	Quantum of Penalty
1	4(5)	Reservation of name by furnishing wrong or incorrect information (in case company is yet not incorporated)	Up to Rs. 1 Lakh
2	10A	Failure to file declaration of commencement of business	Rs. 50,000 (Company) and Rs. 1,000 per day subject to maximum of Rs. 1 Lakh (Officer in default)
3	12	Registered office of the Company	Rs. 1,000 for every day subject to maximum of Rs. 1 Lakh
4	15	Failure to note alteration in copy of memorandum or articles	Rs. 1,000 for every copy circulated without noting alteration
5	17	Failure to furnish copy of memorandum of articles	Rs. 1,000 for every day or Rs. 1 Lakh, whichever is less
6	33	Issue of application without abridged prospectus or failure to furnish copy of prospectus	Rs. 50,000 for each default
7	39	Failure to file return of allotment or to achieve minimum subscription within 30 days of issue of prospectus	Rs. 1,000 for every day or Rs. 1 Lakh, whichever is less
8	42(9)	Failure to file return of allotment of private placement	Rs. 1,000 for every day subject to maximum of Rs. 25 Lakh
9	42(10)	Private placement of securities in contravention of section 42	Amount raised through private placement or Rs. 2 Crore, whichever is lower
10	53	Issue of shares at discount in non-compliance of section	Amount equivalent to amount raised through issue or Rs. 5,00,000 – whichever is lower and refund of money along with interest @12% p.a.
11	60	Failure to publish authorized, subscribed and paid up capital	For each default Rs. 10,000 (Company) and Rs. 5,000 (Officer in default)
12	64	Failure/delay in filing of notice of alteration of share capital	Rs. 1,000 per day or Rs. 5,00,000 – whichever is less
13	91	Closure of register of members in contravention of section 91	Rs. 5,000 for every day subject to maximum of Rs. 1 Lakh
14	92*	Failure/delay in filing of annual return	Rs. 50,000 and for continuous failure, further penalty of Rs. 100 per day subject to maximum of Rs. 5,00,000.
15	94	Refusal of inspection or making of any extract of register of member and annual return	Rs. 1,000 for every day subject to maximum of Rs. 1 Lakh

16	102	Failure to disclose interest in special business	Rs. 50,000 or 5 times of the amount of benefits – whichever is higher
17	105	Default in providing proxy clause in notice of general meeting	Rs. 5,000
18	111	Failure to circulate members' resolution	Rs. 25,000
19	117*	Failure / delay in filing certain resolutions (MGT-14)	Rs. 1,00,000 and for continuous default, further penalty of Rs. 500 per day subject to maximum of Rs. 25,00,000 (Company) and Rs. 50,000 and for continuous default, further penalty of Rs. 500 per day subject to maximum of Rs. 5,00,000 (Officer in default)
20	118	Non-compliances relating to minutes of meetings	Rs. 25,000 (Company) (Officer in default) and Rs. 5,000
21	119	Refusal of inspection or furnishing of copy of minutes of general meeting	For each default Rs. 25,000 (Company) and Rs. 5,000 (Officer in default)
22	121	Failure / delay in filing of report on AGM	Rs. 1,00,000 and for continuous default, further penalty of Rs. 500 per day subject to maximum of Rs. 5,00,000 (Company) and not less than Rs. 25,000 and for continuous default, further penalty of Rs. 500 per day subject to maximum of Rs. 1,00,000 (Officer in default)
23	136	Failure to send copy of annual report or to comply with other requirements laid down under section 136	Rs. 25,000 (Company) (Officer in default) and Rs. 5,000
24	137*	Failure/delay in filing financial statements	Rs. 1,000 per day subject to maximum of Rs. 10,00,000 (Company) and Rs. 1,00,000 and for continuous failure, a further penalty of Rs. 100 per day subject to maximum of Rs. 5,00,000 (Officer in default)
25	140	Failure/delay by auditor in filing details of resignation	Rs. 50,000 or amount equal to remuneration, whichever is less and for continuous failure, a further penalty of Rs. 500 per day subject to maximum of Rs. 5,00,000.
26	157	Failure/delay by company in intimating DIN of director	Rs. 25,000 and for continuous failure, a further penalty of Rs. 100 per day subject to maximum of Rs. 1,00,000 (Company) and not less than Rs. 25,000 and for continuous failure, a further penalty of Rs. 100 per day subject to maximum of Rs. 1,00,000 (Officer in default)

27	159	Contravention of sections 152, 155 and 156	Up to Rs. 50,000 and for continuing default, a further penalty of up to Rs. 500 per day.
28	165	Acceptance of directorship beyond specified limit	Rs. 5,000 per day
29	173	Failure to issue notice of board meetings	Rs. 25,000
30	189	Failure to comply with requirements relating to register of related party transactions	Rs. 25,000
31	190	Failure to keep contract with MD/WTD at registered office or to allow its inspection	For each default Rs. 25,000 (Company) and Rs. 5,000 (Officer in default)
32	191	Contravention in connection with payment to director in case of loss of office	Rs. 1,00,000
33	197	Managerial remuneration	Rs. 1,00,000 (any person other than company) and Rs. 5,00,000 (Company)
34	203	Failure to comply with provision relating to KMP	Rs. 5,00,000 (Company) and Rs. 50,000 and for continuing default, a further penalty of Rs. 1,000 per day subject to maximum of Rs. 5,00,000.
35	238	Failure to register circular containing offer of scheme involving transfer of shares	Rs. 1,00,000

\* In case of OPC or Small Company, the amount of penalty shall not be more than one-half of the penalties prescribed under the specified sections.

### Compounding

The Companies Act, 2013 does not define or for that matter the erstwhile Companies Act, 1956, did not define the word “compounding” or the terms “compounding or composition of offences”. The dictionary meaning of the word “compounding” means “on prosecution, a prosecutor of an offence accepting anything of value, say a monetary fine, under an agreement not to prosecute the victim or to hamper the prosecution of an offence”. To compound would simply mean “to come to a settlement or agreement”.

As per the Black’s Law Dictionary, “to compound” means “to settle a matter by a payment of money in lieu of any other liability.” This definition represents the concept of compounding as a Settlement Mechanism, a settlement by paying the fine to the concerned compounding authority in lieu of facing the prosecution for the offence committed. However, on analysis of section 621A of the erstwhile Companies Act, 1956, or section 441 of the Companies Act, 2013, we can infer that compounding is nothing but admission of guilt by the person accused of violation of law. In the process of compounding, the person may either *suo moto* or on receipt of notice of default /initiation of prosecution, admits the commission of default and makes an application for compounding of the alleged offence. The defaulters agree to pay the fine which may be ordered by the Central Government.

Compounding is essentially a compromise or arrangement between administrator of the enactment and person

committing an offence. Compounding crime consists of payment of some consideration (termed as compounding fees) in return for an agreement not to prosecute one who has committed an offence.

### History of Compounding in Companies Act

The term “*Compounding of offences*” found its way into the Companies Act in the year 1988 when the Companies Act, 1956, was amended with the insertion of a new Section 621A under the recommendation of Sachar Committee vide the Companies (Amendment) Act, 1988. The amendment provided for composition of certain offences for the first time under that Act. Earlier all offences under that Act were required to be tried by the Court (Section 622) on a complaint filed by the Registrar or by a shareholder of the Company, or by a person authorized by the Central Government in that behalf (Section 621). On the recommendations of Sachar Committee and on the enactment of Companies Act, 1956, the offences under the Act were categorized as under:

*Category I:* Offences punishable with fine only;

*Category II:* Offences punishable with imprisonment or with fine or with both; and

*Category III:* Offences punishable with imprisonment.

Offences under Category I, IIA, IIB are compoundable by the Regional Director or by the National Company Law Tribunal or by any officer authorized by the Central Government. In case, where the maximum amount of fine which may be imposed for such offence does not exceed twenty-five lakh rupees, Can be compounded by the Regional Director or any officer authorized by the Central Government.

Offences under Category II was compoundable by the above authorities with the permission of the Court only and offences under Category III were not at all compoundable but had to go through the trial in the Court.

The above categorization has been carried forward in section 441 by the Companies Act, 2013 with some modifications as under:

Category I : Offences punishable with fine only;

Category II A : Offences punishable with imprisonment or with fine;

Category II B : Offences punishable with imprisonment or with fine or with both;

Category II C : Offences punishable with imprisonment and with fine; and

Category III : Offences punishable with imprisonment only.

Offences under Category I, IIA, IIB are compoundable by the Regional Director or by the National Company Law Tribunal or by any officer authorized by the Central Government. In case, where the maximum amount of fine which may be imposed for such offence does not exceed twenty-five lakh rupees, Can be compounded by the Regional Director or any officer authorized by the Central Government.

And offences under Categories IIC and III are appears as offence punishable with imprisonment only or with imprisonment and also with fine not at all compoundable but had to go through the trial in the Special Court and required to follow procedure under Code of Criminal Procedure, 1973 [Section 441(6)].

Section 435 of the Companies Act, 2013 provides that the Central Government may, for the purpose of providing speedy trial of offences under this Act, by notification, establish or designate as many Special Courts as may be necessary.

A Special Court shall consist of –

- (a) a single judge holding office as Session Judge or Additional Session Judge, in case of offences punishable under this Act with imprisonment of two years or more; and
- (b) a Metropolitan Magistrate or a Judicial Magistrate of the First Class, in the case of other offences,



who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

**Section 441(1)** states that notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act whether committed by a company or any officer thereof not being an offence punishable with imprisonment only, or punishable with imprisonment and also with fine, may, either before or after the institution of any prosecution, be compounded by –

- (a) the Tribunal; or
- (b) where the maximum amount of fine which may be imposed for such offence does not exceed twenty-five lakh rupees, by the Regional Director or any officer authorised by the Central Government, on payment or credit, by the company or, as the case may be, the officer, to the Central Government of such sum as that Tribunal or the Regional Director or any officer authorised by the Central Government, as the case may be, may specify:

Provided that the sum so specified shall not, in any case, exceed the maximum amount of the fine which may be imposed for the offence so compounded:

Provided further that in specifying the sum required to be paid or credited for the compounding of an offence under this sub-section, the sum, if any, paid by way of additional fee under sub-section (2) of section 403 shall be taken into account:

Provided also that any offence covered under this sub-section by any company or its officer shall not be compounded if the investigation against such company has been initiated or is pending under this Act.

(2) Nothing in sub-section (1) shall apply to an offence committed by a company or its officer within a period of three years from the date on which a similar offence committed by it or him was compounded under this section.

*Explanation.*—For the purposes of this section, –

- (a) any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence;
- (b) “Regional Director” means a person appointed by the Central Government as a Regional Director for the purposes of this Act.

(3) (a) Every application for the compounding of an offence shall be made to the Registrar who shall forward the same, together with his comments thereon, to the Tribunal or the Regional Director or any officer authorised by the Central Government, as the case may be.

(b) Where any offence is compounded under this section, whether before or after the institution of any prosecution, an intimation thereof shall be given by the company to the Registrar within seven days from the date on which the offence is so compounded.

(c) Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, either by the Registrar or by any shareholder of the company or by any person authorised by the Central Government against the offender in relation to whom the offence is so compounded.

(d) Where the compounding of any offence is made after the institution of any prosecution, such compounding shall be brought by the Registrar in writing, to the notice of the court in which the prosecution is pending and on such notice of the compounding of the offence being given, the company or its officer in relation to whom the offence is so compounded shall be discharged.

(4) The Tribunal or the Regional Director or any officer authorised by the Central Government, as the case may be, while dealing with a proposal for the compounding of an offence for a default in compliance with any provision of this Act which requires a company or its officer to file or register with, or deliver or send to, the



Registrar any return, account or other document, may direct, by an order, if it or he thinks fit to do so, any officer or other employee of the company to file or register with, or on payment of the fee, and the additional fee, required to be paid under section 403, such return, account or other document within such time as may be specified in the order.

(5) Any officer or other employee of the company who fails to comply with any order made by the Tribunal or the Regional Director or any officer authorised by the Central Government under sub-section (4) shall be punishable with imprisonment for a term which may extend to six months, or with fine not exceeding one lakh rupees, or with both.

(6) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.

(7) No offence specified in this section shall be compounded except under and in accordance with the provisions of this section.

### PERMISSION OF THE SPECIAL COURT

Before, the Companies (Amendment) Act, 2019, Section 441(6) provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973,—

- (a) any offence which is punishable under this Act, with imprisonment or fine, or with imprisonment or fine or with both, shall be compoundable with the permission of the Special Court, in accordance with the procedure laid down in that Act for compounding of offences;
- (b) any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.

However, the committee to review offences under the Companies Act, 2013, has recommended that such requirement of clause (a) of sub-section (6) of section 441 should be omitted with the following justification:

*“Clause (a) to sub-section (6) of section 441, which require the permission of the special court for compounding of offence, is a redundant provision. NCLT in its judgment dated 29.08.2017 in Cinepolis India Pvt. Ltd. V. ROC CA (AT) No. 137 of 2017, while relying on the interpretation of Section 621A of Companies Act, 1956. (corresponding to section 441 of CA, 2013) by Supreme Court in VLS Finance v. Union of India, held that a prior approval of Special court before compounding of offence by NCLT is not required.”*

After, the amendment in section 441 in the Companies (Amendment) Act, 2019, now Section 441(6) read as under: Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.

### ADJUDICATION

#### Meaning

**“Adjudication”** is the legal process by which an arbiter or judge reviews evidence and argumentation, including legal reasoning set forth by opposing parties or litigants to come to a decision which determines rights and obligations between the parties involved. As per Ramanathan’s Law Lexicon *“Adjudication”* is the determination of matters in dispute by the decision of a competent Court, arbitration of the determination of such matters by the decision of arbitrators, *whose decision may not be binding until confirmed by a higher Court or assented to by the parties.*

#### History of Adjudication

Technically, the words *“adjudication”* or *“adjudicating authority”* never found a place in the Companies Act until

a new provision namely section 454 was inserted in the Companies Act, 2013, which section came into effect from 1<sup>st</sup> April, 2014.

It is not as if adjudication never happened before enactment of the Companies Act, 2013, for violation of certain sections in the Act. The erstwhile CLB had and now the NCLT has been adjudicating in a limited sense. However, the penal provisions which were in existence in many of the sections could not be implemented due to lack of judicial or quasi-judicial powers with the administrative authorities so much so that the show cause notices issued by the Registrar of Companies on the defaulting companies or the officers in default culminated in the launch of legal proceedings against them before a Magistrates Court or wherever compounding was possible and sought, the Regional Director could dispose of only those cases.

Clause 23 of the J.J. Irani Committee Report which is essentially the backbone of the Companies Act, 2013, recommended adjudication as a tool to empower the Registrar of Companies in levying penalties for offences under various sections of the Act to obviate the cumbersome legal process to bring the defaulters to book. *Inter alia* the Report stated that

*“Under the proposed “in-house” procedure, the power to impose penalty (in the form of fine) may be vested with the Registrar of Companies who is a statutory authority. Since the minimum and maximum quantum of fine would be defined in the Act, this would restrict the scope for discretionary exercise of power. However, it would be necessary to provide for a mechanism for appeals against the orders of such authorities. Such appellate authority may also be specified in the Act.”*

Thus was born the formal adjudicating power which got vested with the Central Government in the form of section 454. Therefore, in exercise of the powers conferred by section 454 read with section 469 of the Companies Act, 2013, the Central Government has framed the rules titled the “Companies (Adjudication of Penalties) Rules, 2014. As part of the exercise in speedy implementation of the penal provisions in the Act, Special Courts as envisaged u/s 441 have been established in exercise of the powers conferred by S. 435(1) by the Central Government commencing with its notification dated 18-5-2016. Section 435 was further amended by the Companies (Amendment) Act, 2017 which came into force from 7-5-2018 to give more teeth to these Special Courts.

Having said that, it is essential for us to understand that with the introduction of section 454 in the Companies Act, 2013, which gives substantial powers to the Central Government to initiate formally the adjudication proceedings in accordance with Rules framed for the purpose, namely the Companies (Adjudication of Penalties) Rules, 2014, what will happen to the compounding powers of the Central Government already vested with the Regional Director and also separately with the NCLT. The following queries, therefore, arise:

- (i) Under what circumstances can an adjudication be ordered u/s 454? Or in short what triggers an action u/s 454? Is it on the findings of the MCA that an offence has occurred following an inspection u/s 206 or on scrutiny of the Balance Sheet or from the statutory auditors’ report or from the secretarial audit report?;
- (ii) Who orders Adjudication Proceedings u/s 454? Can the RoC himself order? In which case can the Central Government appoint him as the adjudicating officer?
- (iii) When there is a provision for compounding u/s 441 how does section 454 come into play? Does S.454 override S.441 since it is a later section? Or do both sections play parallelly? Which section prevails over which? ; and
- (iv) When a suo motto application for compounding is pending disposal, how does S.454 come into play?

Before we address these queries it will only be logical to understand the provisions of sections 441 and 454 and the differences between the words, “*compounding*” and “*adjudication*” and these sections themselves. There are distinct differences as under:

**Differences between Section 441 and Section 454****(A) Adjudication Order u/s 454 is appealable**

While the adjudication order is appealable with the higher authorities as per the express provision provided in sub-section (5) of section 441, with the procedure being provided by the Rules, a compounding order is generally not appealable unless the victim is aggrieved by the compounding order. Once he agrees on the compounding order, he cannot go on appeal against it. The compounding order is delivered generally based on a consensus arrived at by both parties with the compounding authority having a final say on the outcome of the application and the quantum of penalty. Unlike section 454, section 441 itself does not provide for any appeal.

In this connection, it would only be apt to draw reference to certain precedences. There cannot be any penalty or prosecution after compounding as was decided in *P P Varkey V. STO (1999) 114 STC 224 (Bom HC DB)*. Here, it was held that once an offence is compounded, penalty or prosecution proceedings cannot be taken for the same offence. In *S Viswanathan V. State of Kerala (1993) 113 STC 182 (Ker HC DB)*, it was held that once the matter is compounded, neither department nor the assesses can challenge the compounding order. Department cannot reopen the matter on the reason that actual suppression was much higher. No appeal shall lie against order of composition. In *S V Bagi v. State of Karnataka (1992) 87 STC 138* it was held that a person having agreed to the composition of offence is not entitled to challenge the said proceeding by filing an appeal.

However, an affected party can appeal in extra ordinary circumstances to a superior court if he is aggrieved with the compounding order. Therefore, the compounding authority nor the offender can appeal against the compounding order in the normal course.

**(B) Adjudicating officer's order u/s 454 will be arbitrary and not on consensus**

In the case of section 454, the adjudicating officer's order is more arbitrary and not on consensus, though a reasonable opportunity may be given to the company and the officer in default as required u/s 454(4) before the imposition of any penalty. The emphasis in section 454(3) is on the quantum of penalty and the adjudication is not on the merits or demerits of the offence. The fact of existence of default would have been established by the adjudication officer with the various communication with defaulting parties and from the responses of the show causes issued by him. In fact sub-section (3) to section 454 reads as under:

"The adjudicating officer may, by an order impose the penalty on the company and the officer who is in default stating any noncompliance or default under the relevant provision of the Act." (Emphasis added)

Therefore, we find that the Adjudicating Officer's function and role is defined and confined to arriving and imposing a penalty by stating the non-compliance or default under the provisions of the Act and that too by an order. In fact, the role of the adjudicating officer has been clearly brought out in Rule 3(1) of the Companies (Adjudication of Penalties) Rules, 2014 which states as under:

"The Central Government may appoint any of its officers, not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of the Act." (Emphasis added)

Hence, the alleged offences has to be ascertained first and identified for him to state that there is a non-compliance or default and then proceed to arrive at the quantum of penalty as per the Act and use his discretion to levy this penalty within the parameters laid down under the relevant section alleged to have been violated having due regard to the following factors as provided under Rule 3(9) of the Companies (Adjudication of Penalties) Rules, 2014 reproduced hereunder:

"While adjudging quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely,

- (a) the amount of disproportionate gain or unfair advantage wherever quantifiable made as a result of the default;

- (b) the amount of loss caused to an investor or group of investors or creditors as a result of the default;
- (c) the repetitive nature of the default.”

Therefore, there is a boundary within which the adjudicating officer has to operate which is confined to only adjudging the quantum of penalty. He cannot wander into the area of ascertaining the merits and demerits of the offence or whether there is a violation of the provisions of the Act at all in the capacity of an adjudicating officer which is in stark contrast to the spirit of provisions of section 441 enabling compounding.

*(C) Powers under Section 441 are exercised by different authorities in certain cases but the power of adjudication under Section 454 vests with only the Regional Director.*

### **Power to Compound**

Section 441(1) of the Companies Act, 2013 splits the powers into two categories:

#### **Power of Regional Director:**

Where the maximum amount of fine which may be imposed for such offences does not exceed Rupees Twenty Five Lakhs (Rs.25,00,000) the power of compounding is vested with the Regional Director or on an authorized officer of the Central Government. {Sec 441(1)(b)}

#### **Power of NCLT:**

Where the amount of fine which may be imposed for such offences does not fall below Rupees Twenty Five Lakhs (Rs.25,00,000) the power of compounding is vested with the NCLT.

### **Power to delegate Adjudication**

The Central Government has exercised its powers conferred by Section 454 of the Companies Act, 2013 read with the Companies (Adjudication of Penalties) Rules, 2014, and has appointed various Registrar of Companies as adjudicating officers vide its notification dated 24-3-2015. There is no threshold monetary limit stipulated for exercising their powers for these adjudicating officers like the one which is drawn up for the Regional Director u/s 441(1)(b). The RoCs can levy penalties at their discretion bearing in mind the provisions of the sections alleged to have been violated where the maximum and minimum penalties have been stipulated and also the provisions of Rule 3(9) of the Companies (Adjudication of Penalties) Rules, 2014. The concerned adjudicating officer has the power to initiate adjudication and he need not wait for any orders from the concerned Regional Director for such initiation. The power of the Regional Director is confined only to the deal with the appeal of the order of the officers and not initiating adjudication itself.

*(D) Interval between Two Similar Offences for Compounding u/s 441.*

If any offence which was committed by company or the officers was compounded under section 441, and an offence similar to what was compounded earlier is committed again by a company or its officers within a period of three years from the date on which the earlier offence was compounded, then the provisions of this Section will not be applicable and the company and the officers concerned will not be eligible for compounding again. In other words, similar offence can be compounded only once in three years. However, there is no such restriction imposed u/s 454 on adjudicating a penalty.

*(E) Rules governing the sections*

Rules framed for section 441 is confined to those offences where compounding will be done by NCLT. Technical compliances have to be gone through under the National Company Law Tribunal Rules, 2016. There are no specific rules which have been made by the Government where offences for compounding falls under the jurisdiction of the Regional Director or the authorized officer under section 441(1)(b). In practice the procedure followed in filing an application with NCLT is a guiding factor for application to be made to the Regional Director or the authorized officer.

However, in the case of Adjudication u/s 454, the Government has framed the Companies (Adjudication of Penalties) Rules, 2014, which governs the procedure to be adopted by the adjudicating officer and is very elaborate.

*(F) No compounding u/s 441 can be done when Investigation is in progress*

The additional proviso to section 441(1) prohibits compounding of any offence under section 441 either by the NCLT or the Regional Director or by the authorized officer if the investigation against such company has been initiated or is pending under the Act. There is no such restriction provided under section 454 or its Rules. Therefore, adjudication proceedings can be initiated and continued while investigation is in progress.

*(G) Hearing is mandatory in case of adjudication u/s 454*

454(4) – “The adjudicating officer shall, before imposing any penalty, give a reasonable opportunity of being heard to such company, the officer who is in default or any other person.”

Section 454(4) and Rule 3 of the Companies (Adjudication of Penalties) Rules, 2014, provides

- (1) The central government may appoint any of its officers, not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of the Act.
- (2) Before adjudging penalty, the adjudging officer shall issue a written notice in the specified manner, to the company, the officer who is in default or any other person, as the case may be, to show cause, within such period as may be specified in the notice (not being less than fifteen days and more than thirty days from the date of service thereon), why the penalty should not be imposed on it or him.
- (3) Every notice issued under sub-rule (2), shall clearly indicate the nature of non-compliance or default under the Act alleged to have been committed or made by such company, officer in default, or any other person, as the case may be and also draw attention to the relevant penal provisions of the Act and the maximum penalty which can be imposed on the company, and each of the officers in default, or the other person.
- (4) The reply to such notice shall be filed in electronic mode only within the period as specified in the notice:

Provided that the adjudicating officer may, for reasons to be recorded in writing, extend the period referred to above by a further period not exceeding fifteen days, if the company or officer in default or any person as the case may be, satisfies the adjudicating officer that it or he has sufficient cause for not responding to the notice within the stipulated period or the adjudicating officer has reason to believe that the company or the officer or the person has received a shorter notice and did not have reasonable time to give reply.

- (5) If, after considering the reply submitted by such company, its officer, or any other person, as the case may be, the adjudicating officer is of the opinion that physical appearance is required, he shall issue a notice, within a period of ten working days from the date of receipt of reply fixing a date for the appearance of such company, through its authorized representative, or officer of such company, or any other person, whether personally or through his authorized representative:

Provided that if any person, to whom a notice is issued under sub-rule (2), desires to make an oral representation, whether personally or through his authorized representative and has indicated the same while submitting his reply in electronic mode, the adjudicating officer shall allow such person to make such representation after fixing a date of appearance.

- (6) On the date fixed for hearing and after giving a reasonable opportunity of being heard to the person concerned, the adjudicating officer may, subject to reasons to be recorded in writing, pass any order in writing as he thinks fit including as order for adjournment:

Provided that after hearing, adjudicating officer may require the concerned person to submit his reply in

writing on certain other issues related to the notice under sub-rule (2), relevant for determination of the default.

- (7) The adjudicating officer shall pass an order,-
- (a) within thirty days of the expiry of the period in sub-rule (2), or of such extended period as referred therein, where physical appearance was not required under sub rule (5):
  - (b) within ninety days of the date of issue of notice under rule (2), where any person appeared before the adjudicating officer under sub rule (5):

Provided that in case an order is passed after the aforementioned duration, the reasons of the delay shall be recorded by the adjudicating officer and no such order shall be invalid merely because of its passing after the expiry of such thirty days or ninety days as the case may be.

- (8) Every order of the adjudicating officer shall be duly dated and signed by him and shall clearly state the reasons for requiring the physical appearance under sub-rule (5).
- (9) The adjudicating officer shall send a copy of the order passed by him to the concerned company, officer who is in default or any other person or all of them and to the Central Government and a copy of the order shall also be uploaded on the website.
- (10) For the purposes of this rule, the adjudicating officer shall exercise the following powers, namely:-
  - (a) to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case after recording reasons in writing;
  - (b) to order for evidence or to produce any document, which in the opinion of the adjudicating officer, may be relevant to the subject matter.
- (11) If any person fails to reply or neglects or refuses to appear as required under sub-rule (5) or sub-rule (10) before the adjudicating officer, the adjudicating officer may pass an order imposing the penalty, in the absence of such person after recording the reasons for doing so.
- (12) While adjudging quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely:-
  - (a) size of the company;
  - (b) nature of business carried on by the company;
  - (c) injury to public interest;
  - (d) nature of the default;
  - (e) repetition of the default;
  - (f) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; and
  - (g) the amount of loss caused to an investor or group of investors or creditors as a result of the default:

Provided that, in no case, the penalty imposed shall be less than the minimum penalty prescribed, if any, under the relevant section of the Act.

- (13) In case a fixed sum of penalty is provided for default of a provision, the adjudicating officer shall impose that fixed sum, in case of any default therein.
- (14) Penalty shall be paid through Ministry of Corporate Affairs portal only.
- (15) All sums realized by way of penalties under the Act shall be credited to the Consolidated Fund of India.



*Explanation 1* - For the purposes of this rule, the term “specified manner” shall mean service of documents as specified under section 20 of the Act and rules made thereunder and details in respect of address (including electronic mail ID) provided in the KYC documents field in the registry shall be used for communication under this rule.

*Explanation 2* - For the purposes of this rule, it is hereby clarified that the requirement of submission of replies in electronic mode shall become mandatory after the creation of the e-adjudication platform.]

It is pertinent to point out here as per Rule (4)&(5) above, there is a rider for the adjudicating officer in the matter of giving opportunity of being heard. Based on the response to the show cause notice, if the adjudicating officer is of the opinion that physical appearance is required, he will give an opportunity to the appearance of such company, through its authorized representative, or officer of such company, or any other person, whether personally or through his authorized representative of being heard. But the Act will always override the Rules. There is no such rider in section 454(4). Therefore, the adjudicating officer forming an opinion whether an inquiry has to be held or not is of no concern. Whether he likes it or not he has to give to the defaulting company and its officer an opportunity of being heard.

However, in addressing the prayers in a compounding application by the Regional Director or NCLT, the compounding authority need not give any opportunity to the defaulting parties of being heard since the section does not provide for any such opportunity to be given to the defaulting parties though natural justice demands such an opportunity.

**(i) Under what circumstances can adjudication be ordered u/s 454? Or in short what triggers an action u/s 454? Is it on the findings of the MCA that an offence has occurred following an inspection u/s 206 or on scrutiny of the Balance Sheet or from the statutory auditors’ report or from the secretarial audit report?;**

- a) There must have been a default or non-compliance of the provisions of the Companies Act, 2013;
- b) The default has to be ascertained and the nature of non-compliance must be identified by the concerned office of the RoC or emanate from inspection/investigation or from the statutory auditor’s report or the secretarial audit report
- c) Fine is not the same as penalty. Penalty is a broader term which includes fine. Before initiating adjudication proceedings u/s 454, it has to be ascertained if the penal provisions in the section alleged to have been violated for which these proceedings are sought to be initiated are in the nature of fine or penalty.

In general usage, a layman uses these two words synonymously. In fact, in the Companies Act, 2013, there are many sections which talk of “fine” and many other sections talk of “penalty”. Those sections which have stipulated “fines” will necessarily be outside the purview of section 454 since S.454(3) clearly authorizes the adjudicating officer with a power to impose only penalty and it is implied that he has to take cognizance of the penalty stipulated under the section which has been violated. In whichever fines have been stipulated, the defaulting parties can take recourse to seeking compounding of the offence whether a show cause notice is issued or not.

Interestingly, neither section 621A of the Companies Act, 1956, used, nor section 441 of the present act uses the word “penalty” in the text of these sections. The words used in these sections are fine or imprisonment by way of punishment.

**(ii) Who orders adjudication proceedings u/s 454? Can the RoC himself order? In which case can the Central Government appoint him as the adjudicating officer?**

Either the RoC himself on a scrutiny of documents filed with him and on his satisfaction has to come to a conclusion that there has been non-compliance of the provisions of the Act as arrived at under section 206(4) or has to come to a conclusion of such non-compliances based on any report on inspection or investigation, if any,



under the relevant provisions of the Companies Act, 2013, or on the qualifications of the statutory auditors in the Annual Report or by the secretarial auditors in their Secretarial Audit Report whereby he can ascertain and identify the nature of non-compliance or default. In all these cases, he himself cannot initiate any adjudicating proceedings if he is the adjudicating officer even as he may be clothed with a power of adjudication. Therefore, if adjudicating powers are under his jurisdiction, any other officer who is independent of his office has to identify the existence of violation as otherwise the adjudicating officer, being the head of his office may be biased. This is a grey area to be addressed by the Central Government as otherwise the adjudicating officer will be sitting on a judgement of the findings of his own office.

It is pertinent to point out here that it would, therefore, be only logical, prudent and wise for the concerned Regional Director not to appoint as the adjudicating officer pursuant to sub-section (2) of section 454, the same jurisdictional Registrar of Companies whose office has identified the violation.

**(iii) When there is a provision for compounding u/s 441 how does section 454 come into play? Does S.454 override S.441 since it is a later section? Or do both sections play parallelly? Which section prevails over which?;**

Both these sections are independent of each other. The question of one section overriding the other does not arise. They operate concurrently but not parallelly. When we say parallelly it means simultaneously. The Regional Director cannot set the compounding process in motion u/s 441 and simultaneously the RoC cannot order adjudication u/s. 454. Section 441 deals with compounding and Section 454 deals with adjudication. Both are not same. The adjudicating officer has no power to compound. The Regional Director alone can compound. If he has to authorize another officer it has to be u/s 441(1)(b) and not under 454. The adjudicating officer u/s 454 can only adjudicate on the quantum of penalty. He has no right to go into the merits and demerits of the default. Within the parameters set under the sections which are under default he can wander. In fact, he can only revise the fee upwards not downwards as can be seen from the parameters set under Rule 3(9) of the Companies (Adjudication of Penalties) Rules, 2014. Whereas, the Regional Director or the NCLT can afford to give lot of concessions on the quantum of penalty depending on the facts of the case. The power to compound vested with the Regional Director or the NCLT is more subjective.

**(iv) When a suo motto application for compounding is made, how does S.454 come into play?**

The moot question here will be should the Regional Director or the NCLT take cognizance of adjudication proceedings u/s 454(2) when a *suo moto* application made by the defaulter for composition involving an offence, the nature of which the defaulter himself has identified, is pending with him/NCLT for disposal and stop the adjudication proceedings? Therefore, it appears that prima facie section 454 will not come into play. The RoC who has forwarded the compounding application to either of them with his report has to seek directions from the RD/NCLT in such a case. The Regional Director/NCLT may agree for adjudication **after giving justifiable reasons for his choice for adjudication overriding the compounding application in a speaking manner.** But this decision can be challenged before the same RD under section 454(5) by the applicants to a *suo moto* compounding application if the RoC, being the adjudicating officer exercises his power u/s 454, on the grounds that the defaulting party itself has identified the non-compliance and none else and therefore, the offence will obviously come outside the purview of S.454.

To sum up, there is no contradiction between section 441 and 454 as they operate under their own separate spheres. Earlier, the RoC could only initiate the launching of criminal proceedings to implement the penal provisions of the sections which have been violated and the Magistrate's court gave the verdict after trial. Section 454 read with its rules has now given powers to the adjudicating officers from the administrative machinery to adjudicate the penalty instead of launching criminal proceedings before the Magistrate's Court as was being done earlier except when the offences fall under the appropriate Special Courts established under section 435 which is expected to speed up the delivery of justice. Compounding Powers continue to vest with the NCLT/ Regional Director in cases where the sections violated indicate fines.

Section 454A of the Companies Act, 2013 says that where a company or an officer of a company or any other person having already been subjected to penalty for default under any provisions of this Act, again commits such default within a period of three years from the date of order imposing such penalty passed by the adjudicating officer or the Regional Director, as the case may be, it or he shall be liable for the second or subsequent defaults for an amount equal to twice the amount of penalty provided for such default under the relevant provisions of this Act.

**List of offences Compoundable in nature (powers vested with Regional Director)**

Section	Nature of offence	Fine/ Imprisonment
16(3)	Committing default in complying with the directions issued under sub-section (1) relating to rectification of name of company	Fine upto Rs.1,000 for each day of default on company. Fine not less than Rs.5,000 but may be extended to Rs.1 lakh (for officer in default).
26(9)	Contravention of provisions relating to issue of a prospectus	Fine from Rs.50,000 to Rs.3 lakh on company and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than 50,000 rupees but which may extend to 3 lakh rupees, or with both.
48(5)	Committing default in complying with the provisions regarding to variation of shareholders' rights	Every officer of company in default - Imprisonment upto six months or fine not less than Rs.25,000 but may be extended to Rs.5 lakh or with both (for officer in default).
56(6)	Failure to comply with the provision relating to transfer and transmission of securities under sub-section (1) to (5)	Fine not less than Rs.25,000 but may be extended to Rs.5 lakh on company and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than 10,000 rupees but which may extend to 1 lakh rupees.
59(5)	Committing default in complying with the order of Tribunal relating to rectification of register of members	Fine not less than Rs.1 lakh but may be extended to Rs.5 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than 1 lakh rupees but which may extend to 3 lakh rupees, or with both.
66(11)	Failure to publish the order of confirmation of the reduction of share capital by the Tribunal	Fine not less than Rs.5 lakh but may be extended to Rs.25 lakh on company.

67(5)	Contravening provisions relating to purchase by company or loans by company for purchase of its own shares	Fine not less than Rs. 1 lakh but may be extended to Rs.25 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than 1 lakh rupees but which may extend to 25 lakh rupees.
68(11)	If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board of India relating to buy back of securities	Fine not less than Rs.1 lakh but may be extended to Rs.3 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than 1 lakh rupees but which may extend to 3 lakh rupees, or with both.
71(11)	Committing default in complying with the order of Tribunal relating to redemption of debentures	Imprisonment upto three years or fine not less than Rs.2 lakh but may be extended to Rs.5 lakh or with both (for officer in default).
86	Contravention of any provision of Chapter VI relating to Registration of Charges	Fine not less than Rs.1 lakh but may be extended to Rs.10 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than 25,000 rupees but which may extend to 1 lakh rupees, or with both.
88(5)	Failure to maintain register of members or debenture-holders or other security holders as prescribed	The company and every officer of the company who is in default shall be punishable with fine which shall not be less than 50,000 rupees but which may extend to 3 lakh rupees and where the failure is a continuing one, with a further fine which may extend to 1000 rupees for every day, after the first during which the failure continues.
89(5)	Failure to file declaration not holding beneficial interest in any share	Fine upto Rs.50,000 and further fine up to Rs.1,000 for each day of default in case failure continues.
89(7)	Failure to file return relating to beneficial interest in any share before the expiry of the time specified under the first proviso to sub-section (1) of section 403	Fine not less than Rs.500 but may be extended to Rs.1,000 on company & every officer who is in default and further fine up to Rs.1,000 for each day of default in case failure continues.
92(6)	If a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder	Fine which shall not be less than Rs.50,000 but may be extended to Rs.5 lakh.

99	Default in holding a meeting of the company in accordance with section 96 or section 97 or section 98 or in complying with any directions of the Tribunal	Fine upto Rs.1 lakh on company & every officer who is in default and further fine up to Rs.5,000 for each day of default in case failure continues.
105(5)	If invitations to appoint a person as proxy or one of a number of persons specified in the invitations are issued	Every officer of the company who knowingly issue or willfully authorizes or permits their issue shall be punishable with Fine upto Rs.1 lakh.
124(7)	Failure to transfer the amount of accumulated profits to unpaid dividend account and violating other provisions of section 124	Fine not less than Rs.5 lakh but may be extended to Rs.25 lakh on company and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.
128(6)	Failure to keep proper books of account	Imprisonment upto one year or fine not less than Rs.50,000 but may be extended to Rs.5 lakh or with both (for MD, WTD, CFO etc.)
129(7)	Failure to keep proper financial statement	Imprisonment upto one year or fine not less than Rs.50,000 but may be extended to `5 lakh or with both (the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors).
134(8)	Default in complying with the provisions regarding financial statement and Board's report	Fine which shall not be less than 50,000 rupees but which may extend to 25 lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than 50,000 rupees but which may extend to 5 lakh rupees, or with both.
143(15)	Failure of auditor to intimate to Central Government regarding fraud against the company by officers or employees	Fine not less than Rs.1 lakh but may be extended to Rs.25 lakh.
147(1)	Failure of company to comply with the provisions of sections 139 to 146 with regard to auditors	Fine not less than Rs.25,000 but may be extended to Rs.5 lakh on company every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than 10,000 rupees but which may extend to 1 lakh rupees, or with both.

166(7)	Default in complying with the provisions of this section relating to directors duties	Fine not less than Rs.1 lakh but may be extended to Rs.5 lakh on directors.
167(2)	Functioning as a director after vacation of office	Imprisonment upto one year or fine not less than Rs.1 lakh but may be extended to Rs.5 lakh or with both.
172	Contravention of the provisions of Chapter XI relating to appointment and qualifications of directors	Fine not less than Rs.`50,000 but may be extended to Rs.5 lakh.
178(8)	Default in complying with the provisions of section 177 & of this section relating to Committees like Nomination and Remuneration and Stakeholders Relationship Committee	Fine not less than Rs.1 lakh but may be extended to Rs.5 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than 25,000 rupees but which may extend to 1 lakh rupees, or with both.
184(4)	Failure to disclose of director's interest and participation in Board meeting by interested director	Imprisonment upto one year or fine not less than Rs.50,000 but may be extended to Rs.1 lakh or with both.
185(2)	Contravention of the provisions of sub-section 1 relating to loans, guarantee or security	Fine not less than Rs.5 lakh but may be extended to Rs.25 lakh on company or on other officers in default and the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than 5 lakh rupees but which may extend to 25 lakh rupees, or with both.
188(5)(i) 188(5)(ii)	Related party transaction in case of other company and listed company	In case of listed company, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than 25,000 rupees but which may extend to 5 lakh rupees, or with both; and  In case of any other company, be punishable with fine which shall not be less than 25,000 rupees but which may extend to 5 lakh rupees.
186(13)	Contravention of the provisions of this section relating to loans and investment	Fine not less than Rs.25,000 but may be extended to Rs.5 lakh on company for officer in default Rs.25,000 to Rs.1 lakh

187(4)	Contravention of the provisions of this section relating to investment of company held in its name	The company shall be punishable with fine which shall not be less than 25,000 rupees but which may extend to 25 lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than 25,000 rupees but which may extend to 1 lakh rupees, or with both
194(2)	Forward dealing in securities of the company by Key Managerial personnel or director	Imprisonment upto two years or fine not less than Rs.1 lakh but may be extended to Rs.5 lakh or with both (for director or Key Managerial Personnel).
195(2)	Contravention of this section (195) relating to Insider trading of securities by Key Managerial personnel or director	Imprisonment upto five years or fine not less than Rs.5 lakh but may be extended to Rs. 25 crore or three times the profit made on insider trading whichever is higher or with both.
204(4)	(195) relating to Insider trading	Fine not less than Rs.1 lakh but may be extended to Rs.5 lakh on the company, every officer of the company and company secretary in practice.
206(7)	of securities by Key Managerial	Fine up to Rs.1 lakh and further fine up to Rs.500 for each day of default on the company and every officer of the company.
221(2)	Any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1) personnel or director	The company shall be punishable with fine which shall not be less than 1 lakh rupees but which may extend to 25 lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than 50,000 rupees but which may extend to 5 lakh rupees, or with both.
222(2)	Securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1)	Fine not less than Rs.1 lakh but may be extended to Rs.25 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than 25,000 rupees but which may extend to 5 lakh rupees, or with both.

232(8)	Contravention of the provisions by the transfer and transferee company in case of merger or amalgamation	Fine not less than Rs.1 lakh but may be extended to Rs. 25 lakh on company and every officer of such transferor or transferee company who is in default, shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than 1 lakh rupees but which may extend to 3 lakh rupees, or with both.
242(8)	Contravention of the order of Tribunal relating to alterations in memorandum or articles	Fine not less than Rs.1 lakh but may be extended to Rs.25 lakh on company and Rs.25,000 to Rs.1 lakh on officers.
245(7)	Committing default in complying with the order of Tribunal under this section	Fine not less than Rs.5 lakh but may be extended to Rs.25 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
247(3) Proviso	Contravention of the provisions of this section by the valuer	Valuer shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than 1 lakh rupees but which may extend to 5 lakh rupees.
249(2)	Filing of application in restricted cases for removal of name	Fine upto Rs.1 lakh.
284(2)	Failure to extend full cooperation to the company liquidator	Person shall be punishable with imprisonment which may extend to six months or with fine which may extend to 50,000 rupees, or with both.
302(4)	Committing default by official liquidator in forwarding a copy of the order of dissolution of company by Tribunal within the period specified in sub-section (3)	Fine upto Rs.5,000 for each day of default (on company liquidator).
342(6)	Failure or neglect to give assistance required under sub-section (5)	Fine not less than Rs.25,000 but may be extended to Rs.1 lakh.
344(2)	Failure to give statement that the company is in liquidation	The company, and every officer of the company, the Company Liquidator and any receiver or manager, who wilfully authorizes or permits the non-compliance, shall be punishable with Fine not less than Rs.50,000 but may be extended to Rs.3 lakh.



347(4)	Contravention of any rule framed or an order made under sub- section (3)	Imprisonment upto six months or fine upto Rs.50,000 or with both.
348(6)	Contravention of the provisions of information as to pending liquidation	Fine upto Rs.5,000 for each day of default (for Company liquidator).
348(6)	Contravention of the provisions of information as to pending liquidation	Fine upto Rs.5,000 for each day of default (for Company liquidator).
348(7)	Wilful default by company liquidator	Person acts in contravention of any rule framed or an order made under sub-section (3), he shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.
356(2)	Failure to file certified copy of the order of Tribunal relating to declaring dissolution of company void with the Registrar	Fine upto Rs.10,000 for each day of default continues (for Company liquidator or the person on whose application the order was passed).
392	Contravention of the provisions of Chapter XXII by a foreign company	Fine not less than Rs.1 lakh but may be extended to Rs.3 lakh and further fine up to Rs.50,000 for each day of default for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees, or with both.
405(4)	Failure to furnish information or statistics, etc. by the companies required by the Central Government	The company shall be punishable with fine which may extend to twenty-five thousand rupees and every officer of the company who is in default, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to three lakh rupees, or with both.
441(5)	Failure to comply with the order made by Tribunal or Regional Director in relation to Compounding of offences	Imprisonment upto six months or fine upto Rs.1 lakh or with both.
450	No specific penalty or punishment is provided in the Act	Fine up to Rs.10,000 and further fine up to Rs.1,000 for each day of default in case of contravention continues.

451	Repeated default within 3 years	Twice the amount of fine for such offence in addition to any imprisonment provided for that offence.
452(1)	Punishment for wrongful withholding of property	Fine not less than Rs.1 lakh but may be extend to Rs.5 lakh on officer or employee of the company.
453	Improper use of the words "limited" and "private limited"	Fine not less than Rs.500 but may be extended to Rs.2,000 for each day of default.
454(8)	Failure to pay the penalty imposed by the adjudicating officer or Regional Director	Company does not pay the penalty imposed by the adjudicating officer or the Regional Director within a period of ninety days from the date of the receipt of the copy of the order, the company shall be punishable with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees. Where an officer of a company who is in default does not pay the penalty within a period of ninety days from the date of the receipt of the copy of the order, such officer shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.
464(3)	Being a member of a company formed exceeding certain numbers	Fine upto Rs.1 lakh and liabilities incurred in such business.
469(3)	Contravention of the Rules framed by Central Government	Fine upto Rs.5,000 and further fine up to Rs.500 for each day of default in case of contravention continues.

**List of offences compoundable in nature (powers vested with the Tribunal)**

Section	Nature of offence	Fine/ Imprisonment
8(11)	Committing default in complying with the requirements relating to formation of companies with charitable objects, etc.	If a company makes any default in complying with any of the requirements laid down in this section, the company shall, without prejudice to any other action under the provisions of this section, be punishable with fine which shall not be less than ten lakh rupees but which may extend to one crore rupees and the directors and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees, or with both:  Provided that when it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447.
40(5)	Committing default in complying with the provisions of this section relation to securities to be dealt with in stock exchanges	Fine not less than Rs.5 lakh but may be extended to Rs.50 lakh on company and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.
46(5)	Fraudulently issuing of duplicate share certificates by a company	Fine not less than 5 times the face value of the shares involved in the issue of the duplicate certificate but which may extended to 10 times or Rs.10 crore whichever is higher on company and every officer of the company who is in default shall be liable for action under section 447.
74(3)	If a company fails to repay the deposit or part thereof or any interest thereon within the time specified or such further time as may be allowed by the Tribunal	Fine not less than Rs.1 crore but may be extended to Rs.`10 crore on company and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.
447	Punishment for fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is less and does not involve public interest,	any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.

**List of offences non-compoundable in nature**

Section	Nature of offence	Imprisonment and Fine
57	Deceitfully personating as an owner of any shares or interest in a company	Imprisonment minimum of one year but may be extended to three years and with fine not less than Rs.1 lakh but may be extended to Rs. 5 lakh.
58(6)	Contravention of an order of the Tribunal regarding the refusal of registration and appeal against refusal.	Company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
67(5)	Contravening provisions relating to purchase by company or loans by company for purchase of its own shares	Company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
118(12)	Tampering with the minutes of the proceedings of meeting	Imprisonment upto two years and fine not less than Rs.25,000 but may be extended to Rs.1 lakh.
127	Failure to distribute dividend within thirty days	Imprisonment upto two years and fine not less than Rs.1,000 for each day of failure (for every director) and 18% interest liability on company
147(2) Proviso	Failure of auditor to comply with the provisions of sections 139, 143, 144 and 145 If knowingly contravenes	<p>The auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees:</p> <p>Provided that if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.</p>

182(4)	Political contribution made in contravention of this section	Company shall be punishable with fine which may extend to five times the amount so contributed and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed.
186(13)	Contravention of the provisions of this section relating to loans and investment	Company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
207(4)	Disobeys the direction issued by the Registrar or inspector under this section	The director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
217(6)	Disobeys the direction issued by the Registrar or inspector under this section in relation to investigation	The director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
217(8)	Failure to provide information, books or papers, etc. to inspector during investigation	Imprisonment for a term which may extend to six months and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, and also with a further fine which may extend to two thousand rupees for every day after the first during which the failure or refusal continues.
245(7)	Committing default in complying with the order of Tribunal under this section	Any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees

247(3) Proviso	Contravention of the provisions of this section by the valuer	Valuer shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.
336(1)	Offences by officers of companies in liquidation	Person shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.
336(2)	Offences by officers of companies in liquidation covered under sub- Section (viii) of Section (d) of sub- section (1)	Person shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than three lakh rupees but which may extend to five lakh rupees.
337	Frauds by officers	Person punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.
338(1)	Failure to keep proper books of account before winding up	Imprisonment not less than one year but may be extended to three years and fine not less than Rs.1 lakh but may be extended to Rs.3 lakh.
447	Punishment for fraud If the fraud involves public interest	Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:
447	Punishment for fraud If the fraud involves public interest	Imprisonment not less than 3 years but may be extended to 10 years and fine not less than the amount involved in fraud but may be extended to 3 times the amount involved in fraud.
449	Intentionally gives false evidence	Imprisonment not less than three years but may be extended to seven years and fine upto Rs.10 lakh.

452(2)	Wrongful withholding of property	To deliver up or refund any such property or cash wrongfully obtained; the benefits that have been derived, imprisonment for a term which may extend to two years.
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### Offence and penalties under SEBI Act, 1992

SEBI is empowered under Section 11B of SEBI Act, 1992 to levy penalties after adjudication of the matter if it finds that any such statutory contravention has occurred. SEBI, in general practice, assesses factual circumstances and establishes whether or not an offense has been made by the assessee, and levies the penalty stipulated under chapter VIA of the SEBI Act, 1992. The purpose of any adjudicatory proceeding, is not for a mere assessment of facts but must also be a determination of the gravity of the offense and imposing a penalty that is proportionate to the same. SEBI has time and again, imposed penalties at a flat rate in a mechanical, “automatic” manner.

Securities Appellate Tribunal is a statutory body established under the provisions of Section 15K of the Securities and Exchange Board of India Act, 1992 to hear and dispose of appeals against orders passed by the Securities and Exchange Board of India or by an adjudicating officer under the Act; and to exercise jurisdiction, powers and authority conferred on the Tribunal by or under the Act or any other law for the time being in force.

The Enforcement Department is responsible for handling Appeals against SEBI orders filed before the Hon'ble Securities Appellate Tribunal (SAT), Appeals filed against the SAT order in the Hon'ble Supreme Court, Criminal Complaints filed by SEBI in appropriate Courts and Settlement Proceedings. The Department Comprises of three divisions, namely:

- 1) SAT Litigation Division
- 2) Prosecution Division
- 3) Settlement Division

#### 1) SAT Litigation Division

SAT Litigation Division of Securities and Exchange Board of India (SEBI) would be responsible for handling appeals against orders of SEBI or its Adjudicating Officers. While undertaking defence representation in contentious matters involving complex issues of law, the Division would **liaise** with Senior Advocates, law firms, solicitors firms and represent the interest of SEBI at Securities Appellate Tribunal (SAT). The Division would also be an interface between SEBI and SAT, while collaborating with other departments of SEBI. It would also assist SEBI in filing affidavits/written submissions, as and when needed, while attending hearings.

#### 2) Division of Prosecution

The division shall handle work related to filing prosecution proceedings through the courts and follow up to obtain conviction. The Division will also frame procedures for cooperation with public prosecutors, other agencies and for making referrals to prosecutors and other government agencies.

#### 3) Settlement Division

“Settlement Division handles the Settlement Applications filed by the Applicant for the Settlement of the Specified Proceedings that have been initiated or may be initiated by SEBI. The Settlement Applications are processed as per SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 [Settlement Regulations] and if settlement is arrived at, the Settlement Orders are passed.

The Settlement Division is responsible for handling Registration of Settlement Application, Calculation of Settlement amount as per the Settlement Regulations, organizing Internal Committee Meeting between the



Applicants and Internal Committee Members for formulating the settlement amount/terms, Organizing High Powered Advisory Committee (HPAC) Meeting, placing the recommendation of HPAC before the Panel of Whole Time Members for approval.

### Other Jurisdiction of SAT

Consequent to Government Notification No.DL-33004/99 dated 27th May, 2014, SAT hears and disposes of appeals against orders passed by the Pension Fund Regulatory and Development Authority (PFRDA) under the PFRDA Act, 2013. Further, in terms of Government Notification No.DL-(N)/04/0007/2003-15 dated 23rd March, 2015, SAT hears and disposes of appeals against orders passed by the Insurance Regulatory Development Authority of India (IRDAI) under the Insurance Act, 1938, the General Insurance Business (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority Act, 1999 and the Rules and Regulations framed thereunder

## Penalties under SEBI Act, 1992

### Power of SEBI to Issue Directions and Levy Penalty [Section 11B]

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.

Section 11B of the Act provides that if the SEBI is satisfied after making or causing to be made an enquiry due enquiries, 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 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,

the SEBI may issue such directions, –

- (a) to any person or class of persons, or associated with the securities market; or
- (b) to any company in respect of matters relating to issue of capital, transfer of securities and other matter incidental thereto, as may be appropriate in the interests of investors in securities and the securities market.

Without prejudice to the provisions contained in sub-section (1), sub-section (4A) of section 11 and section 15-I, the SEBI may, by an order, for reasons to be recorded in writing, levy penalty under sections 15A, 15B, 15C, 15D, 15E, 15EA, 15EB, 15F, 15G, 15H, 15HA and 15HB after holding an inquiry in the prescribed manner.

## Penalties and Adjudication Under SEBI Act, 1992

S. No.	Section	Particulars
1	15A	Failure to furnish information, return, etc.
2	15B	Failure by any person to enter into agreement with clients.
3	15C	Failure to redress investors' grievances.

4	15D	Default in case of Mutual Funds.
5	15E	Failure to observe rules and regulations by an asset management company.
6	15EA	Default in case of alternative investment funds, infrastructure investment trusts and real estate investment trusts.
7	15EB	Default in case of investment adviser and research analyst.
8	15F	Default in case of stock brokers.
9	15G	Insider Trading.
10	15H	Non-Disclosure of Acquisition of Shares and Takeovers.
11	15HA	Fraudulent and unfair trade practices.
12	15HAA	Penalty for alteration, destruction, etc., of records and failure to protect the electronic database of SEBI.
13	15HB	Contravention where no separate penalty has been provided.
14	15I	Adjudications.
15	15J	Factors to be taken into account by the adjudicating officer.
16	15JA	Crediting sums realised by way of penalties to Consolidated Fund of India
17	15JB	Settlement of administrative and civil proceedings.

### Penalty for failure to furnish information, return, etc. [Section 15A]

If any person, who is required under this Act or any rules or regulations made thereunder, –

- (a) to furnish any document, return or report to the Board, fails to furnish the same or who furnishes or files false, incorrect or incomplete information, return, report, books or other documents, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
- (b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations or who furnishes or files false, incorrect or incomplete information, return, report, books or other documents, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.
- (c) to maintain books of account or records, fails to maintain the same, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

### Penalty for failure by any person to enter into agreement with clients

**Section 15B.** If any person, who is registered as an intermediary and is required under this Act or any rules or regulations made thereunder to enter into an agreement with his client, fails to enter into such agreement,

he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

### **Penalty for failure to redress investors' grievances**

**Section 15C.** If any listed company or any person who is registered as an intermediary, after having been called upon by the Board in writing including by any means of electronic communication, to redress the grievances of investors, fails to redress such grievances within the time specified by the Board, such company or intermediary shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

### **Penalty for certain defaults in case of Mutual Funds**

**Section 15D.** If any person, who is –

- (a) required under this Act or any rules or regulations made thereunder to obtain a certificate of registration from the Board for sponsoring or carrying on any collective investment scheme, including mutual funds, sponsors or carries on any collective investment scheme, including mutual funds, without obtaining such certificate of registration, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds subject to a maximum of one crore rupees;
- (b) registered with the Board as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
- (c) registered with the Board as a collective investment scheme, including mutual funds, fails to make an application for listing of its schemes as provided for in the regulations governing such listing, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
- (d) registered as a collective investment scheme, including mutual funds, fails to dispatch unit certificates of any scheme in the manner provided in the regulation governing such dispatch, he shall be liable to 80[a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
- (e) registered as a collective investment scheme, including mutual funds, fails to refund the application monies paid by the investors within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
- (f) registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

### **Penalty for failure to observe rules and regulations by an asset management company**

**Section 15E.** Where any asset management company of a mutual fund registered under this Act, fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such

asset management company shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

### **Penalty for default in case of alternative investment funds, infrastructure investment trusts and real estate investment trusts**

**Section 15EA.** Where any person fails to comply with the regulations made by the Board in respect of alternative investment funds, infrastructure investment trusts and real estate investment trusts or fails to comply with the directions issued by the Board, such person shall be liable to penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees or three times the amount of gains made out of such failure, whichever is higher.

### **Penalty for default in case of investment adviser and research analyst**

**Section 15EB.** Where an investment adviser or a research analyst fails to comply with the regulations made by the Board or directions issued by the Board, such investment adviser or research analyst shall be liable to penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

### **Penalty for default in case of stock brokers**

**Section 15F.** If any person, who is registered as a stock broker under this Act, –

- (a) fails to issue contract notes in the form and manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupee for which the contract note was required to be issued by that broker;
- (b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
- (c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

### **Penalty for insider trading**

**Section 15G.** If any insider who, –

- (i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or
- (ii) communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or
- (iii) counsels, or procures for any other person to deal in any securities of anybody corporate on the basis of unpublished price-sensitive information,

shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

### **Penalty for non-disclosure of acquisition of shares and takeovers.**

**Section 15H.** If any person, who is required under this Act or any rules or regulations made thereunder, fails to, –

- (i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or
- (ii) make a public announcement to acquire shares at a minimum price; or
- (iii) make a public offer by sending letter of offer to the shareholders of the concerned company; or
- (iv) make payment of consideration to the shareholders who sold their shares pursuant to letter of offer, he shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such failure, whichever is higher

### **Penalty for fraudulent and unfair trade practices.**

**Section 15HA.** If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

### **Penalty for alteration, destruction, etc., of records and failure to protect the electronic database of SEBI**

Section 15HAA provides that any person, who –

- (a) knowingly alters, destroys, mutilates, conceals, falsifies, or makes a false entry in any information, record, document (including electronic records), which is required under this Act or any rules or regulations made thereunder, so as to impede, obstruct, or influence the investigation, inquiry, audit, inspection or proper administration of any matter within the jurisdiction of the SEBI.

*Explanation.* – A person shall be deemed to have altered, concealed or destroyed such information, record or document, in case he knowingly fails to immediately report the matter to the SEBI or fails to preserve the same till such information continues to be relevant to any investigation, inquiry, audit, inspection or proceeding, which may be initiated by the SEBI and conclusion thereof;

- (b) without being authorised to do so, access or tries to access, or denies of access or modifies access parameters, to the regulatory data in the database;
- (c) without being authorised to do so, downloads, extracts, copies, or reproduces in any form the regulatory data maintained in the system database;
- (d) knowingly introduces any computer virus or other computer contaminant into the system database and brings out a trading halt;
- (e) without authorisation disrupts the functioning of system database;
- (f) knowingly damages, destroys, deletes, alters, diminishes in value or utility, or affects by any means, the regulatory data in the system database; or
- (g) knowingly provides any assistance to or causes any other person to do any of the acts specified in clauses (a) to (f)

shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to ten crore rupees or three times the amount of profits made out of such act, whichever is higher.

### **Penalty for contravention where no separate penalty has been provided**

**Section 15HB.** Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

**Power to adjudicate.**

**Section 15-I.** (1) For the purpose of adjudging under sections 15A, 15B, 15C, 15D, 15E, 15EA, 15EB, 15F, 15G, 15H, 15HA and 15HB, the Board may appoint any officer not below the rank of a Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.

(2) While holding an inquiry the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in subsection (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

(3) The Board may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify:

Provided that no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter:

Provided further that nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 15T, whichever is earlier.

**Factors to be taken into account while adjudging quantum of penalty.**

**Section 15J.** While adjudging quantum of penalty under 15-I or section 11 or section 11B, the Board or the adjudicating officer shall have due regard to the following factors, namely :—

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
- (b) the amount of loss caused to an investor or group of investors as a result of the default;
- (c) the repetitive nature of the default.

*Explanation.* — For the removal of doubts, it is clarified that the power to adjudge the quantum of penalty under sections 15A to 15E, clauses (b) and (c) of section 15F, 15G, 15H and 15HA shall be and shall always be deemed to have been exercised under the provisions of this section.

**Crediting sums realized by way of penalties to Consolidated Fund of India.**

**Section 15JA.** All sums realized by way of penalties under this Act shall be credited to the Consolidated Fund of India.

**Settlement of Administrative and Civil Proceedings.**

**Section 15JB.** (1) Notwithstanding anything contained in any other law for the time being in force, any person, against whom any proceedings have been initiated or may be initiated under section 11, section 11B, section 11D, sub-section (3) of section 12 or section 15-I, may file an application in writing to the Board proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

(2) The Board may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by the Board in accordance with the regulations made under this Act.

(3) The settlement proceedings under this section shall be conducted in accordance with the procedure specified in the regulations made under this Act.

(4) No appeal shall lie under section 15T against any order passed by the Board or adjudicating officer, as the case may be, under this section.

(5) All settlement amounts, excluding the disgorgement amount and legal costs, realized under this Act shall be credited to the Consolidated Fund of India.

### Case Study - 1

#### **PACL Limited (“PACL” or “the company”), was a company:**

- carrying business related to buying and selling of agricultural land including development of such land into cultivable land and providing other infrastructure on it. The transactions of PACL are similar to that of a builder or a developer of property. PACL was purchasing lands from its own funds prior to inviting allotments for individual plots of land and is adding value to the land through its development activities. Based on such land banks customers approach PACL through its agents for the purchase of lands. PACL had prepared different plans under which these lands were sold wherein the prospective purchaser would pay the price of the land in one or multiple installments.
- wherein the funds of the investors were pooled and utilized towards the cost of land, registration expenses, developmental charges and other incidental expenses.

#### **Allegations on PACL**

- It had been alleged that PACL was running Collective Investment Scheme (CIS) and was one of the companies which had failed refund money to investors and to submit the information/ details with SEBI.
- PACL collects the money from customers/ investors against the purported sale of a plot/land. The application form and the agreement with its customers contain the clause that the customer is applying for plot of agricultural land and for development and maintenance of the same by PACL. Customer of PACL makes contribution/ payment with a view to receive the profits, income and returns on their initial investments.
- PACL and its promoters & directors had mobilized funds from general public by sponsoring/causing to be sponsored, carrying/causing to be carried, collective investment schemes, without obtaining registration from SEBI as required under the provisions of SEBI Act and SEBI (Collective Investment Schemes) Regulations, 1992.

In view of such defaults of PACL as mentioned above, SEBI in its letter dated 4th March, 1998 had intimated PACL that it was not eligible to take the benefit under the proviso to Section 12(1B) of the SEBI Act and therefore could neither launch any new schemes nor continue raising funds under its existing schemes.

SEBI vide its order dated 22nd August, 2014, finds that the:-

- business/activities/schemes/plans offered and operated by PACL are Collective Investment Schemes, satisfying all the ingredients specified under Section 11AA of the Securities and Exchange Board of India Act, 1992.
- PACL and its directors and promoters to refund the monies, which have been collected in an unauthorized manner, with promised returns to investors.

Further as per the above order, SEBI has passed the following directions:



**SEBI's direction to PACL**

- PACL Limited its promoters and directors including Mr. Tarlochan Singh, Mr. Sukhdev Singh, Mr. Gurmeet Singh and Mr. Subrata Bhattacharya, shall abstain from collecting any money from investors or launch or carry out any Collective Investment Schemes including the schemes which have been identified as a Collective Investment Scheme in this Order.
- PACL Limited, its promoters and directors including Mr. Tarlochan Singh, Mr. Sukhdev Singh, Mr. Gurmeet Singh and Mr. Subrata Bhattacharya, shall wind up all the existing Collective Investment Schemes of PACL Limited and refund the monies collected by the said company under its schemes with returns which are due to its investors as per the terms of offer within a period of three months from the date of this Order and thereafter, within a period of fifteen days, submit a winding up and repayment report to SEBI in accordance with the SEBI (Collective Investment Schemes) Regulations, 1999, including the trail of funds claimed to be refunded, bank account statements indicating refund to the investors and receipt from the investors acknowledging such refunds.
- PACL Limited and its directors, including Mr. Tarlochan Singh, Mr. Sukhdev Singh, Mr. Gurmeet Singh and Mr. Subrata Bhattacharya are also directed to immediately submit the complete and detailed inventory of the assets owned by PACL Limited.
- PACL Limited, its promoters and directors including Mr. Tarlochan Singh, Mr. Sukhdev Singh, Mr. Gurmeet Singh and Mr. Subrata Bhattacharya, shall not alienate or dispose off or sell any of the assets of PACL Limited except for the purpose of making refunds to its investors as directed above.

**SEBI's action in case of non-compliance of above directions**

- PACL Limited and its directors, including Mr. Tarlochan Singh, Mr. Sukhdev Singh, Mr. Gurmeet Singh, Mr. Subrata Bhattacharya, Mr. Anand Gurwant Singh, Mr. Nirmal Singh Bhangoo, Mr. Uppal Devinder Kumar, Mr. Tyger Joginder and Mr. Gurnam Singh shall immediately (on expiry of the three months period available for making refunds) be restrained from accessing the securities market and would further be prohibited from buying, selling or otherwise dealing in securities market till all the Collective Investment Schemes of PACL Limited are wound up and all the monies mobilized through such schemes are refunded to its investors with returns which are due to them.
- SEBI would make a reference to the State Government/ Local Police to register a civil/ criminal case against PACL Limited, its promoters, directors and its managers/ persons in-charge of the business and its schemes, for offences of fraud, cheating, criminal breach of trust and misappropriation of public funds; and
- SEBI would make a reference to the Ministry of Corporate Affairs, to initiate the process of winding up of the company, PACL Limited.
- SEBI shall also initiate attachment and recovery proceedings under the SEBI Act and rules and regulations framed thereunder.

**Case study - 2****Ignorance of law will not excuse the appellant to escape the liability of violating the law**

The Appellant, Mega Resources Limited, is aggrieved by the order dated 13.08.2014 passed by the Adjudicating Officer, SEBI imposing a penalty of Rs. 2,00,000/- under Section 15A(b) of the SEBI Act and Rs. 50,00,000/- under Section 15 H(ii) of the SEBI Act for failure on the part of the appellant to comply with the provisions of Regulation 7(1) read with Regulation 7(2) and Regulation 11(1) read with Regulation 14(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

The appellant has admitted that pursuant to the acquisition of 25000 equity shares through off-market transactions the shareholding of the Promoters/Promoter Group of the Company had increased from 50.46% to 60.46% of the Target Company. This triggered Regulation 11(1) of the erstwhile SAST Regulations along with the requirement of submission of certain disclosures under Regulation 7(1) and 7(2) of the erstwhile Regulations. It is admitted by the appellant that the non compliance with the disclosure requirements in respect of acquisition of shares and failure to make an open offer to the shareholders of the Company was due to lack of awareness of the erstwhile regulations on the part of the Appellant and purely unintentional and without any mala fide intentions. However, It is trite law that ignorance of law will not excuse the appellant to escape the liability of violating the law nor ever absolve the wrongdoer of his crime or misconduct.

Further, the appellant contended that in the matter of imposition of penalty, the Section 15(H)(ii) of the SEBI Act, 1992 was amended dated October 29, 2002 and the penalty for non-disclosure of acquisition of shares and takeovers was enhanced from a maximum of Rs. Five Lakh to Rs. Twenty Five crore. It is argued that since the violation in Appeal was committed in February, 2001, the appellant would be governed by the erstwhile provisions of Section 15H(ii) of the SEBI Act, which existed on the date of violation in question.

Judgment: It is true that the maximum monetary penalty imposable for non disclosure of acquisition of shares and takeovers under the erstwhile SEBI Act on the date of violation by the Appellant was Rs. Five Lakh and by the amendment dated October 29, 2002 it is up to Rs. Twenty Five Crore or three times of the amount of profits made out of such failure, whichever is higher. However, the moot point in this connection to be noted is that as on October 29, 2002 the obligation to make disclosure and public announcement under Regulations 7(1) read with 7(2) and 11(1) read with 14(1) continued. Therefore, because the violation was continued even after October 29, 2002, the appellant has been rightly imposed penalty under the amended provisions of Section 15H(ii) of the SEBI Act. Since the punishment imposable now for such non-disclosure and public announcement is up to Rs. Twenty Five Crore, SAT finds that the penalty of Rs. Fifty Lakh is just and reasonable and not disproportionate. The contention of the appellant in this regard is, therefore, liable to be turned down. Therefore, in the peculiarity of the facts and circumstances of the case and, in particular, the continuity of the obligation to make disclosure and public announcement, the penalty of Rs. Fifty Lakh is upheld and the appeal is dismissed.

## **Offences**

Section 24 of SEBI Act, 1992 stipulates that without prejudice to any award of penalty by the adjudicating officer or the SEBI under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made thereunder, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

If any person fails to pay the penalty imposed by the adjudicating officer or the SEBI or fails to comply with any directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

## **Composition of certain offences**

Section 24A stipulates that notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), any offence punishable under SEBI Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

## **Power to grant immunity**

Section 24B states that the Central Government may, on recommendation by the Board, if the Central

Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of the alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation:

Provided that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity:

Provided further that recommendation of the Board under this sub-section shall not be binding upon the Central Government.

An immunity granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

### **Recovery of amounts**

Section 28A states that If a person fails to pay the penalty imposed under SEBI Act or fails to comply with any direction of the SEBI for refund of monies or fails to comply with a direction of disgorgement order issued under section 11B or fails to pay any fees due to the SEBI, the Recovery Officer may draw up under his signature a statement in the specified form specifying the amount due from the person (such statement being hereafter in this Chapter referred to as certificate) and shall proceed to recover from such person the amount specified in the certificate by one or more of the following modes, namely: –

- (a) attachment and sale of the person's movable property;
- (b) attachment of the person's bank accounts;
- (c) attachment and sale of the person's immovable property;
- (d) arrest of the person and his detention in prison;
- (e) appointing a receiver for the management of the person's movable and immovable properties, and for this purpose, the provisions of sections 220 to 227, 228A, 229, 232, the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time, in so far as may be, apply with necessary modifications as if the said provisions and the rules made thereunder were the provisions of this Act and referred to the amount due under this Act instead of to income-tax under the Income-tax Act, 1961.

### **Case Snippets**

- PACL Ltd. had not taken any steps to refund money to the investors. Therefore SEBI had initiated recovery proceedings against PACL Ltd. and its promoters/ all directors and also against group/ associate entities of PACL Ltd.

SEBI during its recovery proceedings attached all bank accounts including lockers and Demat Accounts/ mutual fund folios, either singly or jointly with any other person or persons and communicated the same to all the banks, depositories and mutual fund houses.

### Penalties under Securities Contracts (Regulation) Act, 1956

The object of Securities Contracts (Regulation) Act, 1956 is to provide for the regulation of stock exchanges, and of transactions in securities dealt on them with a view to preventing undesirable speculation in them. The Act also seeks to regulate the buying and selling of securities outside the limits of stock exchanges, through the licensing of security dealers.

#### Penalties.

The Act prescribes various penalties against persons who might be found guilty of offences under section 23 the Act. These offences are listed below –

#### Section 23. (1) Any person who –

- (a) without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6; or
- (b) enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or
- (c) contravenes the provisions contained in section 17 or section 17A, or section 19; or
- (d) enters into any contract in derivative in contravention of section 18A or the rules made under section 30;
- (e) owns or keeps a place other than that of a recognized stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act and knowingly permits such place to be used for such purposes; or
- (f) manages, controls, or assists in keeping any place other than that of a recognized stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act or at which contracts are recorded or adjusted or rights or liabilities arising out of contracts are adjusted, regulated or enforced in any manner whatsoever; or
- (g) not being a member of a recognized stock exchange or his agent authorized as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17 wilfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; or
- (h) not being a member of a recognized stock exchange or his agent authorized as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17, canvasses, advertises or touts in any manner either for himself or on behalf of any other persons for any business connected with contracts in contravention of any of the provisions of this Act; or
- (i) joins, gathers or assists in gathering at any place other than the place of business specified in the bye-laws of a recognized stock exchange any person or persons for making bids or offers or for entering into or performing any contracts in contravention of any of the provisions of this Act; shall, without prejudice to any award of penalty by the Adjudicating Officer or the Securities and Exchange Board of India under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

(2) Any person who enters into any contract in contravention of the provisions contained in section 15 or who fails to comply with the provisions of section 21 or section 21A or with the orders of] or section 22 or with the orders of the Securities Appellate Tribunal shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

### **Penalty for failure to furnish information, return, etc.**

**Section 23A.** Any person, who is required under this Act or any rules made thereunder, –

- (a) to furnish any information, document, books, returns or report to the recognised stock exchange or to the Board, fails to furnish the same within the time specified therefor in the listing agreement or conditions or bye-laws of the recognised stock exchange or the Act or rules made thereunder, or who furnishes false, incorrect or incomplete information, document, books, return or report, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees for each such failure;
- (b) to maintain books of account or records, as per the listing agreement or conditions, or byelaws of a recognized stock exchange, fails to maintain the same, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

### **Penalty for failure by any person to enter into an agreement with clients.**

**Section 23B.** If any person, who is required under this Act or any bye-laws of a recognized stockexchange made thereunder, to enter into an agreement with his client, fails to enter into such an agreement, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees for every such failure.

### **Penalty for failure to redress investors' grievances.**

**Section 23C.** If any stock broker or sub-broker or a company whose securities are listed or proposed to be listed in a recognized stock exchange, after having been called upon by the Securities and Exchange Board of India or a recognized stock exchange in writing, to redress the grievances of the investors, fails to redress such grievances within the time stipulated by the Securities and Exchange Board of India or a recognized stock exchange, he or it shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

### **Penalty for failure to segregate securities or moneys of client or clients.**

**Section 23D.** If any person, who is registered under section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or moneys of a client or clients for self or for any other client, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

### **Penalty for failure to comply with provision of listing conditions or delisting conditions or grounds.**

**Section 23E.** If a company or any person managing collective investment scheme or mutual fund or real estate investment trust or infrastructure investment trust or alternative investment fund], fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it or he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

### **Penalty for excess dematerialisation or delivery of unlisted securities.**

**Section 23F.** If any issuer dematerialises securities more than the issued securities of a company or delivers in the stock exchanges the securities which are not listed in the recognized stock exchange or delivers securities where no trading permission has been given by the recognized stock exchange, he shall be 122[liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

**Penalty for failure to furnish periodical returns, etc.**

**Section 23G.** If a recognized stock exchange fails or neglects to furnish periodical returns or furnishes false, incorrect or incomplete periodical returns to the Securities and Exchange Board of India or fails or neglects to make or amend its rules or bye-laws as directed by the Securities and Exchange Board of India or fails to comply with directions issued by the Securities and Exchange Board of India, such recognized stock exchange shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

**Penalty for failure to conduct business in accordance with rules, etc.**

**Section 23GA.** Where a stock exchange or a clearing corporation fails to conduct its business with its members or any issuer or its agent or any person associated with the securities markets in accordance with the rules or regulations made by the Securities and Exchange Board of India and the directions issued by it under this Act, the stock exchange or the clearing corporations, as the case may be, shall be liable to penalty which shall not be less than five crore rupees but which may extend to twenty-five crore rupees or three times the amount of gains made out of such failure, whichever is higher.

**Penalty for contravention where no separate penalty has been provided.**

**Section 23H.** Whoever fails to comply with any provision of this Act, the rules or articles or bye-laws or the regulations of the recognized stock exchange or directions issued by the Securities and Exchange Board of India for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

**Power to adjudicate.**

**Section 23-I.** (1) For the purpose of adjudging under sections 23A, 23B, 23C, 23D, 23E, 23F, 23G and 23H, the Securities and Exchange Board of India may appoint any officer not below the rank of a Division Chief of the Securities and Exchange Board of India to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.

(2) While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in subsection (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

(3) The Board may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify:

Provided that no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter:

Provided further that nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 23L, whichever is earlier.

**Factors to be taken into account while adjudging quantum of penalty.**

**Section 23J.** While adjudging the quantum of penalty under 134[section 12A or section 23-I, the Securities and Exchange Board of India or the adjudicating officer] shall have due regard to the following factors, namely:—



- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
- (b) the amount of loss caused to an investor or group of investors as a result of the default;
- (c) the repetitive nature of the default.]

*Explanation.* – For the removal of doubts, it is clarified that the power of an adjudicating officer to adjudge the quantum of penalty under sections 23A to 23C shall be and shall always be deemed to have exercised under the provisions of this section.

### **Settlement of administrative and civil proceedings.**

**Section 23JA.** (1) Notwithstanding anything contained in any other law for the time being in force, any person, against whom any proceedings have been initiated or may be initiated under section 12A or section 23-I, may file an application in writing to the Board proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

(2) The Board may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by the Board in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992.

(3) For the purposes of settlement under this section, the procedure as specified by the Board under the Securities and Exchange Board of India Act, 1992 shall apply.

(4) No appeal shall lie under section 23L against any order passed by the Board or the adjudicating officer, as the case may be, under this section.

(5) All settlement amounts, excluding the disgorgement amount and legal costs, realized under this Act shall be credited to the Consolidated Fund of India.

### **Recovery of amounts.**

**Section 23JB.** (1) If a person fails to pay the penalty imposed 140[ under this Act] or fails to comply with a direction of disgorgement order issued under section 12A or fails to pay any fees due to the Board, the Recovery Officer may draw up under his signature a statement in the specified form specifying the amount due from the person (such statement being hereafter in this Chapter referred to as certificate) and shall proceed to recover from such person the amount specified in the certificate by one or more of the following modes, namely:–

- (a) attachment and sale of the person's movable property;
- (b) attachment of the person's bank accounts;
- (c) attachment and sale of the person's immovable property;
- (d) arrest of the person and his detention in prison;
- (e) appointing a receiver for the management of the person's movable and immovable properties, and for this purpose, the provisions of sections 220 to 227, 228A, 229, 232, the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time, in so far as may be, apply with necessary modifications as if the said provisions and the rules thereunder were the provisions of this Act and referred to the amount due under this Act instead of to income-tax under the Income-tax Act, 1961.

*Explanation 1.* – For the purposes of this sub-section, the person's movable or immovable property or monies held in bank accounts shall include any property or monies held in bank accounts which has been transferred, directly or indirectly on or after the date when the amount specified in certificate had become due, by the person



to his spouse or minor child or son's wife or son's minor child, otherwise than for adequate consideration, and which is held by, or stands in the name of, any of the persons aforesaid; and so far as the movable or immovable property or monies held in bank accounts so transferred to his minor child or his son's minor child is concerned, it shall, even after the date of attainment of majority by such minor child or son's minor child, as the case may be, continue to be included in the person's movable or immovable property or monies held in bank accounts for recovering any amount due from the person under this Act.

*Explanation 2.* – Any reference under the provisions of the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962 to the assessee shall be construed as a reference to the person specified in the certificate.

*Explanation 3.* – Any reference to appeal in Chapter XVIII and the Second Schedule to the Income-tax Act, 1961, shall be construed as a reference to appeal before the Securities Appellate Tribunal under section 23L of this Act.

(2) The Recovery Officer shall be empowered to seek the assistance of the local district administration while exercising the powers under sub-section (1).

(3) Notwithstanding anything contained in any other law for the time being in force, the recovery of amounts by a Recovery Officer under sub-section (1), pursuant to non-compliance with any direction issued by the Board under section 12A, shall have precedence over any other claim against such person.

(4) For the purposes of sub-sections (1), (2) and (3), the expression "Recovery Officer" means any officer of the Board who may be authorized, by general or special order in writing to exercise the powers of a Recovery Officer.

### **Continuance of proceedings.**

**Section 23JC.** (1) Where a person dies, his legal representative shall be liable to pay any sum which the deceased would have been liable to pay, if he had not died, in the like manner and to the same extent as the deceased:

Provided that, in case of any penalty payable under this Act, a legal representative shall be liable only in case the penalty has been imposed before the death of the deceased person.

(2) For the purposes of sub-section (1), –

- (a) any proceeding for disgorgement, refund or an action for recovery before the Recovery Officer under this Act, except a proceeding for levy of penalty, initiated against the deceased before his death shall be deemed to have been initiated against the legal representative, and may be continued against the legal representative from the stage at which it stood on the date of the death of the deceased and all the provisions of this Act shall apply accordingly;
- (b) any proceeding for disgorgement, refund or an action for recovery before the Recovery Officer under this Act, except a proceeding for levy of penalty, which could have been initiated against the deceased if he had survived, may be initiated against the legal representative and all the provisions of this Act shall apply accordingly.

(3) Every legal representative shall be personally liable for any sum payable by him in his capacity as legal representative if, while his liability for such sum remains undischarged, he creates a charge on or disposes of or parts with any assets of the estate of the deceased, which are in, or may come into, his possession, but such liability shall be limited to the value of the asset so charged, disposed of or parted with.

(4) The liability of a legal representative under this section shall, be limited to the extent to which the estate of the deceased is capable of meeting the liability.

*Explanation.*—For the purposes of this section “Legal representative” means a person who in law represents the estate of a deceased person, and includes any person who intermeddles with the estate of the deceased and where a party sues or is sued in a representative character, the person on whom the estate devolves on the death of the party so suing or sued.

### **Crediting sums realized by way of penalties to Consolidated Fund of India.**

**Section 23K.** All sums realized by way of penalties under this Act shall be credited to the Consolidated Fund of India.

### **Appeal to Securities Appellate Tribunal.**

**Section 23L.** (1) Any person aggrieved, by the order or decision of the recognized stock exchange or the adjudicating officer or any order made by the Securities and Exchange Board of India under or sub-section (3) of section 23-I, may prefer an appeal before the Securities Appellate Tribunal and the provisions of sections 22B, 22C, 22D and 22E of this Act, shall apply, as far as may be, to such appeals.

(2) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order or decision is received by the appellant and it shall be in such form and be accompanied by such fee as may be prescribed:

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

(3) On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(4) The Securities Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned adjudicating officer.

(5) The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

### **Offences.**

**Section 23M.** (1) Without prejudice to any award of penalty by the adjudicating officer or the Securities and Exchange Board of India] under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws made thereunder, for which no punishment is provided elsewhere in this Act, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

(2) If any person fails to pay the penalty imposed by the adjudicating officer or the Securities and Exchange Board of India] or fails to comply with the direction or order, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

### **Composition of certain offences.**

**Section 23N.** Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

**Power to grant immunity.**

**Section 23-O.** (1) The Central Government may, on recommendation by the Securities and Exchange Board of India, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation:

Provided that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity: Provided further that the recommendation of the Securities and Exchange Board of India under this sub-section shall not be binding upon the Central Government.

(2) An immunity granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

**Contravention by companies;**

**Section 24.** (1) Where a contravention of any of the provisions of this Act or any rule, regulation, direction or order made thereunder has been committed by a company, every person who, at the time when the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention, and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the contravention was committed without his knowledge or that he exercised all due diligence to prevent the commission of such contravention.

(2) Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or any rule, regulation, direction or order made thereunder has been committed by a company and it is proved that the contravention has been committed with the consent or connivance of, or is attributable to any gross negligence on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer of the company, shall also be deemed to be guilty of that contravention and shall be liable to be proceeded against and punished accordingly.

*Explanation.* – For the purpose of this section, –

- (a) “company” means anybody corporate and includes a firm or other association of individuals, and
- (b) “director”, in relation to –
  - (i) a firm, means a partner in the firm;
  - (ii) any association of persons or a body of individuals, means any member controlling the affairs thereof.

(3) The provisions of this section shall be in addition to, and not in derogation of, the provisions of section 22A.

## PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES UNDER SECURITIES CONTRACT (REGULATIONS) ACT, 1956

SEBI may appoint any of its officers not below the rank of Division Chief to be an adjudicating officer for holding an inquiry whenever SEBI is of the opinion that there are grounds for adjudging penalties and adjudication under SEBI Act, 1992.

In holding an inquiry for the purpose of adjudging whether any person has committed contraventions as specified, SEBI or adjudicating officer shall in the first instance issue a notice to such person requiring him to show cause within such period as may be specified in the notice (being not less than fourteen days from the date of service thereof) why an inquiry should not be held against him.

Every notice to any such person shall indicate the nature of offence alleged to have been committed by him.

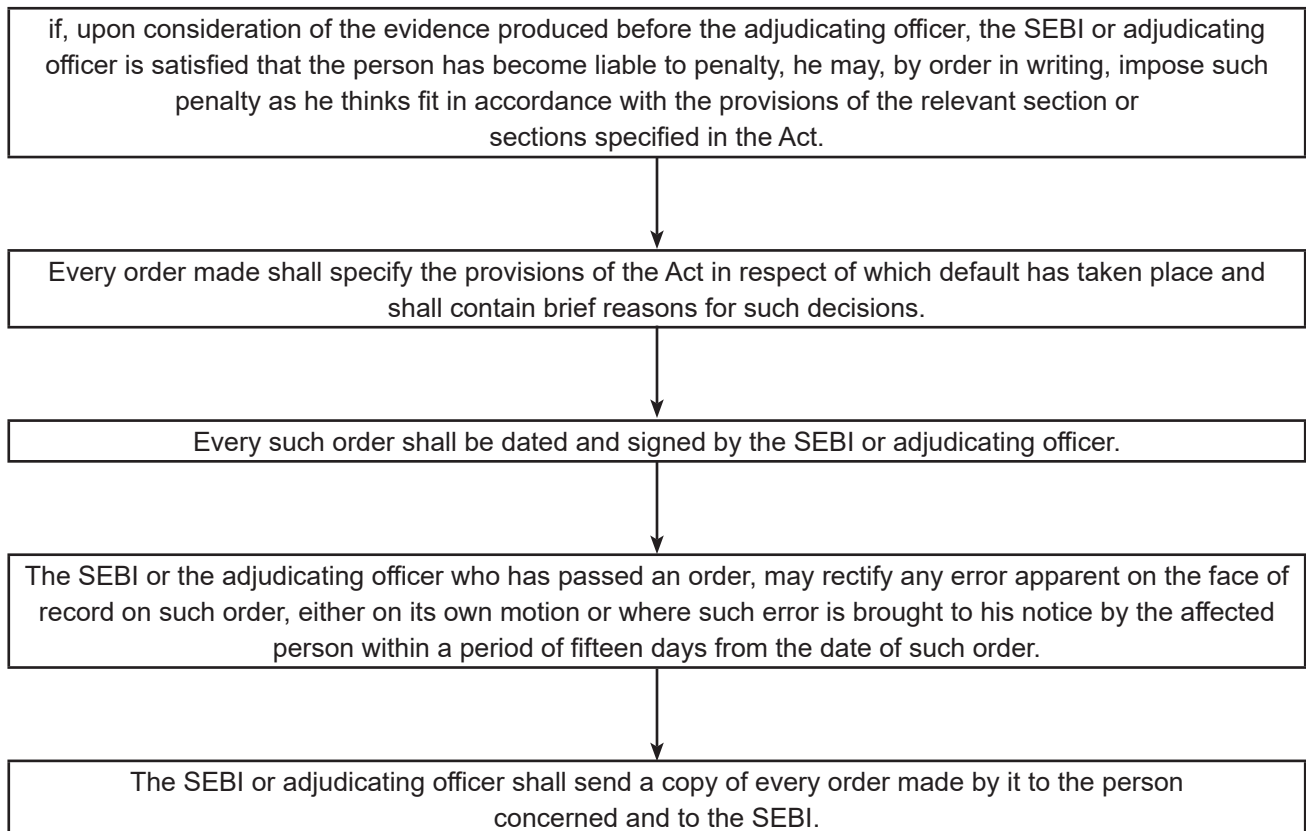
If the SEBI or adjudicating officer is of the opinion that an inquiry should be held, he shall issue a notice fixing a date for the appearance of that person either personally or through his lawyer or other authorised representative.

On the date fixed the SEBI or adjudicating officer shall explain to the person proceeded against or his lawyer or authorised representative, the offence, alleged to have been committed by such person indicating the provisions of the Act, rules or regulations in respect of which contravention is alleged to have taken place.

The SEBI or adjudicating officer shall then give an opportunity to such person to produce such documents or evidence as he may consider relevant to the inquiry and if necessary the hearing may be adjourned to a future date and in taking such evidence the SEBI or the adjudicating officer shall not be bound to observe the provisions of the Evidence Act, 1872.

While holding an inquiry the SEBI or adjudicating officer shall have the power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the SEBI or adjudicating officer, may be useful for or relevant to the subject matter of the inquiry.

If any person fails, neglects or refuses to appear before the adjudicating officer, the SEBI or adjudicating officer may proceed with the inquiry in the absence of such person after recording the reasons for doing so.



[*Explanation.* – For the purpose of this rule, “error apparent on the face of record” shall mean any typographical errors that creep in inadvertently into the order and includes such other errors that do not require a long drawn out reasoning process to ascertain such a mistake.]

## THE CONSERVATION OF FOREIGN EXCHANGE AND PREVENTION OF SMUGGLING ACTIVITIES ACT, 1974

Violations of foreign exchange regulations and smuggling activities are having an increasingly deleterious effect on the national economy and thereby a serious adverse effect on the security of the State and having regard to the persons by whom and the manner in which such activities or violations are organised and carried on, and having regard to the fact that in certain areas which are highly vulnerable to smuggling, smuggling activities of a considerable magnitude are clandestinely organised and carried on, it is necessary for the effective prevention of such activities and violations to provide for detention of persons concerned in any manner therewith, Parliament enacted the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974, is an Act to provide for preventive detention in certain cases for the purposes of conservation and augmentation of Foreign Exchange and prevention of smuggling activities and for matters connected therewith.

### Important Definitions

“Appropriate Government” means, as respects a detention order made by the Central Government or by an officer of the Central Government or a person detained under such order, the Central Government, and as respects a detention order made by a State Government or by an officer of a State Government or a person detained under such order, the State Government;

“Detention order” means an order made under section 3

“**Foreigner**” has the same meaning as in the Foreigners Act, 1946

“**Indian customs waters**” has the same meaning as in clause (28) of section 2 of the Customs Act, 1962

“**Smuggling**” has the same meaning as in clause (39) of section 2 of the Customs Act, 1962 , and all its grammatical variations and cognate expressions shall be construed accordingly;

### Power to make orders detaining certain persons (Section 3)

(1) The Central Government or the State Government or any officer of the Central Government, not below the rank of a Joint Secretary to that Government, specially empowered for the purposes of this section by that Government, or any officer of a State Government, not below the rank of a Secretary to that Government, specially empowered for the purposes of this section by that Government, may, if satisfied, with respect to any person (including a foreigner), that, with a view to preventing him from acting in any manner prejudicial to the conservation or augmentation of foreign exchange or with a view to preventing him from—

- (i) smuggling goods, or
- (ii) abetting the smuggling of goods, or
- (iii) engaging in transporting or concealing or keeping smuggled goods, or
- (iv) dealing in smuggled goods otherwise than by engaging in transporting or concealing or keeping smuggled goods, or
- (v) harboring persons engaged in smuggling goods or in abetting the smuggling of goods, it is necessary so to do, make an order directing that such person be detained.

Provided that no order of detention shall be made on any of the grounds specified in this sub-section on which an order of detention may be made under section 3 of the Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988 or under section 3 of the Jammu and Kashmir Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Ordinance, 1988 (J & K Ordinance 1 of 1988).

(2) When any order of detention is made by a State Government or by an officer empowered by a State Government, the State Government shall, within ten days, forward to the Central Government a report in respect of the order.

(3) For the purposes of clause (5) of article 22 of the Constitution, the communication to a person detained in pursuance of a detention order of the grounds on which the order has been made shall be made as soon as may be after the detention, but ordinarily not later than five days, and in exceptional circumstances and for reasons to be recorded in writing, not later than fifteen days, from the date of detention.

### Execution of detention orders (Section 4)

A detention order may be executed at any place in India in the manner provided for the execution of warrants of arrest under the Code of Criminal Procedure, 1973.

### Power to regulate place and conditions of detention (Section 5)

Every person in respect of whom a detention order has been made shall be liable –

- a. to be detained in such place and under such conditions including conditions as to maintenance, interviews or communication with others, discipline and punishment for breaches of discipline, as the appropriate Government may, by general or special order, specify; and
- b. to be removed from one place of detention to another place of detention, whether within the same State or in another State by order of the appropriate Government:

Provided that no order shall be made by a State Government under clause (b) for the removal of a person from one State to another State except with the consent of the Government of that other State.

#### **Grounds of detention severable (Section 5A)**

Where a person has been detained in pursuance of an order of detention under sub-section (1) of section 3 which has been made on two or more grounds, such order of detention shall be deemed to have been made separately on each of such grounds and accordingly –

- (a) such order shall not be deemed to be invalid or inoperative merely because one or some of the grounds is or are –
  - (i) vague,
  - (ii) non-existent,
  - (iii) not relevant,
  - (iv) not connected or not proximately connected with such person, or
  - (v) invalid for any other reason whatsoever,

and it is not, therefore, possible to hold that the Government or officer making such order would have been satisfied as provided in sub-section (1) of section 3 with reference to the remaining ground or grounds and made the order of detention;

- (b) the Government or officer making the order of detention shall be deemed to have made the order of detention under the said sub-section (1) after being satisfied as provided in that sub-section with reference to the remaining ground or grounds.

#### **Detention orders not to be invalid or inoperative on certain grounds (Section 6)**

No detention order shall be invalid or inoperative merely by reason –

- (a) that the person to be detained thereunder is outside the limits of the territorial jurisdiction of the Government or the officer making the order of detention, or
- (b) that the place of detention of such person is outside the said limits.

#### **Powers in relation to absconding persons (Section 7)**

(1) If the appropriate Government has reason to believe that a person in respect of whom a detention order has been made has absconded or is concealing himself so that the order cannot be executed, that Government may –

- a. make a report in writing of the fact to a Metropolitan Magistrate or a Magistrate of the first class having jurisdiction in the place where the said person ordinarily resides; and thereupon the provisions of sections 82, 83, 84 and 85 of the Code of Criminal Procedure, 1973, shall apply in respect of the said person and his property as if the order directing that he be detained were a warrant issued by the Magistrate;
- b. by order notified in the Official Gazette direct the said person to appear before such officer, at such place and within such period as may be specified in the order; and if the said person fails to comply with such direction, he shall, unless he proves that it was not possible for him to comply therewith and that he had, within the period specified in the order, informed the officer mentioned in the order of the reason which rendered compliance therewith impossible and of his whereabouts, be punishable with imprisonment for a term which may extend to one year or with fine or with both.



(2) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, every offence under clause (b) of sub-section (1) shall be cognizable.

### Advisory Boards

For the purposes of article 22(4)(A) and 22(7)(c) of the Constitution, –

- (a) the Central Government and each State Government shall, whenever necessary, constitute one or more Advisory Boards each of which shall consist of a Chairman and two other persons possessing the qualifications specified in sub-clause (a) of clause (4) of article 22 of the Constitution;
- (b) save as otherwise provided in section 9, the appropriate Government shall, within five weeks from the date of detention of a person under a detention order make a reference in respect thereof to the Advisory Board constituted under clause (a) to enable the Advisory Board to make the report under sub-clause (a) of clause (4) of article 22 of the Constitution;
- (c) the Advisory Board to which a reference is made under clause (b) shall after considering the reference and the materials placed before it and after calling for such further information as it may deem necessary from the appropriate Government or from any person called for the purpose through the appropriate Government or from the person concerned, and if, in any particular case, it considers it essential so to do or if the person concerned desires to be heard in person, after hearing him in person, prepare its report specifying in a separate paragraph thereof its opinion as to whether or not there is sufficient cause for the detention of the person concerned and submit the same within eleven weeks from the date of detention of the person concerned;
- (d) when there is a difference of opinion among the members forming the Advisory Board, the opinion of the majority of such members shall be deemed to be the opinion of the Board;
- (e) a person against whom an order of detention has been made under this Act shall not be entitled to appear by any legal practitioner in any matter connected with the reference to the Advisory Board, and the proceedings of the Advisory Board and its report, excepting that part of the report in which the opinion of the Advisory Board is specified, shall be confidential;
- (f) in every case where the Advisory Board has reported that there is in its opinion sufficient cause for the detention of a person, the appropriate Government may confirm the detention order and continue the detention of the person concerned for such period as it thinks fit and in every case where the Advisory Board has reported that there is in its opinion no sufficient cause for the detention of the person concerned, the appropriate Government shall revoke the detention order and cause the person to be released forthwith.

### Cases in which and circumstances under which persons may be detained for periods longer than three months without obtaining the opinion of Advisory Board (Section 9)

(1) Notwithstanding anything contained in this Act, any person (including a foreigner) in respect of whom an order of detention is made under this Act at any time before the 31st day of July, 1999, may be detained without obtaining, in accordance with the provisions of sub-clause (a) of clause (4) of article 22 of the Constitution, the opinion of an Advisory Board for a period longer than three months but not exceeding six months from the date of his detention, where the order of detention has been made against such person with a view to preventing him from smuggling goods or abetting the smuggling of goods or engaging in transporting or concealing or keeping smuggled goods and the Central Government or any officer of the Central Government, not below the rank of an Additional Secretary to that Government, specially empowered for the purposes of this section by that Government, is satisfied that such person –

- (a) smuggles or is likely to smuggle goods into, out of or through any area highly vulnerable to smuggling;
- or

- (b) abets or is likely to abet the smuggling of goods into, out of or through any area highly vulnerable to smuggling; or
- (c) engages or is likely to engage in transporting or concealing or keeping smuggled goods in any area highly vulnerable to smuggling, and makes a declaration to that effect within five weeks of the detention of such person.

*Explanation 1.*—In this sub-section, “area highly vulnerable to smuggling” means—

- (i) The Indian customs waters contiguous to The States of Goa, Gujarat, Karnataka, Kerala, Maharashtra and Tamil Nadu and the Union territories of Daman and Diu and Pondicherry;
- (ii) The inland area fifty kilometres in width from the coast of India falling within the territories of the States of Goa, Gujarat, Karnataka, Kerala, Maharashtra and Tamil Nadu and the Union territories of Daman and Diu and Pondicherry;
- (iii) the inland area fifty kilometres in width from the India-Pakistan border in the States of Gujarat, Jammu and Kashmir, Punjab and Rajasthan;
- (iv) the customs airport of Delhi; and
- (v) such further or other Indian customs waters, or inland area not exceeding one hundred kilometres in width from any other coast or border of India, or such other customs station, as the Central Government may, having regard to the vulnerability of such waters, area or customs station, as the case may be, to smuggling, by notification in the Official Gazette, specify in this behalf.

*Explanation 2.*—For the purposes of *Explanation 1*, “customs airport” and “customs station” shall have the same meaning as in clauses (10) and (13) of section 2 of the Customs Act, 1962 (52 of 1962), respectively.

(2) In the case of any person detained under a detention order to which the provisions of sub-section (1) apply, section 8 shall have effect subject to the following modifications, namely:—

- (i) in clause (b), for the words “shall, within five weeks”, the words “shall, within four months and two weeks” shall be substituted;
- (ii) in clause (c),—
  - (1) for the words “the detention of the person concerned”, the words “the continued detention of the person concerned” shall be substituted;
  - (2) for the words “eleven weeks”, the words “five months and three weeks” shall be substituted;
- (iii) in clause (f), for the words “for the detention”, at both the places where they occur, the words “for the continued detention” shall be substituted.

### **Maximum period of detention (Section 10)**

The maximum period for which any person may be detained in pursuance of any detention order to which the provisions of section 9 do not apply and which has been confirmed under clause (f) of section 8 shall be a period of one year from the date of detention or the specified period, whichever period expires later and the maximum period for which any person may be detained in pursuance of any detention order to which the provisions of section 9 apply and which has been confirmed under clause (f) of section 8 read with sub-section (2) of section 9 shall be a period of two years from the date of detention or the specified period, whichever period expires later:

Provided that nothing contained in this section shall affect the power of the appropriate Government in either case to revoke or modify the detention order at any earlier time.

*Explanation.*—In this section and in section 10A, “specified period” means the period during which the Proclamation

of Emergency issued under clause (1) of article 352 of the Constitution on the 3rd day of December, 1971 and the Proclamation of Emergency issued under that clause on the 25th day of June, 1975, are both in operation.

### **Extension of period of detention (Section 10A)**

(1) Notwithstanding anything contained in any other provision of this Act, the detention of every person detained under a detention order which has been confirmed under clause (f) of section 8 before the commencement of the Conservation of Foreign Exchange and Prevention of Smuggling Activities (Amendment) Act, 1976, and which is in force immediately before such commencement shall, unless his detention has been continued by the appropriate Government under the said clause for a period shorter than one year from the date of his detention, continue until the expiry of a period of one year from the date of his detention under such order or until the expiry of the specified period, whichever period expires later:

Provided that nothing contained in this sub-section shall affect the power of the appropriate Government to revoke or modify such detention order at any earlier time.

(2) Notwithstanding anything contained in any other provision of this Act, the detention of every person detained under a detention order which has been confirmed under clause (f) of section 8 read with sub-section (2) of section 9 before the commencement of the Conservation of Foreign Exchange and Prevention of Smuggling Activities (Amendment) Act, 1976, and which is in force immediately before such commencement, shall, unless his detention has been continued by the appropriate Government under the said clause (f) read with the said sub-section (2), for a period shorter than two years from the date of his detention, continue until the expiry of a period of two years from the date of his detention under such order or until the expiry of the specified period, whichever period expires later:

Provided that nothing contained in this sub-section shall affect the power of the appropriate Government to revoke or modify such detention order at any earlier time.

### **Revocation of detention orders (Section 11)**

(1) Without prejudice to the provisions of section 21 of the General Clauses Act, 1897 (10 of 1897), a detention order may, at any time, be revoked or modified—

- (a) notwithstanding that the order has been made by an officer of a State Government, by that State Government or by the Central Government;
- (b) notwithstanding that the order has been made by an officer of the Central Government or by a State Government, by the Central Government.

(2) The revocation of a detention order shall not bar the making of another detention order under section 3 against the same person.

### **Temporary release of persons detained (Section 12)**

(1) The Central Government may, at any time, direct that any person detained in pursuance of a detention order made by that Government or an officer subordinate to that Government or by a State Government or by an officer subordinate to a State Government, may be released for any specified period either without conditions or upon such conditions specified in the direction as that person accepts, and may, at any time, cancel his release.

(1A) A State Government may, at any time, direct that any person detained in pursuance of a detention order made by that Government or by an officer subordinate to that Government may be released for any specified period either without conditions or upon such conditions specified in the direction as that person accepts, and may, at any time, cancel his release.

(2) In directing the release of any person under sub-section (1) or sub-section (1A), the Government directing

the release may require him to enter into a bond with sureties for the due observance of the conditions specified in the direction.

(3) Any person released under sub-section (1) or sub-section (1A) shall surrender himself at the time and place, and to the authority, specified in the order directing his release or cancelling his release, as the case may be.

(4) If any person fails without sufficient cause to surrender himself in the manner specified in sub-section (3), he shall be punishable with imprisonment for a term which may extend to two years, or with fine, or with both.

(5) If any person released under sub-section (1) or sub-section (1A) fails to fulfil any of the conditions imposed upon him under the said sub-section or in the bond entered into by him, the bond shall be declared to be forfeited and any person bound thereby shall be liable to pay the penalty thereof.

(6) Notwithstanding anything contained in any other law and save as otherwise provided in this section, no person against whom a detention order made under this Act is in force shall be released whether on bail or bail bond or otherwise.

### **Special provisions for dealing with emergency (Section 12A)**

(1) Notwithstanding anything contained in this Act or any rules of natural justice, the provisions of this section shall have effect during the period of operation of the Proclamation of Emergency issued under clause (1) of article 352 of the Constitution on the 3rd day of December, 1971, or the Proclamation of Emergency issued under that clause on the 25th day of June, 1975, or a period of twenty-four months] from the 25th day of June, 1975, whichever period is the shortest.

(2) When making an order of detention under this Act against any person after the commencement of the Conservation of Foreign Exchange and Prevention of Smuggling Activities (Amendment) Act, 1975 (35 of 1975), the Central Government or the State Government or, as the case may be, the officer making the order of detention shall consider whether the detention of such person under this Act is necessary for dealing effectively with the emergency in respect of which the Proclamations referred to in sub-section (1) have been issued (hereafter in this section referred to as the emergency) and if, on such consideration, the Central Government or the State Government or, as the case may be, the officer is satisfied that it is necessary to detain such person for effectively dealing with the emergency, that Government or officer may make a declaration to that effect and communicate a copy of the declaration to the person concerned;

Provided that where such declaration is made by an officer, it shall be reviewed by the appropriate Government within fifteen days from the date of making of the declaration and such declaration shall cease to have effect unless it is confirmed by that Government, after such review, within the said period of fifteen days.

(1) The question whether the detention of any person in respect of whom a declaration has been made under sub-section (2) continues to be necessary for effectively dealing with the emergency shall be reconsidered by the appropriate Government within four months from the date of such declaration and thereafter at intervals not exceeding four months, and if, on such reconsideration, it appears to the appropriate Government that the detention of the person is no longer necessary for effectively dealing with the emergency, the Government may revoke the declaration.

(2) In making any consideration, review or reconsideration under sub-section (2) or (3), the appropriate Government or officer may, if such Government or officer considers it to be against the public interest to do otherwise, act on the basis of the information and materials in its or his possession without disclosing the facts or giving an opportunity of making a representation to the person concerned.

(3) It shall not be necessary to disclose to any person detained under a detention order to which the provisions of sub-section (2) apply, the grounds on which the order has been made during the period the declaration made in respect of such person under that sub-section is in force, and, accordingly, such period shall not be taken into account for the purposes of sub-section (3) of section 3.

(4) In the case of every person detained under a detention order to which the provisions of sub-section (2) apply, being a person in respect of whom a declaration has been made thereunder, the period during which such declaration is in force shall not be taken into account for the purpose of computing –

- (i) The periods specified in clauses (b) and (c) of section 8;
- (ii) The periods of ‘one year’ and ‘ five weeks ‘ specified in sub section (1) the period of one year’ specified in sub section (2) (i) and the period of “six months” specified in sub section (3) , of section 9

### **Protection of action taken in good faith**

Section 13 provides that No suit or other legal proceeding shall lie against the Central Government or a State Government, and no suit, prosecution or other legal proceedings shall lie against any person, for anything in good faith done or intended to be done in pursuance of this Act.

## **CONTRAVENTION AND PENALTIES, ADJUDICATION AND APPEAL UNDER FOREIGN EXCHANGE MANAGEMENT ACT, 1999**

### **Penalties (Section 13)**

(1) If any person contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject to which an authorisation is issued by the Reserve Bank, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.

(1A) If any person is found to have acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the threshold prescribed under the proviso to sub-section (1) of section 37A, he shall be liable to a penalty up to three times the sum involved in such contravention and confiscation of the value equivalent, situated in India, the Foreign exchange, foreign security or immovable property.

(1B) If the Adjudicating Authority, in a proceeding under sub-section (1A) deems fits, he may, after recording the reasons in writing, recommend for the initiation of prosecution and if the Director of Enforcement is satisfied, he may, after recording the reasons in writing, may direct prosecution by filing a Criminal Complaint against the guilty person by an officer not below the rank of Assistant Director.

(1C) If any person is found to have acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the threshold prescribed under the proviso to sub-section (1) of section 37A, he shall be, in addition to the penalty imposed under sub-section (1A), punishable with imprisonment for a term which may extend to five years and with fine.

(1D) No court shall take cognizance of an offence under sub-section (1C) of section 13 except as on complaint in writing by an officer not below the rank of Assistant Director referred to in sub-section (1B).

(2) Any Adjudicating Authority adjudging any contravention under sub-section (1), may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any, of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.

*Explanation.*– For the purposes of this sub-section, “property” in respect of which contravention has taken place, shall include –

- (a) deposits in a bank, where the said property is converted into such deposits;
- (b) Indian currency, where the said property is converted into that currency; and
- (c) any other property which has resulted out of the conversion of that property.

#### **Enforcement of the orders of Adjudicating Authority (Section 14)**

(1) Subject to the provisions of sub-section (2) of section 19, if any person fails to make full payment of the penalty imposed on him under section 13 within a period of ninety days from the date on which the notice for payment of such penalty is served on him, he shall be liable to civil imprisonment under this section.

(2) No order for the arrest and detention in civil prison of a defaulter shall be made unless the Adjudicating Authority has issued and served a notice upon the defaulter calling upon him to appear before him on the date specified in the notice and to show cause why he should not be committed to the civil prison, and unless the Adjudicating Authority, for reasons in writing, is satisfied—

- (a) that the defaulter, with the object or effect of obstructing the recovery of penalty, has after the issue of notice by the Adjudicating Authority, dishonestly transferred, concealed, or removed any part of his property, or
- (b) that the defaulter has, or has had since the issuing of notice by the Adjudicating Authority, the means to pay the arrears or some substantial part thereof and refuses or neglects or has refused or neglected to pay the same.

(3) Notwithstanding anything contained in sub-section (1), a warrant for the arrest of the defaulter may be issued by the Adjudicating Authority if the Adjudicating Authority is satisfied, by affidavit or otherwise, that with the object or effect of delaying the execution of the certificate the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority.

(4) Where appearance is not made pursuant to a notice issued and served under sub-section (1), the Adjudicating Authority may issue a warrant for the arrest of the defaulter.

(5) A warrant of arrest issued by the Adjudicating Authority under sub-section (3) or sub-section (4) may also be executed by any other Adjudicating Authority within whose jurisdiction the defaulter may for the time being be found.

(6) Every person arrested in pursuance of a warrant of arrest under this section shall be brought before the Adjudicating Authority issuing the warrant as soon as practicable and in any event within twenty-four hours of his arrest (exclusive of the time required for the journey):

Provided that, if the defaulter pays the amount entered in the warrant of arrest as due and the costs of the arrest to the officer arresting him, such officer shall at once release him.

*Explanation.* – For the purposes of this sub-section, where the defaulter is a Hindu undivided family, the *karta* thereof shall be deemed to be the defaulter.

(7) When a defaulter appears before the Adjudicating Authority pursuant to a notice to show cause or is brought before the Adjudicating Authority under this section, the Adjudicating Authority shall give the defaulter an opportunity showing cause why he should not be committed to the civil prison.

(8) Pending the conclusion of the inquiry, the Adjudicating Authority may, in his discretion, order the defaulter to be detained in the custody of such officer as the Adjudicating Authority may think fit or release him on his furnishing the security to the satisfaction of the Adjudicating Authority for his appearance as and when required.

(9) Upon the conclusion of the inquiry, the Adjudicating Authority may make an order for the detention of the defaulter in the civil prison and shall in that event cause him to be arrested if he is not already under arrest:



Provided that in order to give a defaulter an opportunity of satisfying the arrears, the Adjudicating Authority may, before making the order of detention, leave the defaulter in the custody of the officer arresting him or of any other officer for a specified period not exceeding fifteen days, or release him on his furnishing security to the satisfaction of the Adjudicating Authority for his appearance at the expiration of the specified period if the arrears are not satisfied.

(10) When the Adjudicating Authority does not make an order of detention under sub-section (9), he shall, if the defaulter is under arrest, direct his release.

(11) Every person detained in the civil prison in execution of the certificate may be so detained,—

- (a) where the certificate is for a demand of an amount exceeding rupees one crore, up to three years, and
- (b) in any other case, up to six months:

Provided that he shall be released from such detention on the amount mentioned in the warrant for his detention being paid to the officer-in-charge of the civil prison.

(12) A defaulter released from detention under this section shall not, merely by reason of his release, be discharged from his liability for the arrears, but he shall not be liable to be arrested under the certificate in execution of which he was detained in the civil prison.

(13) A detention order may be executed at any place in India in the manner provided for the execution of warrant of arrest under the Code of Criminal Procedure, 1973.

#### **Power of recover arrears of penalty (Section 14A)**

(1) Save as otherwise provided in this Act, the Adjudicating Authority may, by order in writing, authorize an officer of Enforcement not below the rank of Assistant Director to recover any arrears of penalty from any person who fails to make full payment of penalty imposed on him under section 13 within the period of ninety days from the date on which the notice for payment of such penalty is served on him.

(2) The officer referred to in sub-section (1) shall exercise all the like powers which are conferred on the income-tax authority in relation to recovery of tax under the Income-tax Act, 1961 (43 of 1961) and the procedure laid down under the Second Schedule to the said Act shall *mutatis mutandis* apply in relation to recovery of arrears of penalty under this Act.

#### **Power to compound contravention (Section 15)**

(1) Any contravention under section 13 may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank as may be authorized in this behalf by the Central Government in such manner as may be prescribed.

(2) Where a contravention has been compounded under sub-section (1), no proceeding or further proceeding, as the case may be, shall be initiated or continued, as the case may be, against the person committing such contravention under that section, in respect of the contravention so compounded.

#### **Appointment of Adjudicating Authority (Section 16)**

(1) For the purpose of adjudication under section 13, the Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government as it may think fit, as the Adjudicating Authorities for holding an inquiry in the manner prescribed after giving the person alleged to have committed contravention under section 13, against whom a complaint has been made under sub-section (3) (hereinafter in this section referred to as the said person) a reasonable opportunity of being heard for the purpose of imposing any penalty:



Provided that where the Adjudicating Authority is of opinion that the said person is likely to abscond or is likely to evade in any manner, the payment of penalty, if levied, it may direct the said person to furnish a bond or guarantee for such amount and subject to such conditions as it may deem fit.

(2) The Central Government shall, while appointing the Adjudicating Authorities under sub-section (1), also specify in the order published in the Official Gazette, their respective jurisdictions.

(3) No Adjudicating Authority shall hold an enquiry under sub-section (1) except upon a complaint in writing made by any officer authorized by a general or special order by the Central Government.

(4) The said person may appear either in person or take the assistance of a legal practitioner or a chartered accountant of his choice for presenting his case before the Adjudicating Authority.

(5) Every Adjudicating Authority shall have the same powers of a civil court which are conferred on the Appellate Tribunal under sub-section (2) of section 28 and—

- (a) all proceedings before it shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code;
- (b) shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973.

(6) Every Adjudicating Authority shall deal with the complaint under sub-section (2) as expeditiously as possible and endeavor shall be made to dispose of the complaint finally within one year from the date of receipt of the complaint:

Provided that where the complaint cannot be disposed of within the said period, the Adjudicating Authority shall record periodically the reasons in writing for not disposing of the complaint within the said period.

### **Appeal to Special Director (Appeals) (Section 17)**

(1) The Central Government shall, by notification, appoint one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities under this section and shall also specify in the said notification the matter and places in relation to which the Special Director (Appeals) may exercise jurisdiction.

(2) Any person aggrieved by an order made by the Adjudicating Authority, being an Assistant Director of Enforcement or a Deputy Director of Enforcement, may prefer an appeal to the Special Director (Appeals).

(3) Every appeal under sub-section (1) shall be filed within forty-five days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved person and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed:

Provided that the Special Director (Appeals) may entertain an appeal after the expiry of the said period of forty-five days, if he is satisfied that there was sufficient cause for not filing it within that period.

(4) On receipt of an appeal under sub-section (1), the Special Director (Appeals) may after giving the parties to the appeal an opportunity of being heard, pass such order thereon as he thinks fit, confirming, modifying or setting aside the order appealed against.

(5) The Special Director (Appeals) shall send a copy of every order made by him to the parties to appeal and to the concerned Adjudicating Authority.

(6) The Special Director (Appeals) shall have the same powers of a civil court which are conferred on the Appellate Tribunal under sub-section (2) of section 28 and—

- (a) all proceedings before him shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code ;

- (b) shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 197).

### **Appellate Tribunal (Section 18)**

The Appellate Tribunal constituted under sub-section (1) of section 12 of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, shall, on and from the commencement of Part XIV of Chapter VI of the Finance Act, 2017, be the Appellate Tribunal for the purposes of this Act and the said Appellate Tribunal shall exercise the jurisdiction, powers and authority conferred on it by or under FEMA.

### **Appeal to Appellate Tribunal (Section 19)**

(1) Save as provided in sub-section (2), the Central Government or any person aggrieved by an order made by an Adjudicating Authority, other than those referred to in sub-section (1) of section 17, or the Special Director (Appeals), may prefer an appeal to the Appellate Tribunal:

Provided that any person appealing against the order of the Adjudicating Authority or the Special Director (Appeals) levying any penalty, shall while filing the appeal, deposit the amount of such penalty with such authority as may be notified by the Central Government:

Provided further that where in any particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.

(2) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or the Special Director (Appeals) is received by the aggrieved person or by the Central Government and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

(3) On receipt of an appeal under sub-section (1), the Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(4) The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Adjudicating Authority or the Special Director (Appeals), as the case may be.

(5) The appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within one hundred and eighty days from the date of receipt of the appeal:

Provided that where any appeal could not be disposed of within the said period of one hundred and eighty days, the Appellate Tribunal shall record its reasons in writing for not disposing off the appeal within the said period.

(6) The Appellate Tribunal may, for the purpose of examining the legality, propriety or correctness of any order made by the Adjudicating Authority under section 16 in relation to any proceeding, on its own motion or otherwise, call for the records of such proceedings and make such order in the case as it thinks fit.

### **Procedure and powers of Appellate Tribunal and Special Director (Appeals) (Section 28)**

(1) The Appellate Tribunal and the Special Director (Appeals) shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, the Appellate Tribunal and the Special Director (Appeals) shall have powers to regulate its own procedure.

(2) The Appellate Tribunal and the Special Director (Appeals) shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:—

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), requisitioning any public record or document or copy of such record or document from any office;
- (e) issuing commissions for the examination of witnesses or documents;
- (f) reviewing its decisions;
- (g) dismissing a representation of default or deciding it ex parte;
- (h) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and
- (i) any other matter which may be prescribed by the Central Government.

(3) An order made by the Appellate Tribunal or the Special Director (Appeals) under this Act shall be executable by the Appellate Tribunal or the Special Director (Appeals) as a decree of civil court and, for this purpose, the Appellate Tribunal and the Special Director (Appeals) shall have all the powers of a civil court.

(4) Notwithstanding anything contained in sub-section (3), the Appellate Tribunal or the Special Director (Appeals) may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by that court.

(5) All proceedings before the Appellate Tribunal and the Special Director (Appeals) shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code and the Appellate Tribunal shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973.

#### **Civil court not to have jurisdiction (Section 34)**

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Authority or the Appellate Tribunal or the Special Director (Appeals) is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

#### **Appeal to High Court (Section 35)**

Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such order:

Provided that the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

*Explanation.*—In this section “High Court” means —

- (a) the High Court within the jurisdiction of which the aggrieved party ordinarily resides or carries on business or personally works for gain; and
- (b) where the Central Government is the aggrieved party, the High Court within the jurisdiction of which the

respondent, or in a case where there are more than one respondent, any of the respondents, ordinarily resides or carries on business or personally works for gain.

### **Directorate of Enforcement (Section 36)**

- (1) The Central Government shall establish a Directorate of Enforcement with a Director and such other officers or class of officers as it thinks fit, who shall be called officers of Enforcement, for the purposes of this Act.
- (2) Without prejudice to the provisions of sub-section (1), the Central Government may authorize the Director of Enforcement or an Additional Director of Enforcement or a Special Director of Enforcement or a Deputy Director of Enforcement to appoint officers of Enforcement below the rank of an Assistant Director of Enforcement.
- (3) Subject to such conditions and limitations as the Central Government may impose, an officer of Enforcement may exercise the powers and discharge the duties conferred or imposed on him under this Act.

### **Power of search, seizure (Section 37)**

- (1) The Director of Enforcement and other officers of Enforcement, not below the rank of an Assistant Director, shall take up for investigation the contravention referred to in section 13.
- (2) Without prejudice to the provisions of sub-section (1), the Central Government may also, by notification, authorize any officer or class of officers in the Central Government, State Government or the Reserve Bank, not below the rank of an Under Secretary to the Government of India to investigate any contravention referred to in section 13.
- (3) The officers referred to in sub-section (1) shall exercise the like powers which are conferred on income-tax authorities under the Income-tax Act, 1961 (43 of 1961) and shall exercise such powers, subject to such limitations laid down under that Act.

### **Special provisions relating to assets held outside India in contravention of Section 4 of FEMA, 1999 (Section 37)**

- (1) Upon receipt of any information or otherwise, if the Authorised Officer prescribed by the Central Government has reason to believe that any foreign exchange, foreign security, or any immovable property, situated outside India, is suspected to have been held in contravention of section 4, he may after recording the reasons in writing, by an order, seize value equivalent, situated within India, of such foreign exchange, foreign security or immovable property:

Provided that no such seizure shall be made in case where the aggregate value of such foreign exchange, foreign security or any immovable property, situated outside India, is less than the value as may be prescribed.

- (2) The order of seizure along with relevant material shall be placed before the Competent Authority, appointed by the Central Government, who shall be an officer not below the rank of Joint Secretary to the Government of India by the Authorised Officer within a period of thirty days from the date of such seizure.
- (3) The Competent Authority shall dispose of the petition within a period of one hundred eighty days from the date of seizure by either confirming or by setting aside such order, after giving an opportunity of being heard to the representatives of the Directorate of Enforcement and the aggrieved person. Explanation.— While computing the period of one hundred eighty days, the period of stay granted by court shall be excluded and a further period of at least thirty days shall be granted from the date of communication of vacation of such stay order.
- (4) The order of the Competent Authority confirming seizure of equivalent asset shall continue till the disposal

of adjudication proceedings and thereafter, the Adjudicating Authority shall pass appropriate directions in the adjudication order with regard to further action as regards the seizure made under sub-section (1):

Provided that if, at any stage of the proceedings under this Act, the aggrieved person discloses the fact of such foreign exchange, foreign security or immovable property and brings back the same into India, then the Competent Authority or the Adjudicating Authority, as the case may be, on receipt of an application in this regard from the aggrieved person, and after affording an opportunity of being heard to the aggrieved person and representatives of the Directorate of Enforcement, shall pass an appropriate order as it deems fit, including setting aside of the seizure made under sub-section (1).

(5) Any person aggrieved by any order passed by the Competent Authority may prefer an appeal to the Appellate Tribunal.

## **ATTACHMENT, ADJUDICATION AND CONFISCATION UNDER PREVENTION OF MONEY LAUNDERING ACT (PMLA), 2002**

### **Attachment of property involved in money-laundering (Section 5)**

(1) Where the Director or any other officer not below the rank of Deputy Director authorized by the Director for the purposes of this section, has reason to believe (the reason for such belief to be recorded in writing), on the basis of material in his possession, that—

- (a) any person is in possession of any proceeds of crime; and
- (b) such proceeds of crime are likely to be concealed, transferred or dealt with in any manner

which may result in frustrating any proceedings relating to confiscation of such proceeds of crime under this Chapter,

he may, by order in writing, provisionally attach such property for a period not exceeding one hundred and eighty days from the date of the order, in such manner as may be prescribed:

Provided that no such order of attachment shall be made unless, in relation to the scheduled offence, a report has been forwarded to a Magistrate under section 173 of the Code of Criminal Procedure, 1973 (2 of 1974), or a complaint has been filed by a person authorized to investigate the offence mentioned in that Schedule, before a Magistrate or court for taking cognizance of the scheduled offence, as the case may be, or a similar report or complaint has been made or filed under the corresponding law of any other country:

Provided further that, notwithstanding anything contained in first proviso, any property of any person may be attached under this section if the Director or any other officer not below the rank of Deputy Director authorized by him for the purposes of this section has reason to believe (the reasons for such belief to be recorded in writing), on the basis of material in his possession, that if such property involved in money-laundering is not attached immediately under this Chapter, the non-attachment of the property is likely to frustrate any proceeding under this Act.

Provided also that for the purposes of computing the period of one hundred and eighty days, the period during which the proceedings under this section is stayed by the High Court, shall be excluded and a further period not exceeding thirty days from the date of order of vacation of such stay order shall be counted.;

(2) The Director, or any other officer not below the rank of Deputy Director, shall, immediately after attachment under sub-section (1), forward a copy of the order, along with the material in his possession, referred to in that sub-section, to the Adjudicating Authority, in a sealed envelope, in the manner as may be prescribed and such Adjudicating Authority shall keep such order and material for such period as may be prescribed.

(3) Every order of attachment made under sub-section (1) shall cease to have effect after the expiry of the

period specified in that sub-section or on the date of an order made under [sub-section (3)] of section 8, whichever is earlier.

(4) Nothing in this section shall prevent the person interested in the enjoyment of the immovable property attached under sub-section (1) from such enjoyment.

*Explanation.*— For the purposes of this sub-section, “person interested”, in relation to any immovable property, includes all persons claiming or entitled to claim any interest in the property.

(5) The Director or any other officer who provisionally attaches any property under sub-section (1) shall, within a period of thirty days from such attachment, file a complaint stating the facts of such attachment before the Adjudicating Authority.

### **Adjudicating Authorities, composition, powers, etc. (Section 6)**

(1) The Central Government shall, by notification, appoint an Adjudicating Authority to exercise jurisdiction, powers and authority conferred by or under this Act.

(2) An Adjudicating Authority shall consist of a Chairperson and two other Members:

Provided that one Member each shall be a person having experience in the field of law, administration, finance or accountancy.

(3) A person shall, however, not be qualified for appointment as Member of an Adjudicating Authority, —

- (a) in the field of law, unless he —
  - (i) is qualified for appointment as District Judge; or
  - (ii) has been a member of the Indian Legal Service and has held a post in Grade I of that service;
- (b) in the field of finance, accountancy or administration unless he possesses such qualifications, as may be prescribed.

(4) The Central Government shall appoint a Member to be the Chairperson of the Adjudicating Authority. (5) Subject to the provisions of this Act, —

- (a) the jurisdiction of the Adjudicating Authority may be exercised by Benches thereof;
- (b) a Bench may be constituted by the Chairperson of the Adjudicating Authority with one or two Members as the Chairperson of the Adjudicating Authority may deem fit;
- (c) the Benches of the Adjudicating Authority shall ordinarily sit at New Delhi and at such other places as the Central Government may, in consultation with the Chairperson, by notification, specify;
- (d) the Central Government shall, by notification, specify the areas in relation to which each Bench of the Adjudicating Authority may exercise jurisdiction.

(6) Notwithstanding anything contained in sub-section (5), the Chairperson may transfer a Member from one Bench to another Bench.

(7) If at any stage of the hearing of any case or matter it appears to the Chairperson or a Member that the case or matter is of such a nature that it ought to be heard by a Bench consisting of two Members, the case or matter may be transferred by the Chairperson or, as the case may be, referred to him for transfer, to such Bench as the Chairperson may deem fit.

(8) The Chairperson and every Member shall hold office as such for a term of five years from the date on which he enters upon his office:

Provided that no Chairperson or other Member shall hold office as such after he has attained the age of sixty-five years.



(9) The salary and allowances payable to and the other terms and conditions of service of the Member shall be such as may be prescribed:

Provided that neither the salary and allowances nor the other terms and conditions of service of the Member shall be varied to his disadvantage after appointment.

(10) If, for reasons other than temporary absence, any vacancy occurs in the office of the Chairperson or any other Member, then, the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Adjudicating Authority from the stage at which the vacancy is filled.

(11) The Chairperson or any other Member may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the Chairperson or any other Member shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.

(12) The Chairperson or any other Member shall not be removed from his office except by an order made by the Central Government after giving necessary opportunity of hearing.

(13) In the event of the occurrence of any vacancy in the office of the Chairperson by reason of his death, resignation or otherwise, the senior-most Member shall act as the Chairperson of the Adjudicating Authority until the date on which a new Chairperson, appointed in accordance with the provisions of this Act to fill such vacancy, enters upon his office.

(14) When the Chairperson of the Adjudicating Authority is unable to discharge his functions owing to absence, illness or any other cause, the senior-most Member shall discharge the functions of the Chairperson of the Adjudicating Authority until the date on which the Chairperson of the Adjudicating Authority resumes his duties.

(15) The Adjudicating Authority shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, the Adjudicating Authority shall have powers to regulate its own procedure.

### **Staff of Adjudicating Authorities (Section 7)**

(1) The Central Government shall provide each Adjudicating Authority with such officers and employees as that Government may think fit.

(2) The officers and employees of the Adjudicating Authority shall discharge their functions under the general superintendence of the Chairperson of the Adjudicating Authority.

(3) The salaries and allowances and other conditions of service of the officers and employees of the Adjudicating Authority shall be such as may be prescribed.

### **Adjudication (Section 8)**

(1) On receipt of a complaint under sub-section (5) of section 5, or applications made under sub-section (4) of section 17 or under sub-section (10) of section 18, if the Adjudicating Authority has reason to believe that any person has committed an offence under section 3 or is in possession of proceeds of crime, it may serve a notice of not less than thirty days on such person calling upon him to indicate the sources of his income, earning or assets, out of which or by means of which he has acquired the property attached under sub-section (1) of section 5, or, seized or frozen under section 17 or section 18, the evidence on which he relies and other relevant information and particulars, and to show cause why all or any of such properties should not be declared to be the properties involved in money-laundering and confiscated by the Central Government:



Provided that where a notice under this sub-section specifies any property as being held by a person on behalf of any other person, a copy of such notice shall also be served upon such other person:

Provided further that where such property is held jointly by more than one person, such notice shall be served to all persons holding such property.

(2) The Adjudicating Authority shall, after—

- (a) considering the reply, if any, to the notice issued under sub-section (1);
- (b) hearing the aggrieved person and the Director or any other officer authorized by him in this behalf; and
- (c) taking into account all relevant materials placed on record before him,

by an order, record a finding whether all or any of the properties referred to in the notice issued under sub-section (1) are involved in money-laundering:

Provided that if the property is claimed by a person, other than a person to whom the notice had been issued, such person shall also be given an opportunity of being heard to prove that the property is not involved in money-laundering.

(3) Where the Adjudicating Authority decides under sub-section (2) that any property is involved in money-laundering, he shall, by an order in writing, confirm the attachment of the property made under sub-section (1) of section 5 or retention of property or record seized or frozen under section 17 or section 18 and record a finding to that effect, whereupon such attachment or retention or freezing of the seized or frozen property or record shall—

- (a) continue during investigation for a period not exceeding ninety days or the pendency of the proceedings relating to any offence under this Act before a court or under the corresponding law of any other country, before the competent court of criminal jurisdiction outside India, as the case may be; and
- (b) become final after an order of confiscation is passed under sub-section (5) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60 by the Special Court;

(4) Where the provisional order of attachment made under sub-section (1) of section 5 has been confirmed under sub-section (3), the Director or any other officer authorized by him in this behalf shall forthwith take the possession of the property attached under section 5 or frozen under sub-section (1A) of section 17, in such manner as may be prescribed:

Provided that if it is not practicable to take possession of a property frozen under sub-section (1A) of section 17, the order of confiscation shall have the same effect as if the property had been taken possession of.

(5) Where on conclusion of a trial of an offence under this Act, the Special Court finds that the offence of money-laundering has been committed, it shall order that such property involved in the money-laundering or which has been used for commission of the offence of money-laundering shall stand confiscated to the Central Government.

(6) Where on conclusion of a trial under this Act, the Special Court finds that the offence of money-laundering has not taken place or the property is not involved in money-laundering, it shall order release of such property to the person entitled to receive it.

(7) Where the trial under this Act cannot be conducted by reason of the death of the accused or the accused being declared a proclaimed offender or for any other reason or having commenced but could not be concluded, the Special Court shall, on an application moved by the Director or a person claiming to be entitled to possession of a property in respect of which an order has been passed under sub-section (3) of section 8, pass appropriate orders regarding confiscation or release of the property, as the case may be, involved in the offence of money-laundering after having regard to the material before it.

(8) Where a property stands confiscated to the Central Government under sub-section (5), the Special Court, in such manner as may be prescribed, may also direct the Central Government to restore such confiscated property or part thereof of a claimant with a legitimate interest in the property, who may have suffered a quantifiable loss as a result of the offence of money laundering:

Provided that the Special Court shall not consider such claim unless it is satisfied that the claimant has acted in good faith and has suffered the loss despite having taken all reasonable precautions and is not involved in the offence of money laundering:

Provided further that the Special Court may, if it thinks fit, consider the claim of the claimant for the purposes of restoration of such properties during the trial of the case in such manner as may be prescribed.

### **Vesting of property in Central Government (Section 9)**

Where an order of confiscation has been made under sub-section (5) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60 in respect of any property of a person, all the rights and title in such property shall vest absolutely in the Central Government free from all encumbrances:

Provided that where the Special Court or the Adjudicating Authority, as the case may be, after giving an opportunity of being heard to any other person interested in the property attached under this Chapter, or seized or frozen under Chapter V, is of the opinion that any encumbrance on the property or lease-hold interest has been created with a view to defeat the provisions of this Chapter, it may, by order, declare such encumbrance or lease-hold interest to be void and thereupon the aforesaid property shall vest in the Central Government free from such encumbrances or lease-hold interest:

Provided further that nothing in this section shall operate to discharge any person from any liability in respect of such encumbrances which may be enforced against such person by a suit for damages.

### **Management of properties confiscated under this Chapter (Section 10)**

(1) The Central Government may, by order published in the Official Gazette, appoint as many of its officers (not below the rank of a Joint Secretary to the Government of India) as it thinks fit to perform the functions of an Administrator.

(2) The Administrator appointed under sub-section (1) shall receive and manage the property in relation to which an order has been made under sub-section (5) or sub-section (6) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60 in such manner and subject to such conditions as may be prescribed.

(3) The Administrator shall also take such measures, as the Central Government may direct, to dispose of the property which is vested in the Central Government under section 9.

### **Power regarding summons, production of documents and evidence, etc. (Section 11)**

(1) The Adjudicating Authority shall, for the purposes of this Act, have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit in respect of the following matters, namely:—

- (a) discovery and inspection;
- (b) enforcing the attendance of any person, including any officer of a banking company or a financial institution or a company, and examining him on oath;
- (c) compelling the production of records;
- (d) receiving evidence on affidavits;
- (e) issuing commissions for examination of witnesses and documents; and

(f) any other matter which may be prescribed.

(2) All the persons so summoned shall be bound to attend in person or through authorized agents, as the Adjudicating Authority may direct, and shall be bound to state the truth upon any subject respecting which they are examined or make statements, and produce such documents as may be required.

(3) Every proceeding under this section shall be deemed to be a judicial proceeding within the meaning of section 193 and section 228 of the Indian Penal Code (45 of 1860).

## **SUMMONS, SEARCHES AND SEIZURES UNDER PREVENTION OF MONEY LAUNDERING ACT, 2002**

Prevention of Money Laundering Act, 2002 was enacted to fight against the criminal offence of legalizing the income/profits from an illegal source. The Prevention of Money Laundering Act, 2002 enables the Government or the public authority to confiscate the property earned from the illegally gained proceeds.

Recently, The Prevention of Corruption Act, 1988 (the “Act”) was amended by the Prevention of Corruption (Amendment) Act, 2018 (the “Amendment Act”). Most of the amendments are aimed at tightening up the existing provisions in the Act and expanding the coverage of the offences.<sup>1</sup>

Prevention of Corruption (Amendment) Act 2018 as passed by Parliament in July 2018, which amended and brought about significant changes to the extant Prevention of Corruption Act 1988. Among other changes, the Amendment Act has made bribe giving a specific offence and has introduced the concept of corporate criminal liability for acts of bribery.

*Note for Student: A detailed write up PMLA and PMLA (Amendment) Act, 2018 can be studied from Chapter 4 given in the study material of Forensic Audit (Paper 9.4, Professional Programme)*

### **Power of survey (Section 16)**

(1) Notwithstanding anything contained in any other provisions of this Act, where an authority, on the basis of material in his possession, has reason to believe (the reasons for such belief to be recorded in writing) that an offence under section 3 has been committed, he may enter any place—

- (i) within the limits of the area assigned to him; or
- (ii) in respect of which he is authorized for the purposes of this section by such other authority, who is assigned the area within which such place is situated,

at which any act constituting the commission of such offence is carried on, and may require any proprietor, employee or any other person who may at that time and place be attending in any manner to, or helping in, such act so as to,—

- (i) afford him the necessary facility to inspect such records as he may require and which may be available at such place;
- (ii) afford him the necessary facility to check or verify the proceeds of crime or any transaction related to proceeds of crime which may be found therein; and
- (iii) furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceedings under this Act.

**Explanation** – For the purposes of this sub-section, a place, where an act which constitutes the commission of the offence is carried on, shall also include any other place, whether any activity is carried on therein or not, in which the person carrying on such activity states that any of his records or any part of his property relating to such act are or is kept.

1. Sourced: Prakash et al (2018), Prevention Of Corruption (Amendment) Act 2018 – Booster For The Honest Or The Corrupt?, Mondaq

(2) The authority referred to in sub-section (1) shall, after entering any place referred to in that sub-section immediately after completion of survey, forward a copy of the reasons so recorded along with material in his possession, referred to in that sub-section, to the Adjudicating Authority in a sealed envelope, in the manner as may be prescribed and such Adjudicating Authority shall keep such reasons and material for such period as may be prescribed.

(3) An authority acting under this section may—

- (i) place marks of identification on the records inspected by him and make or cause to be made extracts or copies there from,
- (ii) make an inventory of any property checked or verified by him, and
- (iii) record the statement of any person present in the place which may be useful for, or relevant to, any proceeding under this Act.

### **Search and seizure (Section 17)**

(1) Where the Director or any other officer not below the rank of Deputy Director authorized by him for the purposes of this section,] on the basis of information in his possession, has reason to believe (the reason for such belief to be recorded in writing) that any person—

- (i) has committed any act which constitutes money-laundering, or
- (ii) is in possession of any proceeds of crime involved in money-laundering, or
- (iii) is in possession of any records relating to money-laundering, or
- (iv) is in possession of any property related to crime,

then, subject to the rules made in this behalf, he may authorize any officer subordinate to him to —

- (a) enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such records or proceeds of crime are kept;
- (b) break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred by clause (a) where the keys thereof are not available;
- (c) seize any record or property found as a result of such search;
- (d) place marks of identification on such record or property, if required or] make or cause to be made extracts or copies therefrom;
- (e) make a note or an inventory of such record or property;
- (f) examine on oath any person, who is found to be in possession or control of any record or property, in respect of all matters relevant for the purposes of any investigation under this Act:

Provided that no search shall be conducted unless, in relation to the scheduled offence, a report has been forwarded to a Magistrate under section 157 of the Code of Criminal Procedure, 1973 (2 of 1974), or a complaint has been filed by a person, authorized to investigate the offence mentioned in the Schedule, before a Magistrate or court for taking cognizance of the scheduled offence, as the case may be, or in cases where such report is not required to be forwarded, a similar report of information received or otherwise has been submitted by an officer authorized to investigate a scheduled offence to an officer not below the rank of Additional Secretary to the Government of India or equivalent being head of the office or Ministry or Department or Unit, as the case may be, or any other officer who may be authorized by the Central Government, by notification, for this purpose.

(1A) Where it is not practicable to seize such record or property, the officer authorized under sub-section (1), may make an order to freeze such property whereupon the property shall not be transferred or otherwise dealt

with, except with the prior permission of the officer making such order, and a copy of such order shall be served on the person concerned:

Provided that if, at any time before its confiscation under sub-section (5) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60, it becomes practical to seize a frozen property, the officer authorized under sub-section (1) may seize such property.

(2) The authority, who has been authorized under sub-section (1) shall, immediately after search and seizure or upon issuance of a freezing order, forward a copy of the reasons so recorded along with material in his possession, referred to in that sub-section, to the Adjudicating Authority in a sealed envelope, in the manner, as may be prescribed and such Adjudicating Authority shall keep such reasons and material for such period, as may be prescribed.

(3) Where an authority, upon information obtained during survey under section 16, is satisfied that any evidence shall be or is likely to be concealed or tampered with, he may, for reasons to be recorded in writing, enter and search the building or place where such evidence is located and seize that evidence:

Provided that no authorisation referred to in sub-section (1) shall be required for search under this sub-section.

(4) The authority seizing any record or property under sub-section (1) or freezing any record or property under sub-section (1A) shall, within a period of thirty days from such seizure or freezing, as the case may be, file an application, requesting for retention of such record or property seized under sub-section (1) or for continuation of the order of freezing served under sub-section (1A), before the Adjudicating Authority.

### **Search of persons (Section 18)**

(1) If an authority, authorized in this behalf by the Central Government by general or special order, has reason to believe (the reason for such belief to be recorded in writing) that any person has secreted about his person or in anything under his possession, ownership or control, any record or proceeds of crime which may be useful for or relevant to any proceedings under this Act, he may search that person and seize such record or property which may be useful for or relevant to any proceedings under this Act:

Provided that no search of any person shall be made unless, in relation to the scheduled offence, a report has been forwarded to a Magistrate under section 157 of the Code of Criminal Procedure, 1973 (2 of 1974) or a complaint has been filed by a person, authorized to investigate the offence mentioned in the Schedule, before a Magistrate or court for taking cognizance of the scheduled offence, as the case may be, or in cases where such report is not required to be forwarded, a similar report of information received or otherwise has been submitted by an officer authorized to investigate a scheduled offence to an officer not below the rank of Additional Secretary to the Government of India or equivalent being head of the office or Ministry or Department or Unit, as the case may be, or any other officer who may be authorized by the Central Government, by notification, for this purpose.

(2) The authority, who has been authorized under sub-section (1) shall, immediately after search and seizure, forward a copy of the reasons so recorded along with material in his possession, referred to in that sub-section, to the Adjudicating Authority in a sealed envelope, in the manner, as may be prescribed and such Adjudicating Authority shall keep such reasons and material for such period, as may be prescribed.

(3) Where an authority is about to search any person, he shall, if such person so requires, take such person within twenty-four hours to the nearest Gazetted Officer, superior in rank to him, or a Magistrate:

Provided that the period of twenty-four hours shall exclude the time necessary for the journey undertaken to take such person to the nearest Gazetted Officer, superior in rank to him, or Magistrate's Court.

(4) If the requisition under sub-section (3) is made, the authority shall not detain the person for more than twenty-four hours prior to taking him before the Gazetted Officer, superior in rank to him, or the Magistrate referred to in that sub-section:

Provided that the period of twenty-four hours shall exclude the time necessary for the journey from the place of detention to the office of the Gazetted Officer, superior in rank to him, or the Magistrate's Court.

(5) The Gazetted Officer or the Magistrate before whom any such person is brought shall, if he sees no reasonable ground for search, forthwith discharge such person but otherwise shall direct that search be made.

(6) Before making the search under sub-section (1) or sub-section (5), the authority shall call upon two or more persons to attend and witness the search, and the search shall be made in the presence of such persons.

(7) The authority shall prepare a list of record or property seized in the course of the search and obtain the signatures of the witnesses on the list.

(8) No female shall be searched by anyone except a female.

(9) The authority shall record the statement of the person searched under sub-section (1) or sub-section (5) in respect of the records or proceeds of crime found or seized in the course of the search:

(10) The authority, seizing any record or property under sub-section (1) shall, within a period of thirty days from such seizure, file an application requesting for retention of such record or property, before the Adjudicating Authority.

### **Power to arrest (Section 19)**

(1) If the Director, Deputy Director, Assistant Director or any other officer authorized in this behalf by the Central Government by general or special order, has on the basis of material in his possession, reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of an offence punishable under this Act, he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest.

(2) The Director, Deputy Director, Assistant Director or any other officer shall, immediately after arrest of such person under sub-section (1), forward a copy of the order along with the material in his possession, referred to in that sub-section, to the Adjudicating Authority in a sealed envelope, in the manner, as may be prescribed and such Adjudicating Authority shall keep such order and material for such period, as may be prescribed.

(3) Every person arrested under sub-section (1) shall, within twenty-four hours, be taken to a Special Court or Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction:

Provided that the period of twenty-four hours shall exclude the time necessary for the journey from the place of arrest to the Special Court or Magistrate's Court.

### **Retention of property (Section 20)**

(1) Where any property has been seized under section 17 or section 18 or frozen under sub-section (1A) of section 17 and the officer authorized by the Director in this behalf has, on the basis of material in his possession, reason to believe (the reason for such belief to be recorded by him in writing) that such property is required to be retained for the purposes of adjudication under section 8, such property may, if seized, be retained or if frozen, may continue to remain frozen, for a period not exceeding one hundred and eighty days from the day on which such property was seized or frozen, as the case may be.

(2) The officer authorized by the Director shall, immediately after he has passed an order for retention or continuation of freezing of the property for purposes of adjudication under section 8, forward a copy of the order along with the material in his possession, referred to in sub-section (1), to the Adjudicating Authority, in a sealed envelope, in the manner as may be prescribed and such Adjudicating Authority shall keep such order and material for such period as may be prescribed.

(3) On the expiry of the period specified in sub-section (1), the property shall be returned to the person from



whom such property was seized or whose property was ordered to be frozen unless the Adjudicating Authority permits retention or continuation of freezing of such property beyond the said period.

(4) The Adjudicating Authority, before authorizing the retention or continuation of freezing of such property beyond the period specified in sub-section (1), shall satisfy himself that the property is *prima facie* involved in money-laundering and the property is required for the purposes of adjudication under section 8.

(5) After passing the order of confiscation under sub-section (5) or sub-section (7) of section 8, Special Court, shall direct the release of all property other than the property involved in money-laundering to the person from whom such property was seized or the persons entitled to receive it.

(6) Where an order releasing the property has been made by the Special Court under sub-section (6) of section 8 or by the Adjudicating Authority under section 58B or sub-section (2A) of section 60, the Director or any officer authorized by him in this behalf may withhold the release of any such property for a period of ninety days from the date of receipt of such order, if he is of the opinion that such property is relevant for the appeal proceedings under this Act.

### Retention of records (Section 21)

(1) Where any records have been seized, under section 17 or section 18 or frozen under sub-section (1A) of section 17 and the Investigating Officer or any other officer authorized by the Director in this behalf has reason to believe that any of such records are required to be retained for any inquiry under this Act, such records may if seized, be retained or if frozen, may continue to remain frozen, for a period not exceeding one hundred and eighty days from the day on which such records were seized or frozen, as the case may be.

(2) The person, from whom records seized or frozen, shall be entitled to obtain copies of records.

(3) On the expiry of the period specified under sub-section (1), the records shall be returned to the person from whom such records were seized or whose records were ordered to be frozen unless the Adjudicating Authority permits retention or continuation of freezing of such records beyond the said period.

(4) The Adjudicating Authority, before authorizing the retention or continuation of freezing of such records beyond the period specified in sub-section (1), shall satisfy himself that the records are required for the purposes of adjudication under section 8.

(5) After passing of an order of confiscation or release under sub-section (5) or sub-section (6) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60], the Adjudicating Authority shall direct the release of the records to the person from whom such records were seized.

(6) Where an order releasing the records has been made by the Court Adjudicating Authority under sub-section (5) of section 21, the Director or any other officer authorized by him in this behalf may withhold the release of any such record for a period of ninety days from the date of receipt of such order, if he is of the opinion that such record is relevant for the appeal proceedings under this Act.

### Presumption as to records or property in certain cases (Section 22)

(1) Where any records or property are or is found in the possession or control of any person in the course of a survey or a search or where any record or property is produced by any person or has been resumed or seized from the custody or control of any person or has been frozen under this Act or under any other law for the time being in force, it shall be presumed that –

- (i) such records or property belong or belongs to such person;
- (ii) the contents of such records are true; and
- (iii) the signature and every other part of such records which purport to be in the



handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting, and in the case of a record, stamped, executed or attested, that it was executed or attested by the person by whom it purports to have been so stamped, executed or attested.

(2) Where any records have been received from any place outside India, duly authenticated by such authority or person and in such manner as may be prescribed, in the course of proceedings under this Act, the Special Court, the Appellate Tribunal or the Adjudicating Authority, as the case may be, shall—

- (a) presume, that the signature and every other part of such record which purports to be in the handwriting of any particular person or which the court may reasonably assume to have been signed by, or to be in the handwriting of, any particular person, is in that person's handwriting; and in the case of a record executed or attested, that it was executed or attested by the person by whom it purports to have been so executed or attested;
- (b) admit the document in evidence, notwithstanding that it is not duly stamped, if such document is otherwise admissible in evidence.

### **Presumption in inter-connected transactions (Section 23)**

Where money-laundering involves two or more inter-connected transactions and one or more such transactions is or are proved to be involved in money-laundering, then for the purposes of adjudication or confiscation under section 8 or for the trial of the money-laundering offence, it shall unless otherwise proved to the satisfaction of the Adjudicating Authority or the Special Court, be presumed that the remaining transactions from part of such inter-connected transactions.

### **Burden of proof (Section 24)**

In any proceeding relating to proceeds of crime under this Act,—

- (a) in the case of a person charged with the offence of money-laundering under section 3, the Authority or Court shall, unless the contrary is proved, presume that such proceeds of crime are involved in money-laundering; and
- (b) in the case of any other person the Authority or Court, may presume that such proceeds of crime are involved in money-laundering.

## **APPELLATE TRIBUNAL UNDER PMLA**

### **Appellate Tribunal (Section 25)**

The Appellate Tribunal constituted under sub-section (1) of section 12 of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 shall be the Appellate Tribunal for hearing appeals against the orders of the Adjudicating Authority and the other authorities under this Act.

### **Appeal to Appellate Tribunal (Section 26)**

- (1) Save as otherwise provided in sub-section (3), the Director or any person aggrieved by an order made by the Adjudicating Authority under this Act, may prefer an appeal to the Appellate Tribunal.
- (2) Any reporting entity aggrieved by any order of the Director made under sub-section (2) of section 13, may prefer an appeal to the Appellate Tribunal.
- (3) Every appeal preferred under sub-section (1) or sub-section (2) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or Director is received and it shall be in such form and be accompanied by such fee as may be prescribed:

Provided that the Appellate Tribunal may, after giving an opportunity of being heard, entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

(4) On receipt of an appeal under sub-section (1) or sub-section (2), the Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(5) The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Adjudicating Authority or the Director, as the case may be.

(6) The appeal filed before the Appellate Tribunal under sub-section (1) or sub-section (2) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within six months from the date of filing of the appeal.

### Procedure and powers of Appellate Tribunal (Section 35)

(1) The Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other Provisions of this Act, the Appellate Tribunal shall have powers to regulate its own procedure.

(2) The Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit, in respect of the following matters, namely:—

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), requisitioning any public record or document or copy of such record or document from any office;
- (e) issuing commissions for the examination of witnesses or documents;
- (f) reviewing its decisions;
- (g) dismissing a representation for default or deciding it *ex parte*;
- (h) setting aside any order of dismissal of any representation for default or any order passed by it *ex parte*; and
- (i) any other matter, which may be, prescribed by the Central Government.

(3) An order made by the Appellate Tribunal under this Act shall be executable by the Appellate Tribunal as a decree of civil court and, for this purpose, the Appellate Tribunal shall have all the powers of a civil court.

(4) Notwithstanding anything contained in sub-section (3), the Appellate Tribunal may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by that court.

(5) All proceedings before the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code (45 of 1860) and the Appellate Tribunal shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973.

### Distribution of business amongst Benches (Section 36)

Where any Benches are constituted, the Chairman may, from time to time, by notification, make provisions as to

the distribution of the business of the Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with by each Bench.

### **Power of Chairman to transfer cases (Section 37)**

On the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairman may transfer any case pending before one Bench, for disposal, to any other Bench.

### **Decision to be by majority (Section 38)**

If the Members of a Bench consisting of two Members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairman who shall either hear the point or points himself or refer the case for hearing on such point or points by third Member of the Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the Members of the Appellate Tribunal who have heard the case, including those who first heard it.

### **Right of appellant to take assistance of authorized representative and of Government to appoint presenting officers (Section 39)**

(1) A person preferring an appeal to the Appellate Tribunal under this Act may either appear in person or take the assistance of an authorized representative of his choice to present his case before the Appellate Tribunal.

*Explanation.* – For the purposes of this sub-section, the expression “authorized representative” shall have the same meaning as assigned to it under sub-section (2) of section 288 of the Income-tax Act, 1961 (43 of 1961).

(2) The Central Government or the Director may authorize one or more authorized representatives or any of its officers to act as presenting officers and every person so authorized may present the case with respect to any appeal before the Appellate Tribunal.

### **Members, etc., to be public servants (Section 40)**

The Chairman, Members and other officers and employees of the Appellate Tribunal, the Adjudicating Authority, Director and the officers subordinate to him shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code.

### **Civil court not to have jurisdiction (Section 41)**

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Director, an Adjudicating Authority or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

### **Appeal to High Court (Section 42)**

Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law or fact arising out of such order:

Provided that the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

*Explanation.* – For the purposes of this section, “High Court” means –

- (i) the High Court within the jurisdiction of which the aggrieved party ordinarily resides or carries on business or personally works for gain; and

- (ii) where the Central Government is the aggrieved party, the High Court within the jurisdiction of which the respondent, or in a case where there are more than one respondent, any of the respondents, ordinarily resides or carries on business or personally works for gain.

## SPECIAL COURTS UNDER PMLA

### Special Courts (Section 43)

(1) The Central Government, in consultation with the Chief Justice of the High Court, shall, for trial of offence punishable under section 4, by notification, designate one or more Courts of Session as Special Court or Special Courts or such area or areas or for such case or class or group of cases as may be specified in the notification.

*Explanation.* – In this sub-section, “High Court” means the High Court of the State in which a Sessions Court designated as Special Court was functioning immediately before such designation.

(2) While trying an offence under this Act, a Special Court shall also try an offence, other than an offence referred to in sub-section (1), with which the accused may, under the Code of Criminal Procedure, 1973 (2 of 1974), be charged at the same trial.

### Offences triable by Special Courts (Section 44)

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974),—

- (a) an offence punishable under section 4 and any scheduled offence connected to the offence under that section shall be triable by the Special Court constituted for the area in which the offence has been committed:

Provided that the Special Court, trying a scheduled offence before the commencement of this Act, shall continue to try such scheduled offence; or];

- (b) a Special Court may, upon a complaint made by an authority authorized in this behalf under this Act take cognizance of offence under section 3, without the accused being committed to it for trial;
- (c) if the court which has taken cognizance of the scheduled offence is other than the Special Court which has taken cognizance of the complaint of the offence of money-laundering under sub-clause (b), it shall, on an application by the authority authorized to file a complaint under this Act, commit the case relating to the scheduled offence to the Special Court and the Special Court shall, on receipt of such case proceed to deal with it from the stage at which it is committed.
- (d) a Special Court while trying the scheduled offence or the offence of money-laundering shall hold trial in accordance with the provisions of the Code of Criminal Procedure, 1973 (2 of 1974) as it applies to a trial before a Court of Session.

(2) Nothing contained in this section shall be deemed to affect the special powers of the High Court regarding bail under section 439 of the Code of Criminal Procedure, 1973 (2 of 1974) and the High Court may exercise such powers including the power under clause (b) of sub-section (1) of that section as if the reference to “Magistrate” in that section includes also a reference to a “Special Court” designated under section 43.

### Offences to be cognizable and non-bailable (Section 45)

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), no person accused of an offence under this Act shall be released on bail or on his own bond unless—

- (i) the Public Prosecutor has been given a opportunity to oppose the application for such release; and
- (ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable

grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail:

Provided that a person, who, is under the age of sixteen years, or is a woman or is sick or infirm, or is accused either on his own or along with other co-accused of money-laundering a sum of less than one crore rupees may be released on bail, if the Special Court so directs.

Provided further that the Special Court shall not take cognizance of any offence punishable under section 4 except upon a complaint in writing made by –

- (i) the Director; or
- (ii) any officer of the Central Government or a State Government authorized in writing in this behalf by the Central Government by a general or special order made in this behalf by that Government.

(1A) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), or any other provision of this Act, no police officer shall investigate into an offence under this Act unless specifically authorized, by the Central Government by a general or special order, and, subject to such conditions as may be prescribed.

(2) The limitation on granting of bail specified in sub-section (1) is in addition to the limitations under the Code of Criminal Procedure, 1973 (2 of 1974) or any other law for the time being in force on granting of bail.

#### **Application of Code of Criminal Procedure, 1973 to proceedings before Special Court (Section 46)**

(1) Save as otherwise provided in this Act, the provisions of the Code of Criminal Procedure, 1973 (including the provisions as to bails or bonds), shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session and the persons conducting the prosecution before the Special Court, shall be deemed to be a Public Prosecutor:

Provided that the Central Government may also appoint for any case or class or group of cases a Special Public Prosecutor.

(2) A person shall not be qualified to be appointed as a Public Prosecutor or a Special Public Prosecutor under this section unless he has been in practice as an advocate for not less than seven years, under the Union or a State, requiring special knowledge of law.

(3) Every person appointed as a Public Prosecutor or a Special Public Prosecutor under this section shall be deemed to be a Public Prosecutor within the meaning of clause (u) of section 2 of the Code of Criminal Procedure, 1973 (2 of 1974) and the provisions of that Code shall have effect accordingly.

#### **Appeal and revision (Section 47)**

The High Court may exercise, so far as may be applicable, all the powers conferred by Chapter XXIX or Chapter XXX of the Code of Criminal Procedure, 1973, on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

#### **Punishment for vexatious search (Section 62)**

Any authority or officer exercising powers under this Act or any rules made thereunder, who, without reasons recorded in writing, –

- (a) searches or causes to be searched any building or place; or
- (b) detains or searches or arrests any person,

shall for every such offence be liable on conviction for imprisonment for a term which may extend to two years or fine which may extend to fifty thousand rupees or both.

**Punishment for false information or failure to give information, etc. (Section 63)**

(1) Any person wilfully and maliciously giving false information and so causing an arrest or a search to be made under this Act shall on conviction be liable for imprisonment for a term which may extend to two years or with fine which may extend to fifty thousand rupees or both. (2) If any person,—

- (a) being legally bound to state the truth of any matter relating to an offence under section 3, refuses to answer any question put to him by an authority in the exercise of its powers under this Act; or
- (b) refuses to sign any statement made by him in the course of any proceedings under this Act, which an authority may legally require to sign; or
- (c) to whom a summon is issued under section 50 either to attend to give evidence or produce books of account or other documents at a certain place and time, omits to attend or produce books of account or documents at the place or time,

he shall pay, by way of penalty, a sum which shall not be less than five hundred rupees but which may extend to ten thousand rupees for each such default or failure.

(3) No order under this section shall be passed by an authority referred to in sub-section (2) unless the person on whom the penalty is proposed to be imposed is given an opportunity of being heard in the matter by such authority.

(4) Notwithstanding anything contained in clause (c) of sub-section (2), a person who intentionally disobeys any direction issued under section 50 shall also be liable to be proceeded against under section 174 of the Indian Penal Code (45 of 1860).

**Cognizance of offences (Section 64)**

(1) No court shall take cognizance of any offence under section 62 or sub-section (1) of section 63 except with the previous sanction of the Central Government.

(2) The Central Government shall, by an order, either give sanction or refuse to give sanction within ninety days of the receipt of the request in this behalf.

**Code of Criminal Procedure, 1973 to apply (Section 65)**

The provisions of the Code of Criminal Procedure, 1973 shall apply, in so far as they are not inconsistent with the provisions of this Act, to arrest, search and seizure, attachment, confiscation investigation, prosecution and all other proceedings under this Act.

**Disclosure of information (Section 66)**

(1) The Director or any other authority specified by him by a general or special order in this behalf may furnish or cause to be furnished to—

- (i) any officer, authority or body performing any functions under any law relating to imposition of any tax, duty or cess or to dealings in foreign exchange, or prevention of illicit traffic in the narcotic drugs and psychotropic substances under the Narcotic Drugs and Psychotropic Substances Act, 1985 (61 of 1985); or
- (ii) such other officer, authority or body performing functions under any other law as the Central Government may, if in its opinion it is necessary so to do in the public interest, specify, by notification in the Official Gazette, in this behalf, any information received or obtained by such Director or any other authority, specified by him in the performance of their functions under this Act, as may, in the opinion of the Director or the other authority, so specified by him, be necessary for the purpose of the officer, authority or body specified in clause (i) or clause (ii) to perform his or its functions under that law.



(2) If the Director or other authority specified under sub-section (1) is of the opinion, on the basis of information or material in his possession, that the provisions of any other law for the time being in force are contravened, then the Director or such other authority shall share the information with the concerned agency for necessary action.

### Bar of suits in civil courts (Section 67)

No suit shall be brought in any civil court to set aside or modify any proceeding taken or order made under this Act and no prosecution, suit or other proceeding shall lie against the Government or any officer of the Government for anything done or intended to be done in good faith under this Act.

### Corporate frauds included as Scheduled offence under Prevention of Money-laundering Act, 2002

Section 447 of Companies Act is being included as scheduled offence under PMLA so that Registrar of Companies in suitable cases would be able to report such cases for action by Enforcement Directorate under the PMLA provisions. This provision shall strengthen the PMLA with respect to corporate frauds.

Prevention of Corruption (Amendment) Act 2018 as passed by Parliament in July 2018, which amended and brought about significant changes to the extant Prevention of Corruption Act 1988. Among other changes, the Amendment Act has made bribe giving a specific offence and has introduced the concept of corporate criminal liability for acts of bribery. Corporates may claim a defence if it can be proven that adequate procedures were in place to prevent persons associated with it from undertaking anything which may be an offence under the Prevention of Corruption Act. Such procedures must comply with guidelines, which are yet to be prescribed by the government.

## LESSON ROUND UP

- The words “**liable to penalties**” denote civil nature of non-compliances whereas the words “**punishable with fine and/or imprisonment and/or both**” denote criminal nature of non-compliances.
- Offence punishable with imprisonment only or with imprisonment and also with fine is a non-compoundable offence under Companies Act, 2013. However, all other offences, i.e., offences punishable with a) fine only, or b) fine or imprisonment and c) fine or imprisonment or both are compoundable offences under the Companies Act, 2013.
- The adjudication order is appealable with the higher authorities as per the express provision provided in sub-section (5) of section 441, with the procedure being provided by the Rules. However, a compounding order is generally not appealable unless the victim is aggrieved by the compounding order.

## TEST YOURSELF

*(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)*

1. Describe the Power of process of Adjudication under the Companies Act, 2013.
2. Write a note on the decriminalization of offences through Companies (Amendment) Act, 2019.
3. List out the Offences tribal by Special Courts under Prevention of Money Laundering Act, 2002.
4. Discuss the Enforcement of the orders of Adjudicating Authority under Foreign Exchange Management Act, 1999
5. Discuss the provision relating to Advisory Board under Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.







# Lesson 7

## Relief and Remedies

### LESSON OUTLINE

- Compounding of Offences
- Types of Offence
- Compounding Provisions under the Companies Act, 2013
- Who are the Compounding Authorities/ Who can Compound the offence?
- Compounding Provisions under the Foreign Exchange Management Act, 1999
- Mediation and Conciliation
- Section 442 of the Companies Act, 2013
- Companies (Mediation and Conciliation) Rules, 2016
- Settlement and Settlement Proceedings Content Order under SEBI Laws
- New Regulations for Settlement and Settlement Proceedings
- SEBI (Settlement Proceedings) Regulations, 2018
- Application for Settlement
- Terms of Settlement
- Procedure of Settlement
- Summary Settlement Procedure
- Settlement with Confidentiality
- Settlement Orders
- Appeal Against Order – Companies Act, 2013
- Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000
- Appearance before Securities Appellate Tribunal
- Appearance before Statutory Authorities
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

In general, good governance means to comply with all the provisions of laws and regulations applicable to corporates. Non-compliance will result in penalties or penalties with imprisonment.

The lesson cover –

- the compounding procedures under the various legislations and
- the manner of the appeal before the appellate tribunal and
- the rules relating to the Mediation and Conciliation under the Companies Act, 2013.

## REGULATORY FRAMEWORK

Regulations/Act/Rules	Deals with
The Companies Act, 2013	Compounding of offences under Section 441
The Foreign Exchange Management Act, 1999 (FEMA)	Compounding Provisions under FEMA
Section 442 & The Companies (Mediation And Conciliation Rules) 2016	Mediation And Conciliation
The Securities And Exchange Board of India Act, 1992 ("SEBI Act"), Securities Contracts (Regulation) Act, 1956 (SCRA) & Depositories Act, 1996	Compounding Provisions
Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018	Settlement Proceedings
Companies Act, 2013	Appeal Against Orders of Tribunal under Section 421
Securities And Exchange Board Of India Act, 1992, Securities Contracts (Regulation) Act, 1956 And The Depositories Act, 1996	Appeal Against Order-Securities Law
The Foreign Exchange Management Act, 1999 (FEMA)	Appeal Against Order of FEMA
Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000	Adjudication Proceedings And Appeal
Competition Act, 2002	Appearance Before Appellate Tribunal
SEBI	Appearance Before SAT

## COMPOUNDING OF OFFENCES

Companies are expected to comply with the law(s) governing them and /or applicable to them. In this context, the compliance of Companies Act, 2013, Foreign Exchange Management Act, 1999 and SEBI/Securities laws assume significance. When there is a non-compliance or contravention, it is said that an *Offence* is committed *vis-a-vis* the said compliance /regulatory requirement. It is known that when an offence is committed, the accused is liable to be prosecuted as per the law in respect of which the said offence has been committed. While it is true that good corporate governance demands a corporate citizen to comply with all the legal provisions, it may so happen for various reasons that there could be a lapse on compliance especially considering the number of compliances required. But nevertheless, an offence is committed for which the law provides for a penalty / punishment.

## COMPOUNDING – A NECESSITY

It was felt and considered necessary (also by the Rajinder Sachar Committee) that there is great need of leniency in the administration of the Corporate Law(s) particularly its penalty provisions not only because a

large number of defaults are of technical nature but also because they arise out of ignorance of the lengthy and bewildering complexity of the provisions of the Law(s). Therefore, the concept of compounding of offences was incorporated as a measure to avoid the long-drawn process of prosecution, which would save both cost and time in exchange of payment of a penalty to the aggrieved.

## WHAT IS COMPOUNDING

Compounding is not defined in Companies Act or FEMA or SEBI laws. As per the Black's Law Dictionary, to "*Compound*" means "to settle a matter by a money payment, in lieu of other liability." As per this definition Compounding is akin to a *Settlement Mechanism*, a settlement by paying the penalty in lieu of facing the prosecution for the offence committed.

By looking into the provisions of the Corporate Laws which contain provision for compounding, it will be noted that compounding is an admission of guilt either voluntarily or on receipt of notice of default or initiation of prosecution. The defaulters agree to pay penalty which may be ordered by the Compounding authority to be paid.

Thus, it can be said that Compounding is essentially a compromise or arrangement between administrator of the enactment and person committing an offence. Compounding crime consists of receipt of some consideration (termed as compounding fees) in return for an agreement not to prosecute one who has committed an offence.

Normally in law and particularly in criminal law, the power to compound the offence is at the discretion of the victim. The perpetrator of offence cannot demand for compounding of the offence. But in corporate law, compounding is at the discretion of the offender/offending company. When compounding is done, the prosecution is converted into fine i.e. condonation of prosecution by imposing penalty. It enables the offender company and the director/officer-in-default to avail peace and honourable discharge and avoid cumbersome trial.

## TYPES OF OFFENCE

To compound an offence, it is necessary to know the type of offence.

Offence on a topic of compounding can be of two types

- (1) Compoundable offence; and
- (2) Non-compoundable offence.

If the offence is compoundable, the same can be compounded as per the procedure prescribed and it is not possible to compound a non-compoundable offence.

## WHY COMPOUND

Few of the important benefits of the compounding of offences can be:

- Buy peace of mind.
- Compounding amount shall not be treated as fine for the purpose of Part I of Schedule V of CA-2013 relating to appointment of managerial personnel provided therein.
- No need to appear before prosecution authorities. It provides comfort to individuals and corporates and persons connected with it.
- Amount paid as compounding fee under law for can be claimed as a tax deduction under the Income Tax Act while a penalty paid for contravention is not eligible for deduction.
- Speedy disposal of offences and justice
- Judiciary can devote more time and concentrate on serious cases.

Let us now see the important provisions in respect of compounding of offences under Companies Act, 2013 (CA, 2013), FEMA and SEBI Act.

### COMPOUNDING PROVISIONS UNDER THE COMPANIES ACT, 2013

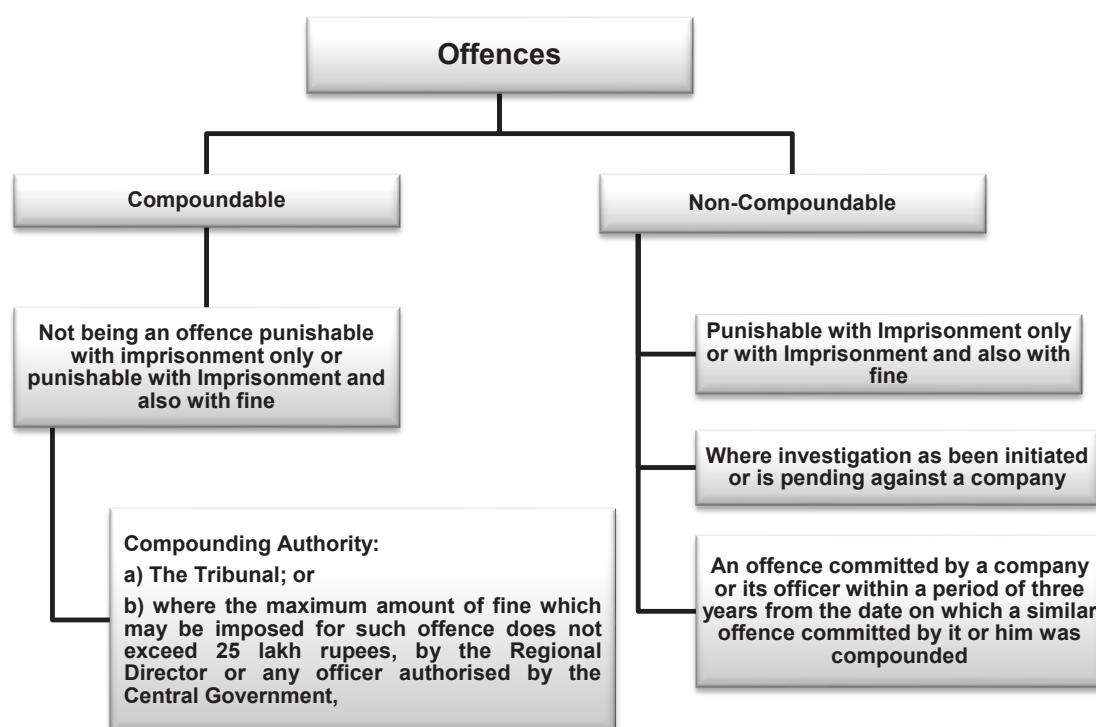
Section 441 of the Companies Act, 2013 deals with the *compounding of certain offences*. This section was amended by the Companies (Amendment) Act 2017 with effect from 9th February 2018. By the Companies (Amendment) Act, 2019 it was further amended to increase the threshold limit of compounding by the Regional Director from five lakh rupees to twenty five lakh rupees. It has to be noted that as per the amendments brought recently in 2019, it is clear that “Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.”.

### WHICH OFFENCES CAN BE COMPOUNDED

Any offence punishable under this Act (whether committed by a company or any officer thereof) not being an offence punishable with imprisonment only or imprisonment and also with fine may be compounded. Thus, if the offence is punishable with fine only or imprisonment or fine or with fine or alone can be compounded.

### WHICH OFFENCES CANNOT BE COMPOUNDED

- Any offence punishable under this Act (whether committed by a company or any officer thereof) being an offence punishable with imprisonment only or imprisonment and also with fine cannot be compounded.
- Any offence otherwise compoundable cannot also be compounded if the investigation against such company has been initiated or is pending under this Act.
- An offence committed by a company or its officer within a period of three years from the date on which a similar offence committed by it or him was compounded under this section. If the offence is not similar, this restriction to compound will not apply. It may be noted that any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence and is eligible to be compounded.



## WHEN COMPOUNDING CAN BE DONE

Compounding can be done either before (or) after the institution of any prosecution.

## WHO ARE THE COMPOUNDING AUTHORITIES/ WHO CAN COMPOUND THE OFFENCE?

The Regional Director appointed by the Central Government as a Regional Director for the purposes of this Act and the National Company Law Tribunal (*Tribunal*) are the two compounding authorities.

Where the maximum amount of fine which may be imposed for an offence does not exceed Twenty-five lakh rupees, the Regional Director or any officer authorized by the Central Government can compound the offence.

In all other case of compoundable offence(s), the Tribunal is authorized to compound.

Here maximum amount of fine means, fine which is payable for alleged violation of a particular section of the Act. The compounding authority has no power to impose fine which exceeds the maximum amount of fine which may be imposed for offence so compounded. In specifying the sum required to be paid or credited for the compounding of an offence, the sum, if any, paid by way of additional fee under sub-section (2) of section 403 shall be taken into account:

### Procedure for Compounding:

- a. Call for a board meeting to decide on compounding as per the CA, 2013.
- b. Arrive at the amount of the fine involved as per the relevant section(s).
- c. Hold the Board Meeting and pass resolution(s) to compound and provide for preparation and providing necessary authorization for compounding.
- d. Every application for the compounding of an offence shall be made to the Registrar who shall forward the same, together with his comments thereon, to the Tribunal or the Regional Director or any officer authorized by the Central Government, as the case maybe. The filing with ROC is done in the e-form GNL-1 prescribed for this purpose. Also deliver sufficient number of hard copies of the compounding application to ROC for him to forward it to RD/Tribunal based on the quantum of fee involved.
- e. There will be a personal hearing before the Regional Director or Tribunal which will decide the amount to be paid for compounding.
- f. Get the order passed by the RD/Tribunal and pay the amount stipulated within the time fixed.
- g. File Order of RD/NCLT with ROC in form INC-28 and ROC will take note of the same.

### Miscellaneous Matters on Compounding

- Where any offence is compounded under this section, whether before or after the institution of any prosecution, an intimation thereof shall be given by the company to the Registrar within seven days from the date on which the offence is so compounded.
- Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, either by the Registrar or by any shareholder of the company or by any person authorized by the Central Government against the offender in relation to whom the offence is so compounded.
- Where the compounding of any offence is made after the institution of any prosecution, such compounding shall be brought by the Registrar in writing, to the notice of the court in which the prosecution is pending and on such notice of the compounding of the offence being given, the company or its officer in relation to whom the offence is so compounded shall be discharged.



- The Tribunal or the Regional Director or any officer authorized by the Central Government, as the case may be, while dealing with a proposal for the compounding of an offence for a default in compliance with any provision of this Act which requires a company or its officer to file or register with, or deliver or send to, the Registrar any return, account or other document, may direct, by an order, if it or he thinks fit to do so, any officer or other employee of the company to file or register with, or on payment of the fee, and the additional fee, required to be paid under section 403, such return, account or other document within such time as may be specified in the order.
- Any officer or other employee of the company who fails to comply with any order made by the Tribunal or the Regional Director or any officer authorized by the Central Government shall be punishable with imprisonment for a term which may extend to six months, or with fine not exceeding one lakh rupees, or with both.
- No penalty or prosecution after compounding: - In *P P Varkey v. STO* (1999) 114 STC 224 (Bom HC DB), it was held that once an offence is compounded, penalty or prosecution proceeding cannot be taken for same offence.
- In *S Viswanathan v. State of Kerala* (1993) 113 STC 182 (Ker HC DB), it was held that once the matter is compounded, neither department nor assessee can challenge the compounding order. Department cannot reopen the matter on the reason that actual suppression was much higher.
- No appeal against order of composition: -A person having agreed to the composition of offence is not entitled to challenge the said proceeding by filing an appeal. (*S V Bagi v. State of Karnataka* (1992) 87 STC 138).

## COMPOUNDING PROVISIONS UNDER THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999 (FEMA)

### PENAL PROVISIONS UNDER FEMA

Section 13 of FEMA contains the penalties for contravention of any provision of FEMA or any rule, regulation, notification, direction or order issued in exercise of the powers under it including contravention of any condition subject to which an authorization is issued. The penalties are quite substantial and can extend up to three times of the sum involved in such contravention where the amount is quantifiable or up to Rupees Two lakhs, where the amount is not directly quantifiable and where the contravention is a continuing one, further penalty which may extend to Rupees Five thousand for every day after the first day during which the contravention continues.

### POWER TO COMPOUND CONTRAVENTION

In terms of Section 15 of the FEMA that any contravention under section 13 may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank as may be authorized in this behalf by the Central Government in such manner as may be prescribed.

(2) Where a contravention has been compounded under sub-section (1), no proceeding or further proceeding, as the case may be, shall be initiated or continued, as the case may be, against the committing such contravention under that section, in respect of the contravention so compounded.

### FOREIGN EXCHANGE (COMPOUNDING PROCEEDINGS) RULES 2000 ("RULES")

Central Government has notified the Foreign Exchange (Compounding Proceedings) Rules 2000 for the purpose of compounding of offences under section 15 of the FEMA. It contains the details for compounding.

## WHO ARE THE COMPOUNDING AUTHORITIES/ WHO CAN COMPOUND THE OFFENCE?

The following are Compounding Authorities under FEMA:

1. officers of the Reserve Bank as may be authorized in this behalf by the Central Government in such manner as may be prescribed if the offence is not contravention under section 3(a) of the FEMA.
2. officers of the Enforcement Directorate not below the rank of Deputy Director or Deputy Legal Adviser (DLA) if it is relating to section 3(a) of FEMA

It may be noted that section 3(a) of FEMA prescribes the provisions for the deal in or transfer any foreign exchange or foreign security to any person not being an authorised person (commonly dubbed as Hawala<sup>1</sup> transaction).

## POWER OF RESERVE BANK TO COMPOUND CONTRAVENTION

If any Person contravenes any provisions of Foreign Exchange Management Act, 1999 except clause (a) of Section 3 of the Act.

- (a) in case where the sum involved in such contravention is ten lakhs rupees or below, by the Assistant General Manager of the Reserve Bank of India;
- (b) in case where the sum involved in such contravention is more than rupees ten lakhs but less than rupees forty lakhs, by the Deputy General Manager of Reserve Bank of India;
- (c) in case where the sum involved in the contravention is rupees forty lakhs or more but less than rupees one hundred lakhs by the General Manager of Reserve Bank of India;
- (d) in case the sum involved in such contravention is rupees one hundred lakhs or more, by the Chief General Manager of the Reserve Bank of India;

It may be noted that a contravention shall be compounded only if the amount involved in such contravention is quantifiable.

## POWER OF ENFORCEMENT DIRECTORATE TO COMPOUND CONTRAVENTIONS

If any Person contravenes provisions of Section 3(a) of Foreign Exchange Management Act.

- (a) in case where the sum involved in such contravention is five lakhs rupees or below, by the Deputy Director of the Directorate of Enforcement;
- (b) in case where the sum involved in such contravention is more than rupees five lakhs but less than rupees ten lakhs, by the Additional Director of the Directorate of Enforcement;
- (c) in case where the sum involved in the contravention is rupees ten lakhs or more but less than fifty lakhs rupees by the Special Director of the Directorate of Enforcement;
- (d) in case where the sum involved in the contravention is rupees fifty lakhs or more but less than one crore rupees by Special Director with Deputy Legal Adviser of the Directorate of Enforcement;
- (e) in case the sum involved in such contravention is one crore rupees or more, by the Director of Enforcement with Special Director of the Enforcement Directorate. Provided further that no contravention shall be compounded unless the amount involved in such contravention is quantifiable.

<sup>1</sup> Hawala is an informal method of transferring money without any physical money actually moving. Interpol's definition of hawala is "money transfer without money movement." Another definition is simply "trust." Hawala is used today as an alternative remittance channel that exists outside of traditional banking systems. Transactions between hawala brokers are made without promissory notes because the system is heavily based on trust and the balancing of hawala brokers' books.

### **LIMIT FOR COMPOUNDING**

- (1) A contravention committed by any person within a period of three years from the date on which a similar contravention committed by him was compounded under these rules cannot be compounded. Any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded shall be deemed to be a first contravention and can therefore be compounded.
- (2) No contravention shall be compounded if an appeal has been filed under section 17 or section 19 of FEMA.

### **PROCEDURE FOR COMPOUNDING**

- (1) Application is to be made to the compounding authority either suo moto or on being advised to compound as per format given in the Foreign Exchange (Compounding Proceedings) Rules 2000.
- (2) Every application for compounding any contravention under this rule shall be made in Form to the along with a fee of Rs. 5000/- by Demand Draft in favour of compounding authority.
- (3) The Compounding Authority may call for any information, record or any other documents relevant to the compounding proceedings.
- (4) The Compounding Authority shall pass an order of compounding after affording an opportunity of being heard to all the concerned as expeditiously as possible as and not later than 180 days from the date of application. If the Enforcement Directorate is of the view that the proceeding initiated before it relates to a serious contravention suspected of money laundering, terror financing or affecting sovereignty and integrity of the nation, the Compounding Authority shall not proceed with the matter and shall remit the case to the appropriate Adjudicating Authority for adjudicating contravention under section 13 of FEMA.
- (5) Where any contravention is compounded before the adjudication of any contravention under section 16 of FEMA, no inquiry shall be held for adjudication of such contravention in relation to such contravention against the person in relation to whom the contravention is so compounded.
- (6) Where the compounding of any contravention is made after making of a complaint under sub-section (3) of section 16, such compounding shall be brought by the authority specified in rule 4 or rule 5 in writing, to the notice of the Adjudicating Authority and on such notice of the compounding of the contravention being given, the person in relation to whom the contravention is so compounded shall be discharged.

### **FACTORS CONSIDERED WHILE CONSIDERING COMPOUNDING APPLICATION**

The following factors, which are only indicative, may be taken into consideration for the purpose of passing compounding order and adjudging the quantum of sum on payment of which contravention shall be compounded:

- a) the amount of gain of unfair advantage, wherever quantifiable, made as a result of the contravention;
- b) the amount of loss caused to any authority/ agency/ exchequer as a result of the contravention;
- c) economic benefits accruing to the contravener from delayed compliance or compliance avoided;
- d) the repetitive nature of the contravention, the track record and/or history of non-compliance of the contravener;
- e) contravener's conduct in undertaking the transaction and in disclosure of full facts in the application and submissions made during the personal hearing; and any other factor as considered relevant and appropriate.

### PAYMENT OF AMOUNT COMPOUNDED AND CERTIFICATE OF COMPOUNDING

The sum for which the contravention is compounded as specified in the order of compounding shall be paid by demand draft in favour of the Compounding Authority within fifteen days from the date of the order of compounding of such contravention. In case a person fails to pay the sum compounded within the time specified he shall be deemed to have never made an application for compounding of any contravention under these rules and the provisions of the Act for contravention shall apply to him. On realization of the sum for which contravention is compounded a certificate in this regard shall be issued subject to the specified conditions, if any, in the order.

### COMPOUNDING PROVISIONS UNDER THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 ("SEBI ACT"), SECURITIES CONTRACTS (REGULATION) ACT, 1956 (SCRA) & DEPOSITORIES ACT, 1996

Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1996 (collectively referred to as SEBI Laws here for brevity) contain penalty provisions for contravention. Section 24A of the Securities and Exchange Board of India Act, 1992, Section 23 N of the Securities Contracts (Regulation) Act, 1956 and section 22A of the Depositories Act, 1996 provide for composition of certain offences thereunder. All the said sections of the SEBI laws read verbatim same and is given below for ready reference:

**Composition of certain offences:** *Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.*

### WHEN COMPOSITION OF OFFENCE POSSIBLE UNDER SEBI LAWS

It can be seen from the above section that, any offence punishable under the SEBI Laws, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending. Thus, if the offence is punishable with fine only or imprisonment or fine or with fine or imprisonment or both alone can be compounded.

### SETTLEMENT PROCEEDINGS / CONSENT ORDERS UNDER SEBI LAWS-APPLICABLE FOR COMPOSITION OF OFFENCE

In SEBI Laws, the term *Settlement / Consent Order* is significant and has to be understood along with or at the time of learning composition of offence.

Consent order may be passed at any stage after probable cause of violation has been found under SEBI Laws. However, in the event of a serious and intentional violation, the process should not be completed till the fact-finding process is completed whether by way of investigation or otherwise.

Compounding of Offence can take place after filing criminal complaint by SEBI. Where a criminal complaint has not yet been filed but is envisaged, the process for consent orders will be followed.

### Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018

SEBI has by notification dated 30<sup>th</sup> November 2018 made regulations to provide for the terms of settlement and the procedure of settlement and matters connected therewith or incidental thereto known as Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018. This regulation has come into force from 1<sup>st</sup> January 2019. Regulation 33 of the said regulation states that the provisions of Chapters IV to VI and Schedule-II may be applied *mutatis mutandis* for arriving at a proposal pursuant to a compounding application.

Students are also advised to read and understand the topic CONSENT ORDERS UNDER SEBI Laws in this context to understand the procedure, factors etc while composition of offence under the SEBI Laws. It is not repeated here for sake of avoiding repetition.

## MEDIATION AND CONCILIATION

### INTRODUCTION

*Mediation and Conciliation* have gained popularity in almost all countries worldwide. In India, the conciliation process was introduced in the Industrial Disputes Act, 1947 and, later, under the Arbitration and Conciliation Act, 1996. In 1999, mediation was specifically recognized in amendments made to the Code of Civil Procedure, 1908. Ever since, courts are empowered to refer a case for resolution through mediation or conciliation at the parties' request, or if the court feels the case has elements of settlement.

### Meaning of mediation

The term "mediation" has been defined under black law dictionary as "an act of a third person who interferes between two contending parties with a view to reconcile them or persuade them to adjust or settle their dispute".

### Meaning of conciliation

The term "Conciliation" has been defined under black law dictionary as "The process of adjusting or settling disputes in a friendly manner through extra judicial mean".

### Differences between mediation and conciliation

<p><b>Conciliation</b> : Conciliator brings the disputants to agreement through negotiation. Further, the Conciliator is appointed only after the dispute has arisen. The decision of the Conciliator is called "award".</p>	<p><b>Mediation</b> : Mediation is a structured process. The Mediator assists the disputants to reach a negotiable settlement. The Process results in signed agreement which decides the future behaviour of the parties. Further, the decision of the mediator is called "settlement".</p>
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It is the process by which the parties to a dispute have closed-door discussions on a contentious issue in the presence of neutral mediator(s). This is a voluntary process and is undertaken only if all the parties are willing to go by it. The mediator, who is specially trained, helps the parties move from their positions, towards assessing where their interests are. Then, s/he helps the parties determine how the matter can be settled, examining various options. Unlike formal adjudicatory processes, the mediation need not be confined to the issues raised in the case, but can go beyond to other matters the parties want resolved. They can also agree to disagree on some issues, while resolving the rest.

Mediation is a time-bound, private and confidential process. The information shared must be kept confidential by all parties, including the mediator. This facilitates a free and frank discussion on matters in dispute. Equally important, the discussions cannot be brought up before the court if the disputes are not resolved through mediation.

The conciliation process is similar to mediation. But the conciliator suggests terms for settlement on evaluation of the issues discussed by the parties.

In mediation, the mediator does not suggest the manner of settlement to the parties. Any settlement arrived at using either process is voluntary. No settlement can be imposed by the mediator or conciliator.

The Companies Act, 2013 has inserted section 442 to it which was effective from 1<sup>st</sup> April 2014 itself. However, the Rules were notified only with effect from 9<sup>th</sup> September, 2016 which deal with mediation and conciliation. The

section enables settlement of dispute through “alternate dispute resolution”. Thus, is a mechanism to reduce the burden of quasi-judicial bodies.

### Importance of Mediation

Disadvantages of adjudicatory process

- (a) delay in resolution of the dispute;
- (b) uncertainty of outcome;
- (c) inflexibility in the result/solution;
- (d) high cost;
- (e) difficulties in enforcement; and
- (f) hostile atmosphere.

The object of mediation is to offer to the litigant public, a speedy and satisfactory alternative dispute resolution process in certain types of civil cases. When the cases suitable for negotiated settlements are referred to mediation, the benefits are twofold. First, the parties find an amicable solution by the negotiated settlement. Second, the courts will have more space to deal with cases which require to be adjudicated by courts. Building awareness regarding mediation and invoking mediation as an alternative dispute resolution process is only to supplement the functioning of courts, with reference to certain types of civil cases. Mediation is not intended to, and in fact cannot, replace courts.

Mediation and conciliation are all basically non-adjudicatory dispute resolution processes, where a neutral third party renders assistance to the parties to the dispute to reach a satisfactory settlement. The neutral third party listens to the parties, ascertains the facts and circumstances and the nature of dispute, identifies the causes for the difference or conflict and facilitates the parties to reach an amicable settlement.

Thus, Mediation gives a voluntary and flexible negotiated conflict reduction process with the assistance of experts. It involves a structured negotiation where the mediator listens to the parties, ascertains the facts and circumstances as also the nature of the grievance, conflict or dispute, encourages the parties to open up to identify the causes therefore, creates a conducive atmosphere to enable the parties to explore various alternatives and ultimately facilitates the parties to find a solution or reach a settlement. In short, it is a professionally and scientifically managed negotiation process.

Conciliation as the assistance rendered by a conciliator to the parties to a dispute, in an independent and impartial manner, in their attempt to reach an amicable settlement of their dispute.

In the landmark case of *Afcons Infrastructure Ltd. v. Cherian Varkey Construction Co. (P) Ltd.*, the Supreme Court held that, that all cases relating to trade, commerce, contracts, consumer disputes and even tortious liability could normally be mediated.

### SECTION 442 OF THE COMPANIES ACT, 2013

This section deals with the following:

- The Central Government shall maintain a panel of experts to be called as the Mediation and Conciliation Panel consisting of such number of experts having such qualifications as may be prescribed for mediation between the parties during the pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal under this Act.
- Any of the parties to the proceedings may, at any time during the proceedings before the Central Government or the Tribunal or the Appellate Tribunal, apply to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in such form along with such fees as may be prescribed,



for referring the matter pertaining to such proceedings to the Mediation and Conciliation Panel and the Central Government or Tribunal or the Appellate Tribunal, as the case may be, shall appoint one or more experts from the panel referred to in sub-section (1).

- The Central Government or the Tribunal or the Appellate Tribunal before which any proceeding is pending may, *suo motu*, refer any matter pertaining to such proceeding to such number of experts from the Mediation and Conciliation Panel as the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, deems fit.
- The fee and other terms and conditions of experts of the Mediation and Conciliation Panel shall be such as may be prescribed.
- The Mediation and Conciliation Panel shall follow such procedure as may be prescribed and dispose of the matter referred to it within a period of three months from the date of such reference and forward its recommendations to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.
- Any party aggrieved by the recommendation of the Mediation and Conciliation Panel may file objections to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

### COMPANIES (MEDIATION AND CONCILIATION) RULES, 2016

The Central Government, in order to facilitate voluntary dispute resolution mechanism, vide Notification dated September 9, 2016 has come up with Companies (Mediation and Conciliation) Rules, 2016 (hereinafter referred to as "Rules").

The Rules pertain to section 442 of the Companies Act, 2013 (hereinafter referred to as "Act, 2013") which provides for the setting up of Mediation and Conciliation Panel for facilitating mediation and reconciliation between the parties during any stage of the proceeding before the quasi-judicial bodies i.e. the Central Government, Tribunal or Appellate Tribunal. There was no such mechanism provided under the Companies Act, 1956.

### ANALYSIS OF THE RULES

#### Panel of mediators or conciliators (Rule 3)

- (1) Regional Director shall prepare a panel of experts willing and eligible to be appointed as mediators or conciliators in the respective regions and such panel shall be placed on the website of the Ministry of Corporate Affairs or on any other website as may be notified by the Central Government.
- (2) The Regional Director may invite applications from persons interested in getting empanelled as mediator or conciliator and possessing the requisite qualifications specified in Rule 4 of the rules.
- (3) A person who intends to get empanelled as mediator or conciliator and possesses the requisite qualifications shall apply to the Regional Director in Form MDC-1. This form is appended to the rules itself and may be studied.
- (4) Application received under sub-rule (3), if rejected by the Regional Director, the Regional Director shall record the reasons in writing for the same.
- (5) The Regional Director shall invite applications from persons interested in getting empanelled as mediator or conciliator every year during the month of February and update the Panel which shall be effective from 1st of April of every year:



**Qualifications for Empanelment (Rule 4)**

A person shall not be qualified for being empanelled as mediator or conciliator unless he —

- (a) has been a Judge of the Supreme Court of India; or
- (b) has been a Judge of a High Court; or
- (c) has been a District and Sessions Judge; or
- (d) has been a Member or Registrar of a Tribunal constituted at the National level under any law for the time being in force; or
- (e) has been an officer in the Indian Corporate Law Service or Indian Legal Service with fifteen years' experience; or
- (f) is a qualified legal practitioner for not less than ten years; or
- (g) is or has been a professional for at least fifteen years of continuous practice as Chartered Accountant or Cost Accountant or Company Secretary; or
- (h) has been a Member or President of any State Consumer Forum; or
- (i) is an expert in mediation or conciliation who has successfully undergone training in mediation or conciliation.

**Disqualifications for empanelment (Rule 5)**

A person shall be disqualified for being empanelled as mediator or conciliator, if he —

- (a) is an undischarged insolvent or has applied to be adjudicated as an insolvent and his application is pending;
- (b) has been convicted for an offence which, in the opinion of the Central Government, involves moral turpitude;
- (c) has been removed or dismissed from the service of the Government or the Corporation owned or controlled by the Government;
- (d) has been punished in any disciplinary proceeding, by the appropriate disciplinary authority; or
- (e) has, in the opinion of the Central Government, such financial or other interest in the subject matter of dispute or is related to any of the parties, as is likely to affect prejudicially the discharge by him of his functions as a mediator or conciliator.

**Application for appointment of Mediator or Conciliator & his appointment (Rule 6)**

- (1) (a) Parties concerned may agree on the name of the sole mediator or conciliator for mediation or conciliation between them;
- (b) Where, there are two or more sets of parties and are unable to agree on a sole mediator or conciliator, the Central Government or the Tribunal or the Appellate Tribunal may ask each party to nominate the mediator or conciliator or the Central Government or the Tribunal or the Appellate Tribunal may appoint the mediator or conciliator, as may be deemed necessary for mediation or conciliation between the parties.
- (2) The application to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, for referring the matter pertaining to any proceeding pending before it for mediation or conciliation shall be in Form MDC-2 (provided in the rules itself) and shall be accompanied with a fee of one thousand rupees.

- (3) On receipt of an application under sub-rule (2), the Central Government or the Tribunal or the Appellate Tribunal shall appoint one or more experts from the panel.
- (4) The Central Government or the Tribunal or the Appellate Tribunal, as the case may be, before which any proceeding is pending may, *suo motu*, refer any matter pertaining to such proceeding to such number of experts from the Mediation and Conciliation Panel, if it deems fit in the interest of parties.

#### **Deletion from the Panel (Rule 7)**

The Regional Director may by recording reasons in writing and after giving him an opportunity of being heard, remove any person from the Panel.

#### **Withdrawing name from Panel (Rule 8)**

Any person who intends to withdraw his name from the Mediation and Conciliation Panel may make an application to the Regional Director indicating the reasons for such withdrawal and the Regional Director shall take a decision on such application within fifteen days of receipt of such application and update the Panel accordingly.

#### **Duty of mediator or conciliator to disclose certain facts (Rule 9)**

- (1) It shall be the duty of a mediator or conciliator to disclose to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, about any circumstances which may give rise to a reasonable doubt as to his independence or impartiality in carrying out his functions.
- (2) Every mediator or conciliator shall from the time of his appointment and throughout continuance of the mediation or conciliation proceedings, without any delay, disclose to the parties about existence of any circumstance referred to in sub-rule (1).

#### **Withdrawal of appointment (Rule 10)**

The Central Government or the Tribunal or the Appellate Tribunal as the case maybe, upon receiving any disclosure furnished by the mediator or conciliator under rule 9, or after receiving any other information from a party or other person in any proceeding which is pending and on being satisfied that such disclosures or information has raised a reasonable doubt as to the independence or impartiality of such mediator or conciliator, may withdraw his appointment and in his place, appoint any other mediator or conciliator in that proceeding.

The mediator or conciliator may, offer to withdraw himself from such proceeding and request the Central Government or the Tribunal or the Appellate Tribunal as the case may be to appoint any other mediator or conciliator.

#### **Procedure for disposal of matters (Rule 11)**

- (1) For the purposes of mediation and conciliation, the mediator or conciliator shall follow the following procedure, namely: -
  - (i) he shall fix, in consultation with the parties, the dates and the time of each mediation or conciliation session, where all parties have to be present;
  - (ii) he shall hold the mediation or conciliation at the place decided by the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, or such other place where the parties and the mediator or conciliator jointly agree;
  - (iii) he may conduct joint or separate meetings with the parties;
  - (iv) each party shall, ten days before a session, provide to the mediator or conciliator a brief memorandum

setting forth the issues, which need to be resolved, and his position in respect of those issues and all information reasonably required for the mediator or conciliator to understand the issue and a copy of such memorandum shall also be given to the opposite party or parties: In suitable or appropriate cases, the above mentioned period may be reduced at the discretion of the mediator or conciliator;

- (v) each party shall furnish to the mediator or conciliator such other information as may be required by him in connection with the issues to be resolved.

(2) Where there is more than one mediator or conciliator, the mediator or conciliators may first concur with the party that agreed to nominate him and thereafter interact with the other mediator or conciliator, with a view to resolve the dispute.

### **Mediator or Conciliator not bound by the Indian Evidence Act, 1872 or the Code of Civil Procedure, 1908 (Rule 12)**

The mediator or conciliator shall not be bound by the Indian Evidence Act, 1872 or the Code of Civil Procedure, 1908 while disposing the matter, but shall be guided by the principles of fairness and natural justice, having regard to the rights and obligations of the parties, usages of trade, if any, and the circumstances of the dispute.

### **Representation of parties (Rule 13)**

The parties shall ordinarily be present personally or through an authorized attorney at the sessions or meetings notified by the mediator or conciliator. The parties may be represented by an authorized person or counsel with the permission of the mediator or conciliator in such sessions or meetings and the mediator or conciliator or the Central Government or the Tribunal or the Appellate Tribunal as the case may be, shall be entitled to direct or ensure the presence of any party to appear in person.

The party not residing in India may, with the permission of the mediator or conciliator, be represented by his or her authorized representative at the sessions or meetings.

### **Consequences of non-attendance of parties at sessions or meetings on due dates (Rule 14)**

If a party fails to attend a session or a meeting fixed by the mediator or conciliator deliberately or wilfully for two consecutive times, the mediation or conciliation shall be deemed to have failed and mediator or conciliator shall report the matter to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

### **Administrative Assistance (Rule 15)**

In order to facilitate the conduct of mediation or conciliation proceedings, the mediator or conciliator with the consent of the parties, may arrange for administrative assistance by a suitable institution or person.

### **Offer of Settlement by Parties (Rule 16)**

(1) Any party to the proceeding may, "without prejudice" offer a settlement to the other party at any stage of the proceedings, with a notice to the mediator or conciliator.

(2) Any party to the proceeding may make a, "with prejudice" offer to the other party at any stage of the proceedings with a notice to the mediator or conciliator.

### **Role of Mediator or Conciliator (Rule 17)**

The mediator or conciliator shall attempt to facilitate voluntary resolution of the dispute by the parties, and communicate the view of each party to the other, assist them in identifying issues, reducing misunderstandings, clarifying priorities, exploring areas of compromise and generating options in an attempt to resolve the dispute, emphasising that it is the responsibility of the parties to take decision which affect them and he shall not impose

any terms of settlement on the parties. On consent of both the parties, the mediator or conciliator may impose such terms and conditions on the parties for early settlement of the dispute as he may deem fit.

### **Parties alone responsible for taking decision (Rule 18)**

The parties shall be made to understand that the mediator or conciliator facilitates in arriving a decision to resolve the dispute and that he shall not and cannot impose any settlement nor the mediator or conciliator give any assurance that the mediation or conciliation shall result in a settlement and the mediator or conciliator shall not impose any decision on the parties.

### **Time limit for completion of mediation or conciliation (Rule 19)**

(1) The process for any mediation or conciliation under these rules shall be completed within a period of three months from the date of appointment of expert or experts from the Panel.

(2) On the expiry of three months from the date of appointment of expert from the Panel, the mediation or conciliation process shall stand terminated.

(3) In case of mediation or conciliation in relation to any proceeding before Tribunal or Appellate Tribunal which could not be completed within three months, the Tribunal or as the case may be, the Appellate Tribunal, may on the application of mediator or conciliator or any of the party to the proceedings, extend the period for mediation or conciliation by such period not exceeding three months.

### **Parties to Act in Good Faith (Rule 20)**

All the parties shall commit to participate in the proceedings in good faith with the intention to settle the dispute.

### **Confidentiality, Disclosure and Inadmissibility of Information (Rule 21)**

(1) When a mediator or conciliator receives factual information concerning the dispute from any party, he shall disclose the substance of that information to the other party, so that the other party may have an opportunity to present such explanation as it may consider appropriate:

When a party gives information to the mediator or conciliator subject to a specific condition that the information may be kept confidential, the mediator or conciliator shall not disclose that information to the other party.

(2) The receipt or perusal, or preparation of records, reports or other documents by the mediator or conciliator, while serving in that capacity shall be confidential and the mediator or conciliator shall not be compelled to divulge information regarding those documents nor as to what transpired during the mediation or conciliation before the Central Government or the Tribunal or the Appellate Tribunal or as the case may be, or any other authority or any person or group of persons.

(3) The parties shall maintain confidentiality in respect of events that transpired during the mediation and conciliation and shall not rely on or introduce the said information in other proceedings as to –

- (i) views expressed by a party in the course of the mediation or conciliation proceedings;
- (ii) documents obtained during the mediation or conciliation which were expressly required to be treated as confidential or other notes, drafts or information given by the parties or the mediator or conciliator.
- (iii) proposals made or views expressed by the mediator or conciliator;
- (iv) admission made by a party in the course of mediation or conciliation proceedings.

(4) There shall be no audio or video recording of the mediation or conciliation proceedings.

(5) No statement of parties or the witnesses shall be recorded by the mediator or conciliator.

**Privacy (Rule 22)**

The mediation or conciliation sessions or meetings shall be conducted in privacy where the persons as mentioned in rule 13 shall be entitled to represent parties but other persons may attend only with the permission of the parties and with the consent of the mediator or conciliator.

**Protection of Action Taken in Good Faith (Rule 23)**

No mediator or conciliator shall be held liable for anything, which is done or omitted to be done by him, in good faith during the mediation or conciliation proceedings for civil or criminal action nor shall be summoned by any party to the suit or proceeding to appear before the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, to testify regarding information received by him or action taken by him or in respect of drafts or records prepared by him or shown to him during the mediation or conciliation proceedings.

**Communication between Mediator or Conciliator and the Central Government or the Tribunal or the Appellate Tribunal (Rule 24)**

In order to preserve the confidence of parties in the Central Government or the Tribunal or the Appellate Tribunal as the case may be and the neutrality of the mediator or conciliator, there shall be no communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in the subject matter. If any communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, is necessary, it shall be in writing and copies of the same shall be given to the parties or the authorized representative. Communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall be limited to communication by the mediator or conciliator:

- (i) about the failure of the party to attend;
- (ii) about the consent of the parties;
- (iii) about his assessment that the case is not suited for settlement through the mediation or conciliation;
- (iv) about settlement of dispute between the parties.

**Settlement agreement (Rule 25)**

(1) Where an agreement is reached between the parties in regard to all the issues or some of the issues in the proceeding, the same shall be reduced to writing and signed by the parties and if any counsel has represented the parties, the conciliator or mediator may also obtain the signature of such counsel on the settlement agreement.

(2) The agreement of the parties so signed shall be submitted to the mediator or conciliator who shall, with a covering letter signed by him, forward the same to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

(3) Where no agreement is reached at between the parties, before the time limit specified in rule 19, or where the mediator or conciliator is of the view that no settlement is possible, he shall report the same to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in writing.

**Fixing date for recording settlement and passing order (Rule 26)**

(1) The Central Government or the Tribunal or the Appellate Tribunal as the case may be, shall fix a date of hearing normally within fourteen days from the date of receipt of the report of the mediator or conciliator under rule 25 and on such date of hearing, if the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, is satisfied that the parties have settled their dispute, it shall pass an order in accordance with terms thereof.

(2) If the settlement disposes of only certain issues arising in the proceeding, on the basis of which any order is passed as stated in sub-rule (1), the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall proceed further to decide the remaining issues.

### **Expenses of the Mediation and Conciliation (Rule 27)**

(1) At the time of referring the matter to the mediation or conciliation, the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, may fix the fee of the mediator or conciliator and as far as possible, a consolidated sum may be fixed rather than for each session or meeting.

(2) The expense of the mediation or conciliation including the fee of the mediator or conciliator, costs of administrative assistance and other ancillary expenses concerned, shall be borne equally by the various contesting parties or as may be otherwise directed by the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

(3) Each party shall bear the costs for production of witnesses on his side including experts or for production of documents.

(4) The mediator or conciliator may, before the commencement of the mediation or conciliation, direct the parties to deposit equal share of the probable costs of the mediation or conciliation including the fees to be paid to the mediator or conciliator.

(5) If any party or parties do not pay the amount referred to sub-rule (4), the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall on the application of the mediator or conciliator, or any party, issue appropriate directions to the concerned parties.

(6) The mediation or conciliation shall commence only on the deposit of amount referred to in sub-rule (4) and in case amount is not paid before such commencement, the mediation or conciliation shall be deemed to have terminated.

### **Ethics to be followed by Mediator or Conciliator (Rule 28)**

The mediator or conciliator shall –

- (a) follow and observe the rules strictly and with due diligence;
- (b) not carry on any activity or conduct which shall reasonably be considered as conduct unbecoming of a mediator or conciliator;
- (c) uphold the integrity and fairness of the mediation or conciliation process;
- (d) ensure that the parties involved in the mediation or conciliation are fairly informed and have an adequate understanding of the procedural aspects of the process;
- (e) satisfy himself or herself that he or she is qualified to undertake and complete the assignment in a professional manner;
- (f) disclose any interest or relationship likely to affect impartiality or which might seek an appearance of partiality or bias;
- (g) avoid, while communicating with the parties, any impropriety or appearance of impropriety;
- (h) be faithful to the relationship of trust and confidentiality imposed in the office of mediator or conciliator;
- (i) conduct all proceedings related to the resolutions of a dispute, in accordance with the relevant applicable law;
- (j) recognise that the mediation or conciliation is based on principles of self-determination by the parties

and that the mediation or conciliation process relies upon the ability of parties to reach a voluntary, undisclosed agreement; and

- (k) maintain the reasonable expectations of the parties as to confidentiality and refrain from promises or guarantees of results.

If any party finds that conduct of mediator or conciliator violates the ethics laid down in this rule, the party may immediately bring it to the notice of the Regional Director.

### **Resort to arbitral or judicial proceedings (Rule 29)**

The parties shall not initiate, during the mediation or conciliation under these rules, any arbitral or judicial proceedings in respect of a matter that is the subject-matter of the mediation or conciliation, except that a party may initiate arbitral or Judicial proceedings, where, in his, opinion, such proceedings are necessary for protecting his rights.

### **Matters not to be referred to the mediation or conciliation (Rule 30)**

The following matters shall not be referred to mediation or conciliation, namely: -

- (a) the matters relating to proceedings in respect of inspection or investigation under Chapter XIV of the Act; or the matters which relate to defaults or offences for which applications for compounding have been made by one or more parties.
- (b) cases involving serious and specific allegations of fraud, fabrication of documents forgery, impersonation, coercion etc.
- (c) cases involving prosecution for criminal and non-compoundable offences.
- (d) cases which involve public interest or interest of numerous persons who are not parties before the Central Government or the Tribunal or the Appellate Tribunal as the case may be.

## **SETTLEMENT AND SETTLEMENT PROCEEDINGS CONTENT ORDER UNDER SEBI LAWS**

Under the Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956 (SCRA) and the Depositories Act, 1996 (collectively also known as *securities laws*), SEBI pursues two streams of enforcement actions i.e. Administrative /Civil (or) Criminal.

Administrative/civil actions include issuing directions such as remedial orders, cease and desist orders, suspension or cancellation of certificate of registration and imposition of monetary penalty under the respective statutes and action pursued or defended in a court of law/tribunal.

Criminal action involves initiating prosecution proceedings against violators by filing complaint before a criminal court.

The Parliament of India has recognized the powers of SEBI to pass consent orders under the SEBI Act and the Depositories Act. This will of the Parliament is apparent from Section 15T of the SEBI Act 1992 and section 23 A of the Depositories Act. Further, section 24A of the SEBI Act, section 23N of the SCRA and section 22A of the Depositories Act permit composition of offences.

Section 15T(2) of the SEBI Act reads as under:

“15T (2) No appeal shall lie to the Securities Appellate Tribunal from an order made

- (a) by the Board on and after the commencement of the Securities Laws (Second Amendment) Act, 1999;
- (b) by an adjudicating officer, **with the Consent of the parties.**”

Thus, the Parliament in its wisdom has recognized that SEBI and its authorized delegate have power to pass



consent orders. Similarly, courts have well recognized inherent powers to settle a case before them on an application made by the parties.

### What is a Consent Order

Consent Order means an order settling administrative or civil proceedings between the regulator and a person (Party) who may *prima facie* be found to have violated securities laws. It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. A Consent Order may or may not include a determination that a violation has occurred.

Consent Order provides flexibility of wider array of enforcement and remedial actions which will achieve the twin goals of an appropriate sanction, remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

Consent orders cannot be construed as waiver of statutory powers by the Board. The Board always has the right to proceed for appropriate action if it cannot achieve its objectives through a consent order.

US Securities and Exchange Commission settles a substantial number (over 90%) of administrative/civil cases by consent orders. Consent orders may provide flexibility of wider array of enforcement actions which will achieve the twin goals of an appropriate sanction and deterrence without resorting to a long-drawn litigation before SEBI/Tribunal/Courts. Passing of consent orders will also reduce regulatory costs and would save time and efforts taken in pursuing enforcement actions. This effort could more effectively be used for pursuing cases which require the full process of enforcement action and for policy work.

Therefore, it has been decided that all appropriate administrative or civil actions e.g. proceedings under sections 11, 11B, 11D, 12(3) and 15I of SEBI Act and equivalent proceedings under the SCRA and the Depositories Act, 1996 and other civil matters pending before Securities Appellate Tribunal (SAT) / courts may be settled between SEBI and a person (party) who may *prima facie* be found to have violated the securities laws or against whom administrative or civil action has been commenced for such violation. Compounding of offence may cover appropriate prosecution cases filed by SEBI before the criminal courts.

### SETTLEMENT AND SETTLEMENT PROCEEDINGS

To enable pass consent orders after arriving at a settlement, SEBI issued Circular No. EFD/ED/Cir-1/2007 containing guidelines for passing consent orders and for considering requests for composition of offences. This circular was further amended by the Board's circular ref No. CIR/EFD/1/2012 dated May 25, 2012. On 9<sup>th</sup> January, 2014, SEBI notified Securities and Exchange Board of India (Settlement of Administrative and Civil Proceedings) Regulations, 2014 to provide for the terms of settlement and the procedure of settlement and matters connected therewith or incidental thereto, rescinding the above two circulars. These regulations were deemed to have come into force from 20<sup>th</sup> April, 2007.

### NEW REGULATIONS FOR SETTLEMENT AND SETTLEMENT PROCEEDINGS

With passage of time and as over two decades have lapsed from the issue of the first guidelines on 20<sup>th</sup> April 2007 for settlement /consent and passing of consent orders, SEBI has now issued a new set of regulations which have come into force from 1<sup>st</sup> day of January 2019 which are new /revised regulations to provide for the terms of settlement and the procedure of settlement and matters connected therewith or incidental thereto. These regulations were notified on November 31, 2018 and is in force from 1<sup>st</sup> January 2019.

For the sake of understanding of the students and considering the importance of the topic the new regulations are given below. Students are expected to understand them and be familiar with the regulations.

## SECURITIES AND EXCHANGE BOARD OF INDIA (SETTLEMENT PROCEEDINGS) REGULATIONS, 2018

In exercise of the powers conferred by Section 15JB of the Securities and Exchange Board of India Act, 1992, Section 23JA of the Securities Contracts (Regulation) Act, 1956 and Section 19-IA of the Depositories Act, 1996 read with Section 30 of the Securities and Exchange Board of India Act, 1992, Section 31 of the Securities Contracts (Regulation) Act, 1956 and Section 25 of the Depositories Act, 1996, the Securities and Exchange Board of India hereby makes the following regulations to provide for the terms of settlement and the procedure of settlement and matters connected therewith or incidental thereto, namely- Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018. They shall come into force on the 1st day of January 2019.

### Important Definitions (Regulation 2)

- (a) “alleged default” means an alleged or probable contravention of any provision of the securities laws;
- (b) “Board” means the Securities and Exchange Board of India established under the provisions of Section 3 of the Act;
- (c) “Panel of Whole Time Members” means the panel consisting of two or more Whole Time Members of the Board;
- (d) “securities laws” means the Act, the Securities Contract (Regulations) Act, 1956 (42 of 1956), the Depositories Act, 1996 (22 of 1996), the relevant provisions of any other law to the extent it is administered by the Board and the relevant rules and regulations made thereunder;
- (e) “specified proceedings” means the proceedings that may be initiated by the Board or have been initiated and are pending before the Board or any other forum, for the violation of securities laws, under Section 11, Section 11B, Section 11D, sub-Section (3) of Section 12 or Section 15-I of the Act or Section 12A or Section 23-I of the Securities Contracts (Regulation) Act, 1956 or Section 19 or Section 19H of the Depositories Act, 1996, as the case may be;
- (f) “Tribunal” means the Securities Appellate Tribunal established under Section 15K of the Securities and Exchange Board of India Act, 1992.

### APPLICATION FOR SETTLEMENT

#### Application (Regulation 3)

(1) A person against whom any specified proceedings have been initiated and are pending or may be initiated, may make an application to the Board in the Form specified in Part-A of the Schedule-I.

(2) The application made under sub-regulation (1) shall be accompanied by a non-refundable application fee as specified in Part-B of Schedule I and the undertakings and waivers as specified in Part-C of Schedule-I: Provided that the rejection or withdrawal of the application shall not affect the continued validity of the undertakings and waivers given in respect of limitation or laches in respect of the initiation or continuation or restoration of any legal proceeding and the waivers given under sub-para (d), (e), (f) and (g) of para 12 of the undertaking and waivers as provided in Part-C of the Schedule-I and subject to such undertakings and waivers, the Board or the applicant, shall be free to initiate or pursue such proceedings as may be appropriate in accordance with law.

(3) The applicant shall make full and true disclosures in the application in respect of the alleged default(s): Provided that the facts established against the applicant or admitted in any ongoing or concluded proceedings in India or outside India, with respect to the same cause of action, under any law, shall be deemed to be admitted by the applicant in respect of the proceedings proposed to be settled.

(4) The applicant shall make one application for settlement of all the proceedings that have been initiated or may be initiated in respect of the same cause of action.

(5) An application that is not complete in all respects or does not conform to the requirements of these regulations shall be returned to the applicant.

(6) The applicant whose application has been returned under sub-regulation (5) may, within fifteen days from the date of communication from the Board, submit the complete and revised application that conforms to the requirements of these regulations: Provided that no further opportunity shall be given to the applicant to make an application in respect of the alleged default at the same stage of the proceedings, as indicated in Table I in Schedule-II.

(7) Where the applicant is an association or a firm or a body corporate or a limited liability partnership, the application and undertakings and waivers shall be executed by the person in charge of, and responsible for the conduct of the business of such firm or association or body corporate and the same shall bind the firm or association, the body corporate and any officer who is in default. *Explanation.* - For the purpose of this sub-regulation, the expression 'officer who is in default' shall have the same meaning as provided in sub-section (60) of Section 2 of the Companies Act, 2013.

(8) An application for settlement of defaults related to disclosures, shall to the extent possible, be made after making the required disclosure.

#### **Limitation (Regulation 4)**

(1) An application in respect of any specified proceeding pending before the Board shall not be considered if it is made after sixty days from the date of service of the notice to show cause or supplementary notice(s) to show cause, whichever is later.

(2) Notwithstanding anything contained in sub-regulation (1), the Board may consider the application, if satisfied that there was sufficient cause for not filing it within the specified period and it is accompanied with non-refundable fees as specified in Part-B of the Schedule-I: Provided that, where the application is filed after sixty calendar days from the expiry of the period specified in sub-regulation (1), the settlement amount determined in accordance with Schedule-II of these regulations shall be increased by twenty five percent: Provided further that, no such delayed application shall be considered if the application is filed after one hundred and twenty calendar days from the expiry of the period specified in sub-regulation (1) or after the first hearing, whichever is earlier.

(3) The provisions of this regulation shall not apply in the case of proceedings pending before the Tribunal or any court.

### **SCOPE OF SETTLEMENT**

#### **Scope of settlement proceedings (Regulation 5)**

(1) No application for settlement of any specified proceedings shall be considered, if:

- (a) an earlier application with regard to the same alleged default had been rejected;
- (b) the audit or investigation or inspection or inquiry, if any, in respect of any cause of action, is not complete, except in case of applications involving confidentiality; or
- (c) monies due under an order issued under securities laws are liable for recovery under securities laws.

(2) The Board may not settle any specified proceeding, if it is of the opinion that the alleged default, -

- i. as market wide impact,

- ii. caused losses to a large number of investors, or
- iii. affected the integrity of the market.

(3) Without prejudice to the generality of the foregoing provisions, for settling any specified proceeding the Board may *inter alia* take into account the following factors, -

- (a) whether the applicant has refunded or disgorged the monies due, to the satisfaction of the Board;
- (b) whether the applicant has provided an exit or purchase option to investors in compliance with securities laws, to the satisfaction of the Board;
- (c) whether the applicant is in compliance with securities laws or any order or direction passed under securities laws, to the satisfaction of the Board;
- (d) any other factor as may be deemed appropriate by the Board.

(4) Without prejudice to sub-regulations (1) and (3), the Board may not settle the specified proceedings where the applicant is a wilful defaulter, a fugitive economic offender or has defaulted in payment of any fees due or penalty imposed under securities laws. (5) Nothing contained in these regulations shall be construed to restrict the right of the Panel of Whole Time Members to consider or reject any application in respect of any specified proceeding without examination by the Internal Committee or the High- Powered Advisory Committee.

#### **Rejection of Application (Regulation 6)**

(1) An application may at any time be rejected on the following grounds:

- (a) Where the applicant refuses to receive or respond to the communications sent by the Board;
- (b) Where the applicant does not submit or delays the submission of information, document, etc., as called for by the Board;
- (c) Where the applicant who is required to appear, does not appear before the Internal Committee on more than one occasion;
- (d) Where the applicant violates in any manner the undertaking and waivers as provided in Part-C of the Schedule-I;
- (e) Where the applicant does not remit the settlement amount within the period specified in clause (a) of sub-regulation (2) of regulation 15 and/or does not abide by the undertaking and waivers. (2) The rejection under sub-regulation (1) shall be communicated to the applicant:

Provided that the applicant shall continue to be bound by the waivers given in respect of limitation or laches in respect of the initiation or continuation or restoration of any legal proceeding and the waivers given under sub-para (d), (e), (f) and (g) of para 12 of the undertaking and waivers as provided in Part-C of the Schedule-I.

#### **Withdrawal of Application (Regulation 7)**

(1) An application may be withdrawn at any time prior to the communication of the decision of the Panel of Whole Time Members under regulation 15.

(2) An applicant who withdraws an application under sub-regulation (1) shall not be permitted to make another application in respect of the same default: Provided that, as may be recommended by the High-Powered Advisory Committee, such an application may be considered subject to an increase of at least fifty percent over the settlement amount determined in accordance with Schedule-II of these Regulations.

#### **Effect of Pending Application on Specified Proceedings (Regulation 8)**

(1) The filing of an application for settlement of any specified proceedings shall not affect the continuance of

the proceedings save that the passing of the final order shall be kept in abeyance till the application is disposed of.

(2) Where the application is filed in case of proceedings that may be initiated against the applicant, such proceedings shall not be initiated till the application is rejected or withdrawn: Provided that, the filing of an application shall not prohibit the initiation of any proceedings, in so far as may be deemed necessary for the purpose of issuance of interim civil and administrative directions to protect the interests of investors and to maintain the integrity of the securities markets.

*Explanation.* – Where any proceeding is pending or to be initiated against several persons but the settlement application is filed only by one or more persons, but not all, the filing of such an application shall not affect the initiation, continuation and disposal of the proceedings against the person who has not filed the application for settlement and any adverse observations made in such proceedings against the applicant shall qua the applicant be subject to the outcome of the settlement application filed by such applicant.

## TERMS OF SETTLEMENT

### Settlement terms (Regulation 9)

(1) The settlement terms may include a settlement amount and/or non-monetary terms, in accordance with the guidelines specified in Schedule-II.

(2) The non-monetary terms may include the following:

- (a) Suspension or cessation of business activities for a specified period;
- (b) Exit from Management;
- (c) Disgorgement on account of the action or inaction of the applicant;
- (d) Refraining from acting as a partner or officer or director of an intermediary or as an officer or director of a company that has a class of securities regulated by the Board, for specified periods;
- (e) Cancel securities and reduce holdings where the securities are issued fraudulently, including bonus shares received on such securities, if any, and reimburse any dividends received, etc.;
- (f) Lock-in of securities;
- (g) Implementation of enhanced policies and procedures to prevent future securities laws violations as well as agreeing to appoint or engage an independent consultant to review internal policies, processes and procedures;
- (h) Provide enhanced training and education to employees of intermediaries and securities market infrastructure institutions;
- (i) Submit to enhanced internal audit and reporting requirements.

(3) The settlement amount, excluding the legal costs and disgorged amount, shall be credited to the Consolidated Fund of India.

(4) The application fee referred to in sub-regulation (2) of regulation 3 and the legal costs, if any, forming part of the settlement amount shall be credited to the Securities and Exchange Board of India General Fund.

*Explanation.* – Legal costs shall include liquidated costs, as may be determined by the Board, in respect of costs for obtaining appropriate orders from the Tribunal or Court under sub-regulation (2) of regulation 24.

(5) The amount of profits made or losses avoided by the applicant that may be disgorged as part of the settlement terms, shall be credited to the Investor Protection and Education Fund.

**Factors to be considered to arrive at the settlement terms (Regulation 10)**

While arriving at the settlement terms, the factors indicated in Schedule-II may be considered, including but not limited, to the following:

- (a) conduct of the applicant during the specified proceeding, investigation, inspection or audit;
- (b) the role played by the applicant in case the alleged default is committed by a group of persons;
- (c) nature, gravity and impact of alleged defaults;
- (d) whether any other proceeding against the applicant for non-compliance of securities laws is pending or concluded;
- (e) the extent of harm and/or loss to the investors' and/or gains made by the applicant;
- (f) processes that have been introduced since the alleged default to minimize future defaults or lapses;
- (g) compliance schedule proposed by the applicant;
- (h) economic benefits accruing to any person from the non-compliance or delayed compliance;
- (i) conditions which are necessary to deter future non-compliance by the same or another person;
- (j) satisfaction of claim of investors regarding payment of money due to them or delivery of securities to them;
- (k) any other enforcement action that has been taken against the applicant for the same violation;
- (l) any other factors necessary in the facts and circumstances of the case.

**COMMITTEES****High Powered Advisory Committee (Regulation 11)**

(1) The Board shall constitute a High-Powered Advisory Committee for consideration and recommendation of the terms of settlement.

(2) The High-Powered Advisory Committee shall consist of a judicial member who has been the Judge of the Supreme Court or a High Court and three external experts having expertise in securities market or in matters connected therewith or incidental thereto.

(3) The term of the members of the High-Powered Advisory Committee shall be three years which may be extended for a further period of two years.

(4) The quorum for a meeting of the High-Powered Advisory Committee shall be of three members. Explanation. - Meeting includes meeting through audio-video electronic means or through the medium of electronic video linkage.

(5) The High-Powered Advisory Committee shall conduct its meetings in the manner specified by the Board in this regard:

Provided that:

- (i) where any member of the High-Powered Advisory Committee seeks recusal, the remaining two or more members may submit their recommendation on the terms of settlement;
- (ii) where no consensus or majority may be reached, the recommendation made by the Judicial member shall be considered to be the recommendation of the High-Powered Advisory Committee and in case of recusal of the Judicial member, the recommendations of the remaining two or more members shall be submitted for consideration to the Panel of Whole Time Members; and



- (iii) where all or all but one of the members of the High-Powered Advisory Committee recuse themselves in respect of an application, the Board may constitute another High-Powered Advisory Committee.

### **Internal Committee(s) (Regulation 12)**

- (1) Internal Committee(s) shall be constituted by the Board.
- (2) The Internal Committee(s) shall comprise of an officer of the Board not below the rank of Chief General Manager and such other officers as may be specified by the Board.

## **PROCEDURE OF SETTLEMENT**

### **Proceedings before the Internal Committee (Regulation 13)**

- (1) Save as otherwise provided in these regulations, an application shall be referred to an Internal Committee to examine whether the proceedings may be settled and if so to determine the settlement terms in accordance with these regulations.

- (2) The Internal Committee may:

- (a) call for relevant information, documents, etc., pertaining to the alleged default(s) in possession of the applicant or obtainable by the applicant;

*Explanation.* – Nothing in these regulations shall confer a right upon the applicant to seek information from the Board or require the Board to seek information from any other person for the purpose of relying upon it in the settlement proceedings or request the Board to permit it to present information not already disclosed in the application, which the applicant was aware of at the time of making the application or which information upon diligent enquiry being made could have become known to the applicant.

- (b) call for the personal appearance of the applicant before it:

Provided that a duly authorized representative of the applicant may represent on behalf of the applicant:

*Explanation.* – Personal appearance under this clause includes appearance through audio-video electronic means or through the medium of electronic video linkage as may be permitted by the Internal Committee.

- (c) permit the applicant to submit revised settlement terms within a period not exceeding ten working days from the date of the Internal Committee meeting: Provided that the revised settlement terms received after ten working days, but within twenty working days may be considered subject to an increase of ten percent over the recommended settlement amount.

- (3) The proposed settlement terms, if any, shall be placed before the High-Powered Advisory Committee

### **Proceedings before the High-Powered Advisory Committee (Regulation 14)**

- (1) The High-Powered Advisory Committee shall consider the proposed settlement terms placed before it along with the following:

- (a) the application, undertaking and waivers of the applicant;
  - (b) factors specified in regulation 10;
  - (c) settlement terms or revised settlement terms proposed by the applicant;
  - (d) any other relevant material available on record.

- (2) The High-Powered Advisory Committee may seek revision of the settlement terms and refer the application back to the Internal Committee.



(3) The recommendations of the High-Powered Advisory Committee shall be placed before the Panel of Whole Time Members.

### **Action on the recommendation of High-Powered Advisory Committee (Regulation 15)**

(1) The Panel of Whole Time Members shall consider the recommendations of the High Powered Advisory Committee and may accept or reject the same:

Provided that where the recommendations of the High Powered Advisory Committee to settle the specified proceedings are rejected, the panel of Whole Time Members shall record reasons for rejection of the recommendations: Provided further that where the recommendation of the High Powered Advisory Committee to settle the specified proceedings are rejected, such decision of the panel of Whole Time Members shall be communicated to the applicant.

(2) Where the Panel of Whole Time Members accepts the recommendation of the High Powered Advisory Committee to settle the specified proceedings, the applicant shall be issued a notice of demand within seven working days of the decision of the panel and the applicant shall, - (a) remit the settlement amount forming part of the settlement terms, not later than fifteen calendar days from the date of receipt of the notice of demand, which may be extended by the Panel of Whole Time Members for reasons to be recorded, by fifteen calendar days: *Explanation.* – Remittance of settlement amount shall be done by way of a demand draft drawn in favour of 'Securities and Exchange Board of India' payable at Mumbai or by way of direct credit in the specified bank account through NEFT/RTGS/IMPS or any other authorized mode of payment. Provided that, where the settlement amount is remitted after thirty calendar days from the date of receipt of the notice of demand and on or before the ninetieth day from such receipt, the settlement amount payable by the applicant shall be increased by the levy of simple interest at the rate of six per cent per annum from the date of receipt of the notice of demand till the date of payment of the settlement amount: Provided further that, in no case shall such remittance be accepted after the ninetieth calendar day from the date of the receipt of the notice of demand. (b) fulfil/undertake in writing to abide by, the other settlement terms, if any, within the time provided to the applicant.

(3) Where the Panel of Whole Time Members does not accept the recommendation of the High Powered Advisory Committee to settle the specified proceedings on the settlement terms recommended by it, the panel may return the application for re-examination of the settlement terms and thereafter the procedure as applicable in the case of an original application shall be followed by the Internal Committee and the High Powered Advisory Committee.

## **SUMMARY SETTLEMENT PROCEDURE**

### **Summary settlement procedure (Regulation 16)**

(1) Notwithstanding anything contained in Chapter VI, before initiating any specified proceeding, the Board may issue a notice of summary settlement in the format as specified in Part-A of Schedule-III, calling upon the noticee to file a settlement application under Chapter-II and submit the settlement amount and/or furnish an undertaking in respect of other non-monetary terms or comply with other non-monetary terms, as may be specified in the summary settlement notice in respect of the specified proceeding(s) to be initiated for the following defaults,- i. Delayed disclosures, including filing of returns, report, document, etc.; ii. Non-disclosure in relation to companies exclusively listed on regional stock exchanges which have exited; iii. Disclosures not made in the specified formats; iv. Delayed compliance of any of the requirements of law or directions issued by the Board; v. Such other defaults as may be determined by the Board. Provided that, the specified proceeding(s) shall not be settled under this Chapter, if in the opinion of the Board, the applicant has failed to make a full and true disclosure of facts or failed to co-operate in the required manner.

(2) Notwithstanding anything contained in the notice of settlement, the Board shall have the power to modify

the enforcement action to be brought against the noticee and the notice of settlement shall not confer any right upon the noticee to seek settlement or avoid any enforcement action.

(3) The noticee may, within thirty calendar days from the date of receipt of the notice of settlement, -

- (a) file a settlement application in the Form specified in Part-A of Schedule-I along with non-refundable application fee as specified in Part-B and the undertakings and waivers as specified in Part-C of Schedule-I;
- (b) remit the settlement amount as specified in the notice of settlement;
- (c) comply or undertake to comply with other non-monetary terms as specified in the notice of settlement, as the case may be; and
- (d) seek rectification of the calculation of the settlement amount, as communicated in the notice of settlement, at the time of filing the settlement application and in all such cases, the decision of the Board shall be final and remittance shall be done within thirty calendar days from the date of receipt of the decision of the Board:

Provided that, the Board may for reasons to be recorded, grant extension of time not exceeding a further period of fifteen calendar days for filing the settlement application, remittance of the settlement amount and/or furnishing an undertaking in respect of any of the non-monetary terms or compliance with any of the non-monetary terms specified in the notice of settlement.

(4) Upon being satisfied with the remittance of settlement amount and undertaking furnished in respect of the non-monetary terms or compliance with non-monetary terms, if any as detailed in the settlement notice, the Board shall pass an order of settlement under regulation 23.

Regulation 17 states that notwithstanding anything contained in these regulations, where a noticee does not file a settlement application under this Chapter or remit the settlement amount and/or comply with other non-monetary terms to the satisfaction of the Board or withdraws the settlement application at any time prior to the communication of the decision of the Board, the specified proceedings may be initiated, and such a noticee shall only be permitted to file a settlement application in respect of the proceedings pending before the Court or Tribunal, after conclusion of proceedings before the Adjudicating Officer or the Board, as the case may be.

## **SETTLEMENT NOTICE**

### **Settlement notice (Regulation 18)**

(1) A notice of settlement in the format as specified in Part-B of Schedule-III, indicating the substance of the probable charges and enforcement actions, may, except in cases covered under Chapter VII, be issued by the Board prior to the issuance of the notice to show cause so as to afford the noticee an opportunity to file a settlement application under Chapter-II, within fifteen calendar days from the date of receipt of the settlement notice.

(2) Notwithstanding anything contained in the settlement notice, the Board shall have the right to modify the nature of the enforcement action to be initiated against the noticee and the charges stated in the notice shall not confer any right to seek settlement on the said basis or avoid any enforcement action due to modified charges.

(3) Where a noticee does not file the settlement application under this Chapter or withdraws the settlement application at any time prior to the communication of the decision of the Panel of Whole Time Members under regulation 15, the specified proceedings may be initiated and such a noticee shall only be permitted to file a settlement application in respect of the proceedings pending before a Court or tribunal, after conclusion of the proceedings before the Adjudicating Officer or the Board, as the case may be.

## SETTLEMENT WITH CONFIDENTIALITY

### Settlement with confidentiality (Regulation 19)

(1) An applicant seeking the benefit of confidentiality in return for admitting for the limited purpose of settlement of specified proceedings to be initiated and agreeing to provide substantial assistance in the investigation, inspection, inquiry or audit, to be initiated or ongoing, against any other person in respect of a violation of securities laws, shall fulfil the conditions of this Chapter, including –

- (a) cease to participate in the violation of securities laws from the time of the disclosure of information, unless otherwise directed by the Board;
- (b) provide and continue to provide complete and true disclosure of information, documents and evidence, which is in his possession or he is able to obtain, to the satisfaction of the Board in respect of the alleged contravention of the provisions of securities laws;
- (c) co-operate fully, continuously and expeditiously throughout the investigation, inspection, inquiry or audit and related proceedings before the Board; and
- (d) not conceal, destroy, manipulate or remove the relevant documents in any manner that may contribute to the establishment of the alleged violation. *Explanation.* – Violation of securities laws in this Chapter refers to defaults other than those of disclosure and reporting requirements detailed in Schedule II.

Provided that an application made under this chapter shall be made only in cases prior to or pending investigation, inspection, inquiry or audit.

(2) Notwithstanding anything contained in this Chapter, where an applicant fails to comply with the conditions mentioned in this regulation, the Board may rely upon the information and evidence submitted by the applicant in any proceedings

(3) Without prejudice to sub-regulations (1) and (2), the Board may subject the applicant to further restrictions or conditions, as deemed fit, after considering the facts and circumstances of the case.

(4) For the purpose of seeking confidentiality, the applicant or its authorized representative may make an application containing all the relevant disclosures pertaining to the information as specified in Schedule-IV for furnishing the information and evidence relating to the commission of any violation of securities laws.

(5) Upon being satisfied the Board may assure the benefit of confidentiality and shall thereupon mark the status of the application depending upon its priority and convey the same to the applicant in writing.

(6) The Board may, for reasons to be recorded in writing, at any stage, reject the application if the information, documents or evidence is found to be incomplete or false to the knowledge of the applicant.

(7) The rejection of the application for confidentiality shall be communicated to the applicant.

### Procedure (Regulation 20)

(1) The provisions of Chapters IV to VI of these regulations may be applied *mutatis mutandis* to a settlement application filed under this Chapter and a settlement order passed accordingly.

(2) The information, documents and evidence provided by the applicant under this chapter shall be submitted in the manner specified by the Board.

### Confidentiality and Assurance (Regulation 21)

For the purposes of providing the applicant with interim confidentiality and assurance from being proceeded with, the Board may not initiate regulatory measures when the Board has a reasonable belief that the information provided to it relates to a possible securities law violation that has occurred, is ongoing or about to occur.

**Confidentiality (Regulation 22)**

The following shall be treated as confidential,

- (a) the identity of the applicant seeking confidentiality; and
- (b) the information, documents and evidence furnished by the applicant under this Chapter:

Provided that, the identity of the applicant or such information or documents or evidence may not be treated as confidential if, –

- (i) the disclosure is required by law;
- (ii) the applicant has agreed to such disclosure in writing; or
- (iii) there has been a public disclosure by the applicant.

**SETTLEMENT ORDERS****Settlement of proceedings before the Adjudicating Officer and the Board (Regulation 23)**

(1) The Adjudicating Officer shall by an appropriate order dispose of the proceeding pending before him on the basis of the approved settlement terms.

*Explanation.* -In case of concurrent proceedings, a comprehensive order may be passed by the Panel of Whole Time Members and thereafter the concerned Adjudicating officer may pass an order, disposing of the relevant proceedings before him, in view of the settlement.

(2) The Panel of the Whole Time Members shall by an appropriate order dispose of proceedings initiated or proposed to be initiated other than the proceedings referred to in sub-regulation (1).

(3) The settlement order passed under these regulations shall, contain the details of the alleged default(s), relevant provisions of the securities laws, brief facts and circumstances relevant to the alleged default, the admissions made by the applicant, if any and the settlement terms.

**Settlement of the proceedings pending before the Tribunal or any court (Regulation 24)**

(1) Save as otherwise provided in these regulations, the provisions with regard to settlement of specified proceedings shall *mutatis mutandis* apply to an application for settlement of any proceeding pending before the Tribunal or any court.

(2) The proposal of settlement along with the settlement terms or rejection thereof shall be placed before such Tribunal or court for appropriate orders.

**Service and publication of settlement order (Regulation 25)**

Settlement orders shall be served on the applicant and shall also be published on the website of the Board:

Provided that settlement orders in matters relating to the confidentiality shall not, directly or indirectly, disclose the identity of the applicant, but shall indicate the provisions of securities laws which the applicant is alleged to have violated.

**Settlement Schemes (Regulation 26)**

Notwithstanding anything contained in these regulations, the Board may specify the procedure and terms of settlement of specified proceedings under a settlement scheme for any class of persons involved in respect of any similar specified defaults.

*Explanation.* – A settlement order issued under a Settlement scheme shall be deemed to be a settlement order under these regulations.

### **Effect of settlement order on third party rights or other proceedings (Regulation 27)**

(1) A settlement order under these regulations shall not be admissible as evidence in any other proceeding relating to an alleged default not covered under the settlement order nor affect the right of third parties arising out of the alleged default.

(2) Where any applicant who obtains a settlement order is also noticee along with any other person in any civil and administrative proceeding, the Adjudicating Officer or the Board while disposing proceedings against such other person may make necessary observations in respect of the applicant in so far as is necessary to prove the act of another: Provided that, unless the settlement order is revoked, such observations shall qua the applicant be subject to the settlement order obtained by the applicant.

(3) Where any person has obtained a settlement order, which contains observations in respect of any other person for the commission of an alleged default, such an order shall not in itself be admissible as evidence against such other person.

### **Revocation of the settlement order (Regulation 28)**

(1) If the applicant fails to comply with the settlement order or at any time after the settlement order is passed, it comes to the notice of the Board that the applicant has not made full and true disclosure or has violated the undertakings or waivers, settlement order shall stand revoked and withdrawn and the Board shall restore or initiate the proceedings, with respect to which the settlement order was passed.

(2) Whenever any settlement order is revoked, no amount paid under these regulations shall be refunded.

### **Confidentiality of information (Regulation 29)**

(1) All information submitted and discussions held in pursuance of the settlement proceedings under these regulations shall be deemed to have been received or made in a fiduciary capacity and the same may not be released to the public, if the same prejudices the Board and/or the applicant.

(2) Where an application is rejected or withdrawn, the applicant and the Board shall not rely upon or introduce as evidence before any court or Tribunal, any proposals made or information submitted or representation made by the applicant under these regulations:

Provided that this sub-regulation shall not apply where the settlement order is revoked or withdrawn under these regulations.

*Explanation.* – When any fact is discovered in consequence of information received from a person in pursuance of an application, so much of such information, whether it amounts to an admission or not, as relates distinctly to the fact thereby discovered, may be proved.

## **APPEAL AGAINST THE ORDERS**

### **IMPORTANCE OF APPEAL**

*When an order is passed under law by the adjudicating authority, is it capable of being appealed against? Why appeal is important right vested in law? These are important things to be understood.*

In an ideal world, a trial decides justice equitably and fairly in accordance with the law. In most cases, this is exactly what happens, but occasionally, a judge or adjudicating authority for whatever reason, makes a mistake or even a serious mistake that results in the miscarriage of justice. Nevertheless, the law also gives a right or rather vests in the aggrieved party a right to appeal to a higher authority to hear the grievance and consider the matter and look into it for re-consideration. Right of appeal is available in all laws and Corporate Laws are

no exception. Companies Act, 2013, Foreign Exchange Management Act, 1999, SEBI Laws, Taxation laws all provide for the right of appeal against the order passed.

Let us now look at the provisions relating to appeal under the different laws related to us.

## **APPEAL AGAINST ORDER - COMPANIES ACT, 2013 (ACT)**

### **APPEAL AGAINST ORDER PASSED BY THE NATIONAL COMPANY LAW TRIBUNAL (NCLT)**

It is provided in section 420 of the Act that the NCLT may, after giving the parties to any proceeding an opportunity of being heard, pass such orders thereon as it thinks fit. Though the word is “may”, it is mandatory for the NCLT to pass an order so that the aggrieved party may exercise his /its right of appeal against the order under section 421 of the Act.

Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal- that is the National Company Law Appellate Tribunal (NCLAT) under section 421 of the Act. However, no appeal shall lie to NCLT from an order made by the NCLT with the consent of parties.

Every appeal to NCLAT shall be filed within a period of forty-five days from the date on which a copy of the order of the Tribunal is made available to the person aggrieved and shall be in such form, and accompanied by such fees, as may be prescribed: As per the National Company Law Appellate Tribunal Rules, 2016, every appeal shall be presented in form NCLAT-1 in triplicate accompanied by a certified copy of the impugned order. There shall be an index of documents in triplicate also. The fee presently payable on appeal under section 421 of the Act is Rs.5000/- which is to be deposited in separate demand draft or Indian Postal Order favouring “Pay and Accounts Officer, Ministry of Corporate Affairs, payable at New Delhi.”

NCLAT may entertain an appeal after the expiry of the said period of forty-five days from the date aforesaid, but within a further period not exceeding forty-five days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.

### **Procedure for appeal:**

The procedure for appeal to NCLAT is contained in the National Company Law Appellate Tribunal Rules, 2016 and has to be followed strictly.

Every appeal filed before the NCLAT shall be dealt with and disposed of by it as expeditiously as possible and every endeavour shall be made by for the disposal of appeal within three months from the date of the filing of the appeal before it.

If the appeal is not disposed of within the period, NCLAT shall record the reasons for not disposing of the appeal within the period so specified and the Chairperson, may, after taking into account the reasons so recorded, extend the period by such period not exceeding ninety days as he may consider necessary.

On the receipt of an appeal, NCLAT shall, after giving the parties to the appeal a reasonable opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

NCLAT shall send a copy of every order made by it to NCLT and the parties to appeal.

<b>Forms</b>	<b>NCLAT Rules, 2016</b>	<b>Purpose</b>
FORM NCLAT- 1	Rule 22	Presentation of appeal in triplicate by the appellant or petitioner or applicant or respondent, as the case may be, in person or by his duly authorised representative duly appointed in this behalf



FORM NCLAT-2	Rule 31	Interlocutory Application
FORM NCLAT-3	Rule 59	Application for grant of inspection
Form NCLAT-4	Rule 68	Form and contents of the affidavit
FORM NCLAT-5	Rule 70	Affidavits of illiterate, visually challenged person
Form NCLAT-6	Rule 74	Form for suo motu summoning for production of public document or other documents in the custody of a public officer by NCLAT
FORM NCLAT-7	Rule 82	Recording of deposition of witness
FORM NCLAT-8	Rule 84	Grant of discharge certificate by NCLAT
FORM NCLAT-9	Rule 100	Register of Special leave Petitions/Appeal

### **APPEAL AGAINST ORDER PASSED BY THE NATIONAL COMPANY LAW APPELLATE TRIBUNAL (NCLAT)**

Any person aggrieved by any order of the NCLAT may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the NCLAT to him on any question of law arising out of such order. However, if the Supreme Court is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, it may allow the appeal to be filed within a further period not exceeding sixty days. (Section 423 of the Act).

Thus, appeal to Supreme Court is possible only on any question of law arising out of the order of NCLAT and not any other order.

### **APPEAL AGAINST ORDER – SECURITIES LAWS**

Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1996 (collectively referred to as SEBI Laws here for brevity provide for passing orders of penalties for offence after the adjudication is over. These orders can be appealed against under the SEBI Laws. It is dealt with below.

### **APPEAL AGAINST ORDER PASSED BY BOARD OR ADJUDICATING OFFICER**

Any person aggrieved by an order made by an adjudicating officer or by an order of the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority may prefer an appeal to a Securities Appellate Tribunal (SAT) having jurisdiction in the matter.

Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by the Board or the Adjudicating Officer or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be, is received by him and it shall be in such form and be accompanied by such fee as may be prescribed. Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

### **Procedure for appeal :**

The procedure for appeal to SAT is contained in the Securities Appellate Tribunal (Procedure) Rules, 2000 and has to be followed strictly.



- The Memorandum of appeal shall be presented in the Form by any aggrieved person in the registry of the Appellate Tribunal within whose jurisdiction his case falls or shall be sent by registered post addressed to the Registrar. A memorandum of appeal sent by post shall be deemed to have been presented in the registry on the day it was received in the registry
- Every appeal, application, reply, representation or any document filed before the Appellate Tribunal shall be typewritten, cyclostyled or printed neatly and legibly on one side of the good quality paper of foolscap size in double space and separate sheets shall be stitched together and every page shall be consecutively numbered and filed in the prescribed manner.
- The appeal shall be presented in 5[five] sets in a paper book along with an empty file size envelope bearing the full address of the respondent and in case the respondents are more than one, then sufficient number of extra paper books together with empty file size envelope bearing full addresses of each respondent shall be furnished by the appellant.
- Every memorandum of appeal shall be accompanied with the prescribed fee and such fee may be remitted in the form of crossed demand draft drawn on any nationalised bank in favour of “the Registrar, Securities Appellate Tribunal” payable at the station where the registry is located. (Mumbai).
- On receipt of an appeal the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- The appeal filed before the Securities Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

#### **APPEAL AGAINST ORDER PASSED BY THE SECURITIES APPELLATE TRIBUNAL (SAT)**

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order. Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Thus, appeal to Supreme Court is possible only on any question of law arising out of the order of SAT and not any other order.

#### **APPEAL AGAINST ORDER– FOREIGN EXCHANGE MANAGEMENT ACT, 1999**

#### **APPEAL TO SPECIAL DIRECTOR (APPEALS) – Section 17 of FEMA**

The first stage of appeal in FEMA is the appeal against the order of the Adjudicating Authorities. It is an appeal to the Special Director (Appeals)

- The Central Government shall, by notification, appoint one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities under this section and shall also specify in the said notification the matter and places in relation to which the Special Director (Appeals) may exercise jurisdiction.
- Any person aggrieved by an order made by the Adjudicating Authority, being an Assistant Director of Enforcement or a Deputy Director of Enforcement, may prefer an appeal to the Special Director (Appeals)

- The appeal shall be filed within forty-five days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved person and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed.
- The Special Director (Appeals) may entertain an appeal after the expiry of the said period of forty-five days, if he is satisfied that there was sufficient cause for not filing it within that period.
- On receipt of an appeal the Special Director (Appeals) may after giving the parties to the appeal an opportunity of being heard, pass such order thereon as he thinks fit confirming, modifying or setting aside the order appealed against.
- The Special Director (Appeals) shall send a copy of every order made by him to the parties to appeal and to the concerned Adjudicating Authority.
- The Special Director (Appeals) shall have the same powers of a civil court which are conferred on the Appellate Tribunal.

### **APPEAL TO APPELLATE TRIBUNAL – Section 18 of FEMA**

The Central Government shall, by notification, establish an Appellate Tribunal to be known as the Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals) under this Act.

### **Appeal to Appellate Tribunal – Section 19 of FEMA**

- Central Government or any person aggrieved by an order made by an Adjudicating Authority other than those referred to sub-section (1) of section 17, or the Special Director (Appeals), may prefer an appeal to the Appellate Tribunal:
- Any person appealing against the order of the Adjudicating Authority or the Special Director (Appeals) levying any penalty, shall while filing the appeal, deposit the amount of such penalty with such authority as may be notified by the Central Government. Where in any particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.
- Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or the Special Director (Appeals) is received by the aggrieved person or by the Central Government and it shall be in such form verified in such manner and be accompanied by such fee as may be prescribed. The Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.
- On receipt of an appeal, the Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Adjudicating Authority (or the Special Director (Appeals) as the case may be.
- The appeal filed before the Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within one hundred and eighty days from the date of receipt of the appeal. That where any appeal could not be disposed off within the said period of one hundred and eighty days, the Appellate Tribunal shall record its reasons in writing for not disposing off the appeal within the said period.

## **FOREIGN EXCHANGE MANAGEMENT (ADJUDICATION PROCEEDINGS AND APPEAL) RULES, 2000**

Students may note that the Foreign Exchange Management (Adjudication proceedings and Appeal) Rules, 2000 deal, besides others, with the procedural aspects relating to appeal to the Special Director (Appeals) and Appellate Tribunal.

### **APPEAL TO SPECIAL DIRECTOR (APPEAL)**

1. Every appeal presented to the Special Director (Appeals) under section 17 of the Act shall be in the Form I signed by the applicant. The appeal shall be filed in triplicate and accompanied by three copies of the order appealed against. Every appeal shall be accompanied by a fee of Rupees five thousand in the form of cash or demand draft payable in favour of the Special Director (Appeal).
2. The appeal shall set forth concisely and under distinct heads the grounds of objection to the order appealed against without any argument of narrative and such grounds shall be numbered consecutively; and shall specify the address for service at which notice or other processes may be served on the applicant, the date on which the order appealed against was served on the applicant.
3. Where the appeal is presented after the expiry of the period of forty-five days referred to in sub-section (3) of section 17, it shall be accompanied by a petition, in triplicate, duly verified and supported by the documents, if any, relied upon by the applicant, showing cause how the applicant had been prevented from preferring the appeal within the said period of forty-five days.
4. Any notice required to be served on the applicant shall be served on him in the manner specified in rule 9 at the address for service specified in the appeal.
5. On receipt of an appeal, the Special Director (Appeals) shall send a copy of the appeal, together with a copy of the order appealed against, to the Director of Enforcement.
6. The Special Director (Appeals) shall, then, issue notices to the applicant and the Director of Enforcement fixing a date for hearing of the appeal.
7. On the date fixed for hearing of the appeal or any other day to which the hearing of the appeal may be adjourned, the applicant as well as the presenting officer of the Directorate of Enforcement shall be heard.
8. Where on the date fixed, or any other day to which the hearing of the appeal may be adjourned, the applicant or the presenting officer fail to appear when the appeal is called for hearing, the Special Director (Appeals) may decide the appeal on the merits of the case.

### **APPEAL TO THE APPELLATE TRIBUNAL**

1. Every appeal presented to the Appellate Tribunal under section 19 of the Act shall be in the Form II signed by the applicant. The appeal shall be sent in triplicate and accompanied by three copies of the order appealed against. Every appeal shall be accompanied by a fee of Rupees ten thousand in the form of cash or demand draft payable in favour of the Registrar, Appellate Tribunal for Foreign Exchange, New Delhi.

The applicant shall deposit the amount of penalty imposed by the Adjudicating Authority or the Special Director (Appeals) as the case may be, to such authority as may be notified under the first proviso to section 19 of the Act:

Where in a particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.

2. The appeal shall set forth concisely and under distinct heads the grounds of objection to the order appealed against without any argument of narrative and such grounds shall be numbered consecutively; and shall specify the address for service at which notice or other processes may be served on the applicant, the date on which the order appealed against was served on the applicant; and the sum imposed by way of penalty under section 13 and the amount of fee prescribed in sub-rule (1) had been deposited or not.
3. Where the appeal is presented after the expiry of the period of forty five days referred to in sub-section (2) of section 19, it shall be accompanied by a petition, in triplicate, duly verified and supported by the documents, if any, relied upon by the applicant, showing cause how the applicant had been prevented from preferring the appeal within the said period of forty five days.
4. Any notice required to be served on the applicant shall be served on him in the manner prescribed in rule 14 at the address for service specified in the appeal.
5. On receipt of an appeal under rule 10, the Appellate Tribunal shall send a copy of the appeal, together with a copy of the order appealed against, to the Director of Enforcement.
6. The Appellate Tribunal shall, then, issue notices to the applicant and the Director of Enforcement fixing a date for hearing of the appeal.
7. On the date fixed for hearing of the appeal, or any other day to which the hearing of the appeal may be adjourned, the applicant as well as the presenting officer of the Directorate of Enforcement shall be heard.
8. Where on the date fixed, or any other day to which the hearing of the appeal may be adjourned, the applicant or the presenting officer fail to appear when the appeal is called on for hearing, the Appellate Tribunal may decide the appeal on the merits of the case.

### APPEAL TO HIGH COURT – Section 35 of FEMA

Any person aggrieved by any decision or order of the Appellate Tribunal or the Special Director (Appeals) may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal or the Special Director (Appeals) to him on any question of law arising out of such order. The High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Thus, appeal to High Court is possible only on any question of law arising out of the order of Appellate Tribunal or Special Director (Appeals) and not any other order.

### REVISION /RECTIFICATION OF ORDER

The question that is normally raised is whether a quasi-judicial tribunal like the NCLT has the power to revise / rectify an order passed by it. This right -whether it is there is not can be understood from the rules made which govern the powers etc of the Tribunal and also the section(s) contained in the act governing it.

In this material, let us see whether the National Company Law Tribunal (NCLT/Tribunal) has the power to revise order passed by it.

Section 420(2) of the Companies Act, 2013 reads as under:

*The Tribunal may, at any time within two years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it, and shall make such amendment, if the mistake is brought to its notice by the parties:*

***Provided that no such amendment shall be made in respect of any order against which an appeal has been preferred under this Act....***

### Inherent Powers of Tribunal

Rule 11 of the NCLT Rules, 2016 state that nothing in these rules shall be deemed to limit or otherwise affect the inherent powers of the Tribunal to make such orders as may be necessary for meeting the ends of justice or to prevent abuse of the process of the Tribunal.

**Rectification of Order:** Rule 154 of the NCLT Rules, 2016 provides that:

- (1) Any clerical or arithmetical mistakes in any order of the Tribunal or error therein arising from any accidental slip or omission may, at any time, be corrected by the Tribunal on its own motion or on application of any party by way of rectification.
- (2) An application under sub-Rule (1) may be made in Form No. NCLT 9 within two years from the date of the final order for rectification of the final order not being an interlocutory order.

**Omission** means when something is left out. It connotes an unintentional act [*CIT v. J. K. A. Subramania Chettiar* [1977] 110 ITR 602 (Mad.)]. It would mean that what was intended to have been done was not done as it ought to have been done.

**General power to amend:**

Rule 155 of the NCLT Rules, 2016 further provides that the Tribunal may, within a period of thirty days from the date of completion of pleadings, and on such terms as to costs or otherwise, as it may think fit, amend any defect or error in any proceeding before it; and all necessary amendments shall be made for the purpose of determining the real question or issue raised by or depending on such proceeding.

### NCLT not bound by CPC, 1908 but shall be guided by the principles of natural justice

Section 424(1) of the Companies Act, 2013 provides that the Tribunal and the Appellate Tribunal shall not, while disposing of any proceeding before it or, as the case may be, an appeal before it, be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice, and, subject to the other provisions of this Act and of any rules made thereunder, the Tribunal and the Appellate Tribunal shall have power to regulate their own procedure.

### Power to review or rectify its order by NCLT

The Supreme Court in *Lily Thomas vs. Union of India*, AIR 2000 SC 1650 held that the power of review can only be exercised for correction of a mistake and not to substitute a view and that the power of review could only be exercised within the limits of the statute dealing with the exercise of such power. The review cannot be treated like an appeal in disguise. The mere possibility of two views on the subject is not a ground for review. Once a review petition is dismissed no further petition of review can be entertained.

In *Patel Narshi Thakershi v. Pradyumansinghji Arjunsinghji* AIR 1970 SC 1273, the Supreme Court held that the power of review is not an inherent power. It must be conferred either specifically or by necessary implication. It does not stand to reason that, if the power of review is not present with the Tribunal, it nevertheless, can exercise such power indirectly when it cannot do so directly.

In *Pushpa Katoch v Manu Maharani Hotels Ltd.* (2001) 41 CLA 196 (CLB) case decided on 30 August, 2001 (CLB), it was held that the CLB (now Tribunal) has no power to review its own orders.

In *Honda Siel Power Products Ltd. v. CIT* [2007] 295 ITR 466/ 165 Taxman 307, the Supreme Court in held that no party appearing before the Tribunal, be it an assessee or the department, should suffer on account of any mistake committed by the Tribunal. This fundamental principle has nothing to do with the inherent powers of the Tribunal. The Supreme Court further held that one of the important reasons for giving the power of rectification to the Tribunal is to see that no prejudice is caused to either of the parties appearing before it by its decision based on a mistake apparent from the record. When prejudice results from an order, then it is the duty of the

Tribunal to set it right. Atonement to the wronged party by the Court or Tribunal for the wrong committed by it has nothing to do with the concept of inherent power to review.

In *Asstt. CIT v. Saurashtra Kutch Stock Exchange Ltd.* [2008] 305 ITR 227/ 173 Taxman 322 (SC), it was held that the rectification of an order stems from the fundamental principle that justice is above all. It is exercised to remove the error and to disturb the finality. It was further held that non-consideration of a decision of jurisdictional Court or of the Supreme Court can be said to be a mistake apparent from the record.

In *Saurashtra Kutch Stock Exchange Ltd.'s case (supra)*, the Division Bench of the Gujarat High Court was dealing with a writ petition conferred under articles 226 and 227 of the Constitution of India. In the said case, the assail was to the order passed by the Tribunal under section 254(2) of the Income Tax Act, 1961, whereby the Tribunal had recalled the earlier order. *[It should be noted that Section 254(2) of the Income Tax Act, 1961 also enables the ITAT in a manner similar to Section 420(2) of the Companies Act, 2013, to rectify any mistake apparent from the record]*. The Division Bench dealt with the contention canvassed by the revenue that the Tribunal cannot obliterate its earlier findings/reasonings/order and the original order cannot be wiped out and came to hold as follows:

1. The Tribunal has power to rectify a mistake apparent from the record on its own motion or on an application by a party under section 254(2) of the Act.
2. An order on appeal would consist of an order made under section 254(1) or it could be an order made under sub-section (1) as amended by an order under section 254(2).
3. The power of rectification is to be exercised to remove an error or correct a mistake and not for disturbing finality, the fundamental principle being that power of rectification is for justice and fair play.
4. That power of rectification can be exercised even if a mistake is committed by the Tribunal or even if a mistake has occurred at the instance of party to appeal.
5. A mistake apparent from record should be self-evident, should not be debatable issue, but the test might break down, because judicial opinions differ, and what is a mistake apparent from the record cannot be defined precisely and must be left to be determined judicially on the facts of each case.
6. Non-consideration of judgment of the jurisdictional High Court would always constitute a mistake apparent from the record, regardless of the judgment being rendered prior to or subsequent to the order proposed to be rectified.
7. After the mistake is corrected, consequential order must follow, and the Tribunal has power to pass all necessary consequential order.

On the basis of the said conclusions, the writ Court affirmed the order of recall passed by the Tribunal. The Supreme Court also upheld the decision of the High Court.

In *S. Nagaraj v. State of Karnataka* [1993] Suppl 4 SCC 595, the Supreme Court held that justice is a virtue which transcends all barriers. Neither the rules of procedure nor technicalities of law can stand its way. The order could not be prejudicial to any one. Rule of share decisis is adhered for consistency, but it not as inflexible in Administrative Law as in Public Law. Even the law bends before justice. Entire concept of writ jurisdiction exercised by the higher Courts is founded on equity and fairness. If the Court finds that the order was passed under a mistake and it would not have exercised the jurisdiction but for the erroneous assumption which in fact did not exist and its perpetration shall result in miscarriage of justice, then it cannot on any principle be precluded from rectifying error. Difference lies in the nature of mistake and scope of rectification, depending on if it is of fact or law. But the root from which power flows is the anxiety to avoid injustice. It is either statutory or inherent. The latter is available where the mistake is of the Court. In Administrative Law, the scope is still wider. Technicalities apart, if the Court is satisfied of the injustice, then it is constitutional and legal obligation to set it right by recalling its order.



**Can NCLT rectify the mistake on suo motu basis:** The provisions contained in section 420(2) of the Companies Act, 2013 can be dissected in the following limbs:

The Tribunal may at any time within two years from the date of the order, with a view to rectifying any mistake apparent from the record:

- (i) amend any order passed by it,
- (ii) and shall make such amendment, if the mistake is brought to its notice by the parties

The word “may” suggest that the provision confers a discretionary power on the tribunal in the matter of rectifying what it may find to be a mistake in its order.

In *Sree Ayyanar Spinning & Weaving Mills Ltd. v. CIT* [2008] 301 ITR 434/171 Taxman 498 (SC)(adapted), it was held that under first part of the provision, the tribunal is empowered to *suo motu* rectify any mistakes apparent on record any time within two years from the date of its original order. Under the second part, either the taxpayer or the department may file an application highlighting the mistake apparent on record. In light of the provision, the Apex Court held that the appellate tribunal took time beyond the stipulated period even though the application was filed well within the period. Thus, in the event the applicant has filed the application within the stipulated period of two years from the date of original order, it is binding for the appellate tribunal to decide the matter on the basis of merits and not on the ground of limitation.

Thus, Section 420(2) read with Rules 11, 154 and 155 mentioned above substantiate that the Tribunal has power to rectify a mistake apparent from the record on its own motion or on an application by a party under the Act.

**Mistake apparent from record – meaning thereof:**

In *Smt. Baljeet Jolly -v.CIT* [2000] 113 Taxman 38 (Delhi), it was held that ‘Mistake’ means to take or understand wrongly or inaccurately; to make an error in interpreting; it is an error; a fault, a misunderstanding, a misconception.

‘Apparent’ means visible; capable of being seen; easily seen; obviously; plain. The plain meaning of the word ‘apparent’ is that it must be something which appears to be so *ex facie* and is incapable of argument or debate. The plain reading of the word ‘apparent’ is that it must be something which appears to be so *ex facie* and it is incapable of argument or debate. It, therefore, follows that a decision on a debatable point of law or fact or failure to apply the law to a set of facts which remains to be investigated cannot be corrected by way of rectification.

In *CIT v.Maruti Insurance Distribution Services Ltd.* [2012] 26 taxmann.com 68/[2013] 212 Taxman 123 (Mag.) (Delhi), it was held that a mistake should exist and must be apparent from the record. The power to rectify the mistake, however, does not cover cases where a revision or review of the order is intended. ‘Mistake’ means to understand wrongly or inaccurately; it is an error; a fault, a misunderstanding, a misconception. ‘Apparent’ implies something that can be seen, or is visible, obvious; plain. A mistake which can be rectified is one which is patent, obvious and whose discovery is not dependent on argument. The amendment of an order under section 254(2) of the Income Tax Act, 1961 (corresponding to Section 420(2) under the Companies Act, 2013), therefore, does not mean entire obliteration of the order originally passed and its substitution by a new order which is not permissible. Further, where an error is far from self-evident, it ceases to be an ‘apparent’ error. Undoubtedly, a mistake capable of rectification under section 420(2) is not confined to clerical or arithmetical mistakes, at the same time, it does not cover any mistake which may be discovered by a complicated process of investigation, argument or proof.

From the above it is clear that the Tribunal, while exercising the power of rectification under can recall its order in its entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal’s mistake, error or omission and which error is manifest error and it has nothing to do with the doctrine or concept



of inherent power of review. Basic philosophy inherent in it is the universal acceptance of human fallibility. An application for review may be necessitated by way of invoking the latin maxim '*actus curiae neminem gravabit*' which means an act of the court shall prejudice no man.

The above principles equally apply to other tribunals based on the principle(s) enumerated above.

### APPEARANCE BEFORE QUASI-JUDICIAL AND OTHER BODIES

As a professionally qualified and eligible person, a company secretary can and is authorized to act as "Authorised Representative" and appear before quasi-judicial bodies such as the National Company Law Tribunal( NCLT), National Company Law Appellate Tribunal( NCLAT), Securities Appellate Tribunal (SAT), Competition Commission Tribunal (CCI Tribunal) and also appear before other statutory authorities / bodies like the Registrar of Companies (ROC), Regional Director (RD) and Competition Commission of India (CCI) etc.

The relevant provisions dealing with person who can appear before the quasi and other bodies under the laws applicable and the relevant rules made thereunder is stated below:

### APPEARANCE BEFORE THE NCLT

As per Rule 2(6) of the National Company Law Tribunal Rules, 2016, Authorised Representative means a person authorized in writing by a party to present his case before the tribunal as the representative of such party as provided under section 432 of the Companies Act, 2013.

Section 432 of the Act deals with Right to legal representation and states that "*A party to any proceeding or appeal before the Tribunal or the Appellate Tribunal, as the case may be, may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any other person to present his case before the Tribunal or the Appellate Tribunal, as the case may be*".

### APPEARANCE BEFORE THE NCLAT

Rule 63 of the National Company Law Appellate Tribunal Rules, 2016 as amended by the amendment rules in 2017 (with effect from 23/08/2017) states that *Subject to provisions of* Section 432 of the Act, a party to any proceedings or appeal before the Appellate Tribunal may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any other person to present his case before the Appellate Tribunal. The Central Government, Regional Director, Registrar of Companies or official liquidator may authorise an officer [not below the rank of Junior Time Scale or Company prosecutor] or advocate to represent in the proceedings before the NCLAT.

### APPEARANCE BEFORE SECURITIES APPELLATE TRIBUNAL (SAT)

The appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal.

*Explanation.* – For the purposes of this section, –

- (a) **chartered accountant** means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (b) **company secretary** means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 (56 of 1980) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

- (c) **cost accountant** means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (d) **legal practitioner** means an advocate, vakil or any attorney of any High Court, and includes a pleader in practice.

### APPEARANCE BEFORE APPELLATE TRIBUNAL COMPETITION ACT, 2002

Section 53-S of the Competition Act, 2002 dealing with the right of legal representation, enables a person preferring an appeal to the Appellate Tribunal may either appear in person or authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Appellate Tribunal. The Central Government or a State Government or a local authority or any enterprise preferring an appeal to the Appellate Tribunal may authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to act as presenting officers and every person so authorized may present the case with respect to any appeal before the Appellate Tribunal.

### Appellate Tribunal under Competition Act, 2002

Section 53A of the Competition Act, 2002 provide that the National Company Law Appellate Tribunal constituted under section 410 of the companies Act, 2013 shall, on and from the commencement of Part XIV of Chapter VI of the Finance Act, 2017, be the Appellate Tribunal for the purpose of Competition Act and the said appellate Tribunal shall –

- (a) to hear and dispose of appeals against any direction issued or decision made or order passed by the Commission under sub-sections (2) and (6) of section 26, section 27, section 28, section 31, section 32, section 33, section 38, section 39, section 43, section 43A, section 44, section 45 or section 46 of the Act;
- (b) to adjudicate on claim for compensation that may arise from the findings of the Commission or the orders of the Appellate Tribunal in an appeal against any finding of the Commission or under section 42A or under sub-section (2) of section 53Q of this Act, and pass orders for the recovery of compensation under section 53N of the Act

### Appeal to Appellate Tribunal

Section 53B of the Competition Act, 2002 provide that the Central Government or the State Government or a local authority or enterprise or any person, aggrieved by any direction, decision or order referred to in clause (a) of section 53A may prefer an appeal to the Appellate Tribunal.

Every appeal under sub-section (1) shall be filed within a period of sixty days from the date on which a copy of the direction or decision or order made by the Commission is received by the Central Government or the State Government or a local authority or enterprise or any person referred to in that sub-section and it shall be in such form and be accompanied by such fee as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of sixty days if it is satisfied that there was sufficient cause for not filing it within that period.

On receipt of an appeal under sub-section (1), the Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the direction, decision or order appealed against. (4) The Appellate Tribunal shall send a copy of every order made by it to the Commission and the parties to the appeal.

The appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as

possible and endeavour shall be made by it to dispose of the appeal within six months from the date of receipt of the appeal.

## APPEARANCE BEFORE STATUTORY AUTHORITIES

Company Secretaries will be required during the course of their practice or employment to appear before the various statutory authorities under the provisions of the Companies Act, 2013, Before the Reserve Bank of India, Competition Commission of India and the like. This is not the same as appearing before quasi-judicial authorities. However, when they appear before the authorities, they are the face of the organisation they represent. Hence, they should ensure that they are well prepared and able to present themselves with full facts and details required under law.

Under the Companies Act, 2013, Company Secretaries will be more frequently be required to interact with the Registrar of Companies, Regional Director(s) and the Ministry of Company Affairs officials. They have to ensure that all details sought by the officials are provided to them so that the fact of compliance of law is brought out to them. Similarly, while dealing with the officials of the Reserve bank of India or similar regulatory agencies, Company Secretaries should conduct themselves in a professional manner.

## AUTHORITY TO APPEAR

While appearing before quasi-judicial bodies, the Authorised Representative shall ensure that he is properly authorized to appear. We saw above that he appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case.

- In case of a legal practitioner a vakalatnama to be filed and in case of other authorized representative(s) like chartered accountants or company secretaries or cost accountants, a memorandum of appearance is required to be filed. The Memorandum of Appearance has to be as per the prescribed format in the rules framed and duly executed and it shall be accompanied by a copy of the resolution of the board of directors of the company authorising the person to represent the company before the quasi-judicial body.
- A legal practitioner proposing to file a Vakalatnama or Memorandum of Appearance as the case may be, in any pending case or proceeding before the Tribunal in which there is already a legal practitioner or authorized representative on record, shall do so only with the written consent of the legal practitioner or the authorized representative on record or when such consent is refused, with the permission of the Tribunal after revocation of Vakalatnama or Memorandum of Appearance as the case may be, on an application filed in this behalf, which shall receive consideration only after service of such application on the counsel already on record.
- A legal practitioner or the authorized representative as the case may be, who has tendered advice in connection with the institution of any case or other proceeding before the Tribunal or has drawn pleadings in connection with any such matter or has during the progress of any such matter acted for a party, shall not, appear in such case or proceeding or other matter arising therefrom or in any matter connected therewith for any person whose interest is opposed to that of his former client, except with the prior permission of the Tribunal.
- The party who has engaged a legal practitioner or authorized representative to appear for him before the Tribunal may be restricted by the Tribunal in making presentation before it.

While presenting before officials such as Registrar of Companies, Regional Director etc, the representative is always advised to fill in the visitors register maintained by the office before meeting the officials.

## PROFESSIONAL DRESS

The professional dress prescribed under the code of conduct for the professional is required to be worn by the authorized representative while appearing before the authorities.

The Council of ICSI has approved the following Guidelines for Professional Dress Code for Company Secretaries to appear before judicial / quasi-judicial bodies and tribunals like NCLT- NCLAT, SAT, etc.:

1. For Male Members:
  - a. Navy Blue Suit (Coat & Trouser), with CS logo, Insignia  
OR  
Navy Blue Blazer over a sober colored Trouser
  - b. Neck Tie (ICSI)
  - c. White full sleeve Shirt
  - d. Formal Black Leather Shoes (Shined)
2. For Female Members:
  - a. Navy Blue corporate suit (Coat & Trouser), could be with a neck tie/ Insignia OR
  - b. Saree / any other dress of sober colour with Navy Blue Blazer with CS logo
  - c. A sober footwear like Shoes/Bellies/Wedges, etc (shined)

## LESSON ROUND UP

- Any offence punishable under this Act (whether committed by a company or any officer thereof) being an offence punishable with imprisonment only or imprisonment and also with fine cannot be compounded.
- Any offence otherwise compoundable cannot also be compounded if the investigation against such company has been initiated or is pending under this Act.
- An offence committed by a company or its officer within a period of three years from the date on which a similar offence committed by it or him was compounded under this section is not compoundable.

## TEST YOURSELF

*(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)*

1. Describe the limits of the various Compounding Authority and the procedure for compounding under the Companies Act, 2013.
2. What are the power of enforcement directorate to compound contraventions under FEMA Act, 1999.
3. Write differences between Mediation and Conciliation.
4. Discuss the Confidentiality, disclosure and inadmissibility of information under Mediation and Conciliation rules, 2016.
5. Discuss the grounds on which the application for settlement under SEBI (Settlement) Regulations, 2018 can be rejected.

[illegible]



# Lesson 8

## Crisis Management & Risk and Liability Mitigation

### LESSON OUTLINE

- Family Tree of Concepts
- Crisis Management
- Professional Liability
- D&O Policy
- Other Risk Mitigation Approaches
- LESSON ROUND UP
- TEST YOURSELF

### LEARNING OBJECTIVES

The lesson covers :

- Understanding of the various technical concepts pertaining to Crisis Management;
- Professional Liability;
- D&O Insurance;
- Other risk management approaches.



## FAMILY TREE OF CONCEPTS



### CRISIS MANAGEMENT

**Crisis management** is the identification of threats to an organization and its stakeholders, and the methods used by the organization to deal with these threats. Due to the unpredictability of global events, organizations must be able to cope with the potential for drastic changes in the way they conduct business. Crisis management often requires decisions to be made within a short time frame, and often after an event has already taken place. In order to reduce uncertainty in the event of a crisis, organizations often create a crisis management plan.

Crisis management is the process by which an organization deals with a disruptive and unexpected event that threatens to harm the organization or its stakeholders. The study of crisis management originated with large-scale industrial and environmental disasters in the 1980s. It is considered to be the most important process in public relations.

Any business, large or small, may run into problems that may negatively impact its normal course of operations. Crises such as a fire, death of a key managerial personnel, terrorist attack, data breach, natural disasters, management disputes, litigations, and/or regulatory actions can lead to tangible and intangible costs to a company in terms of lost sales, customers, and a decrease in the firm's net income. Businesses that effectively put a business continuity plan in place in case of unforeseen contingencies can mitigate the effects of any negative event that occurs. The process of having a continuity plan in place in the event of a crisis is known as crisis management.

In order to have a business continuity plan in the aftermath of a crisis, most firms start by conducting risk analysis on their operations. **Risk analysis** is the process of identifying any adverse events that may occur and the likelihood of the events occurring. By running simulations and random variables with risk models, such as scenario tables, a risk manager can assess the probability of a risk occurring in the future, the best- and worst-case outcome of any negative event, and the damage that the company would incur should the risk actually happen. For example, a risk manager may estimate that the probability of a flood occurring within a company's area of operation is very high. The worst-case scenario of a flood will be destroying the company's computer systems and hard drives, thereby, losing pertinent data on customers, suppliers, and ongoing projects.

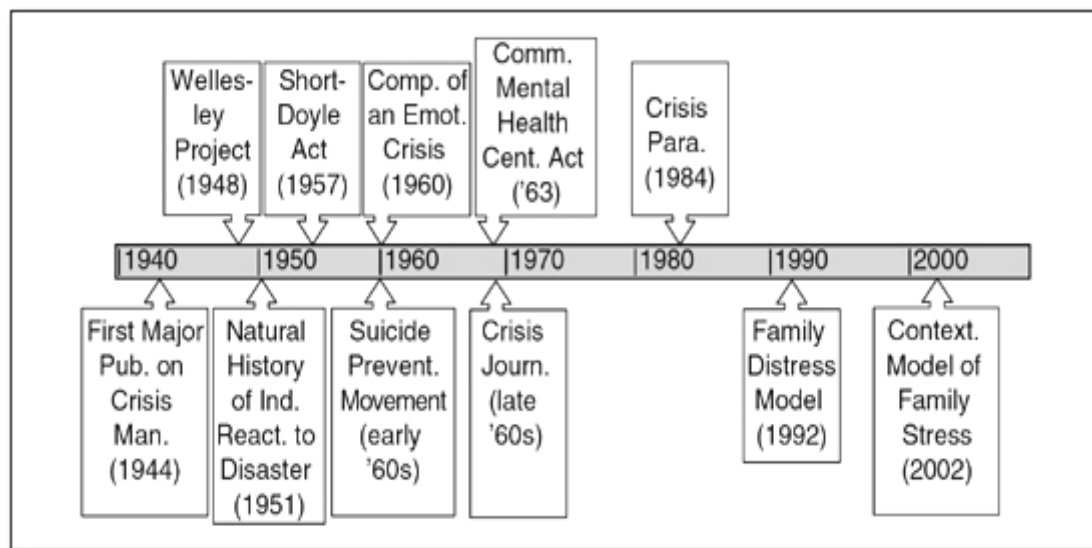
Once the risk manager knows what s/he is dealing with in terms of possible risks and the impact to the firm, a

plan is developed by the crisis management team to contain any emergency if and when it becomes a reality. Following the example above in which a company faces a high probability of a flood damage, a back-up system for all computer systems might be created. This way, if a flood occurs that affects the company, it would still have a record of its data and work processes stored. Although business might slow down for a short period of time while the company purchases new computer equipment, business operations would not be completely halted. By having a crisis resolution in place, a company and its stakeholders can prepare and adapt well to sudden, unexpected, and adverse developments.

Crisis management is not necessarily the same thing as risk management. Unlike risk management, which involves planning for events that might occur in the future, crisis management involves reacting to negative events during and after they have occurred. An oil company for example, may have a plan in place to deal with the possibility of an oil spill, but if such a disaster actually occurs, the magnitude of the spill, the backlash of public opinion, and the cost of cleanup can vary greatly and may exceed expectations.

Crisis can either be self-inflicted or caused by external forces. Examples of external forces that could affect an organization's operations include natural disasters, security breaches, or false information about a company that hurts its reputation. Self-inflicted crises are caused within the organization, such as when an employee smokes in an environment with hazardous chemicals, opens or downloads questionable files on an office laptop, offers poor customer service that goes viral online, or an accounting department cooking the books. Internal crisis can be managed, mitigated, or avoided if a company enforces strict compliance guidelines and protocols regarding ethics, policies, rules, and regulations among employees.

### Timeline of Formal Crisis Management



Source: <http://sk.sagepub.com/books/individual-and-family-stress-and-crises/n10.xml>

### Types of Crisis

(1) **Natural Crisis:** Disturbances in the environment and nature lead to natural crisis. Such events are generally beyond the control of human beings. Tornadoes, Earthquakes, Hurricanes, Landslides, Tsunamis, Flood, Drought all result in natural disaster.

(2) **Technological Crisis:** Technological crisis arises as a result of failure in technology. Problems in the overall systems lead to technological crisis. Breakdown of machines, corrupted software and so on give rise to technological crisis.

**(3) Confrontation Crisis:**

- a) Confrontation crises arise when employees fight amongst themselves. Individuals do not agree to each other and eventually depend on non-productive acts like boycotts, strikes for indefinite periods and so on.
- b) In such a type of crisis, employees disobey superiors; give them ultimatums and force them to accept their demands.
- c) Internal disputes, ineffective communication and lack of coordination give rise to confrontation crisis.

**(4) Crisis of Malevolence:**

- a) Organizations face crisis of malevolence when some notorious employees take the help of criminal activities and extreme steps to fulfill their demands.
- b) Acts like kidnapping company's officials, false rumours all lead to crisis of malevolence.

**(5) Crisis of Organizational Misdeeds**

- a) Crises of organizational misdeeds arise when management takes certain decisions knowing the harmful consequences of the same towards the stakeholders and external parties.
- b) In such cases, superiors ignore the after effects of strategies and implement the same for quick results. Crisis of organizational misdeeds can be further classified into following three types:
  - i) *Crisis of Skewed Management Values*: Crisis of Skewed Management Values arises when management supports short term growth and ignores broader issues.
  - ii) *Crisis of Deception*: Organizations face crisis of deception when management purposely tampers data and information. Management makes fake promises and wrong commitments to the customers. Communicating wrong information about the organization and products lead to crisis of deception.
  - iii) *Crisis of Management Misconduct*: Organizations face crisis of management misconduct when management indulges in deliberate acts of illegality like accepting bribes, passing on confidential information and so on.

**(6) Crisis due to Workplace Violence:** Such a type of crisis arises when employees are indulged in violent acts such as beating employees, superiors in the office premises itself.

**(7) Crisis due to Rumours:** Spreading false rumours about the organization and brand lead to crisis. Employees must not spread anything which would tarnish the image of their organization.

**(8) Bankruptcy:** A crisis also arises when organizations fail to pay its creditors and other parties. Lack of fund leads to crisis.

**(9) Crisis Due to Natural Factors:** Disturbances in environment and nature such as hurricanes, volcanoes, storms, floods; droughts, earthquakes etc result in crisis.

**(10) Sudden Crisis:** As the name suggests, such situations arise all of a sudden and on an extremely short notice. Managers do not get warning signals and such a situation is in most cases beyond any one's control.

**(11) Smouldering Crisis:** Neglecting minor issues in the beginning lead to smouldering crisis later. Managers often can foresee crisis but they should not ignore the same and wait for someone else to take action. Warn the employees immediately to avoid such a situation.

**Case Studies on Crisis Management**

During the year major companies made plenty of public-relations blunders, including Lockheed Martin's

campaign that unwittingly produced images documenting how the arms contractor's products are used to kill children, as well as Under Armour's admission that it had paid for staff trips to strip clubs. Following are some of the corporate fiascos which should be considered to understand the corporate crisis:

**1. Facebook's silence about its data breach:** The social media giant reportedly chose to stay silent even though it had known for three years that Cambridge Analytica - the consulting firm hired by President Donald Trump's 2016 campaign - improperly accessed information on millions of people. Since then, the company has racked up misstep after misstep. From the failure to issue an immediate statement from Chief Executive Officer Mark Zuckerberg when Facebook finally admitted what happened to hiring a shady opposition research firm to investigate its critics. Facebook was the subject of more trouble, when the New York Times reported that it shared even more user data with outside companies than previously acknowledged.

**Moral of the story:** When the news broke, disclosure is the most effective strategy in a crisis because the truth always emerges. Companies and even the government need to explain what happened on their own terms and regain confidence by demonstrating that they have learned a lesson and are taking immediate steps to change course.

**2. Lockheed Martin asks people to share photos of its products:** In August, the world's largest weapons maker tweeted: "Do you have an amazing photo of one of our products? Tag us in your pic and we may feature it during our upcoming #WorldPhotoDay celebration on Aug. 19!" People quickly responded with pictures showing the impact of its weapons, including an image of UNICEF backpacks belonging to children killed in Yemen with a bomb made by the company. Lockheed Martin later deleted the tweet.

**Moral of the story:** Although it's important to engage in conversations on social media, first be aware of how people generally feel about your company, products and policies. Carefully consider possible responses before asking for content.

**3. Under Armour Inc. winks at employees' trips to strip clubs:** Earlier in the year 2018, the company emailed staffers to inform them they could no longer put strip-club visits on their corporate credit cards. According to the Wall Street Journal, "Over the years, executives and employees of the sports-apparel company, including Chairman and Chief Executive Kevin Plank, went with athletes or co-workers to strip clubs after some corporate and sporting events, and the company often paid for the visits of many attendees."

**Moral of the story:** Although the company was right to end the practice in 2018, the fact that it allowed it at all shows an astonishing lack of judgment. But there's a larger takeaway here: Executives need to avoid the temptation to socialize with staffers through activities that are offensive or exclude team members. As Laura Liswood, former managing director of global leadership and diversity at Goldman Sachs, wrote in "The Loudest Duck: Moving beyond Diversity While Embracing Differences," if a manager plays basketball with colleagues, for example:

You will feel comfortable with your sports buddies, and when the next opportunity comes up, you may be inclined to put that companion forward for a promotion - possibly over someone better qualified whom you know less well, or with whom you have fewer common bonds. To keep the playing field level, the skilled manager needs to find ways to learn about the other members of the team so that an equal level of comfort and knowledge exists with the people who aren't naturally like you.

**4. H&M uses black child to model "coolest monkey in the jungle" hoodie:** The picture generated widespread outrage on social media. The company apologized quickly and later stopped selling the item.

**Moral of the story:** A diverse team needs to dissect every message and image to make sure it doesn't inadvertently offend people of different races, cultures, genders, generations and views.

**5. KFC's Chicken Crisis:** A chicken restaurant without any chicken is not an ideal situation in terms of bottom line or reputation. The chain went through an intense few weeks in the UK last year, after a logistics fiasco with

a new delivery partner DHL, which took over the contract on Valentine's Day alongside Quick Service Logistics (QSL).

Problems with deliveries of KFC's highly perishable supplies started immediately: KFC started to shut down outlets after managers complained their chicken had not arrived, and by 18 February most of its 900 UK restaurants were closed.

KFC posted statements about the "delivery hiccups" in its closed shops and went into full-on social media response and media relations mode – as head of brand engagement Jenny Packwood told the Holmes Report, the team handled the equivalent of half its annual press calls in one week. The offensive culminated in a national newspaper advertising campaign as the restaurants slowly re-opened.

"Within hours of the initial problems coming to light, customers knew exactly what had gone wrong, how it was being resolved and, importantly, when it would be fixed," he says. "Not only did KFC recognize mistakes had clearly been made, but they also used that to their advantage by injecting their own sense of humour and keeping the language straight-forward, clear and to the point."

## **6. Nissan's Boss Gets Arrested**

Even by Japan's storied standards of corporate malfeasance, the scandal at Nissan Motor deserves special mention – combining, as it does, financial wrongdoing, political intrigue and hubris to almost unparalleled effect. Now relegated to a tiny cell in Tokyo, former Nissan chairman Carlos Ghosn sits at the heart of the affair, arrested and charged with understating his compensation by more than \$80m over eight years, and causing Nissan to make payments to the company of a Saudi Arabian friend.

## **7. Coca-Cola PR Crisis Management**

The company came under a storm of criticism after The New York Times charged that Coca-Cola was funding obesity research that attempted to disprove the link between obesity and diet and shift the problem to lack of exercise. The article says Coca-Cola, desperate to halt sliding sales, financed the new non profit Global Energy Balance Network. Critics call it a front group created to espouse misinformation and deflect the role of soft drinks in the spread of obesity and Type 2 diabetes.

Corporations under fire can look to Kent's op-editorial for guidance when responding to attacks and considering apologies.

Kent outlines the company's response and admits the company's misstep while not exactly apologizing in his opinion, Coca-Cola: We'll Do Better. In a matter-of-fact tone, Kent takes the accusations head on, acknowledging the accusations that it has deceived the public about its support for scientific research. He defends the company by saying it is attempting to tackle the global obesity epidemic and has always had good intentions.

### ***A New Strategy***

Kent also admits the company's strategy "is not working." "I am disappointed that some actions we have taken to fund scientific research and health and well-being programs have served only to create more confusion and mistrust," he writes.

He explains how the company will act going forward. First, he says it will act with even more transparency. The company will publish a list of health and well-being partnerships and research activities it has funded in the past five years on its website and will update the list every six months.

The company will continue its efforts to provide healthy options, he says, such as waters, lower-calorie and lower-sugar drinks, diet soda and zero-calorie drinks. At the same time, he inserts a sales plug by referring to Coca-Cola's wide range of beverage options.

Opinion stresses the company's commitment to fighting obesity. "We want to get focused on real change, and we have a great opportunity ahead of us," he says. "We are determined to get this right."

Mark Braykovich, vice president at Atlanta-based The Wilbert Group, says Kent successfully filled the three O's of crisis management:

Own up to it. Assuming responsibility at some level usually helps the corporate reputation over the long run.

Get the CEO Out front. The CEO is the best spokesperson for the corporation. Most PR disasters happen when companies shield the CEO, or the CEO appears to have little interest in the problem.

Make an Outsized response. Overaction is preferable to small measures or ignoring the critics. Kent directs the president of Coca-Cola North America to create an oversight committee of independent experts to provide governance on company investments in academic research, and engage experts to explore opportunities for research and health initiatives.

Braykovich says he gives Kent an A for using the three O's.

*Bottom Line:* Coca-Cola's response to accusations that it financed a front group to protect its interests at the expense of public health is a case study in PR crisis management. As opined by Coca-Cola CEO Muhtar Kent epitomizes a corporate response that contains the essential elements of effective corporate PR crisis management.

## 8. The United Airlines PR Crisis

The conflict occurred in United Airlines flight number 3411, which departed from Chicago to Louisville on April 9, 2017. Before passengers began boarding, it was announced that the flight was overbooked. United needed to put their employees on this plane. So, they asked for volunteers to give up their seats in exchange for \$400 US, a free hotel room and a ticket for a flight the next day. No one volunteered. When boarding was complete, it was announced that four passengers had to leave the plane. Again, no one volunteered, so the company decided to choose passengers randomly. Two of the passengers left, and one refused. The one who remained said that he was a doctor and needed to get to his patients. When he refused to leave the plane, he was forcefully dragged from his seat and was struck in the process. The crisis started when a cell phone video recording of the incident was published on social media.

### *How the crisis was managed?*

When United realized that they couldn't get out of the scandal, the CEO Oscar Munoz commented on the situation. He apologized for "having to re-accommodate" the customer. The statement of CEO Oscar Munoz is as under:

"This is an upsetting event to all of us here at United. I apologize for having to re-accommodate these customers. Our team is moving with a sense of urgency to work with the authorities and conduct our own detailed review of what happened.

***We are also reaching out to this passenger to talk directly to him and further address and resolve this situation."***

This statement provoked a new wave of crisis. United's social media audience accused him of being disrespectful and of misidentifying the cause of the problem. Instead of apologizing for forcing the passenger to deplane, Munoz apologized for his inconvenience. The company's social media audience was indignant. They satirized the situation, created memes and GIFs, and made jokes.

What's more, United lost more than \$800 Million in revenue. United wasn't able to manage the crisis by themselves, and they had to hire a professional crisis management team.

### **Take away from the Case**

In United's case, the CEO apologized, but his words caused even more indignation than before. Why was



that? The instance that occurred on the plane was quite traumatic to those that witnessed it personally and those that saw it on video. It deserved a heartfelt response, but the tweet showed a lack of understanding and accountability. In United's case, the CEO's apology sounded as if he didn't actually care, and their audience immediately felt it.

Online apologies have to be carefully crafted. Think of the emotions that need to be addressed and consider your words carefully - "how could this be offensive"? An apology should not sound like a press-release. When a brand makes a mistake they need to own up to it and let the public know they are going to address it and ensure it never happens again.

## PROFESSIONAL LIABILITY

Professional liability insurance protects professionals such as accountants, lawyers and physicians against negligence and other claims initiated by their clients. It is required by professionals who have expertise in a specific area because general liability insurance policies do not offer protection against claims arising out of business or professional practices such as negligence, malpractice or misrepresentation.

Depending on the profession, professional liability insurance may have different names, such as medical malpractice insurance for the medical profession, and errors & omissions insurance for real estate agents.

Professional liability insurance is a specialty coverage that is not provided under homeowners' endorsements, in-home business policies or business-owners' policies. It only covers claims made during the policy period.

(Errors and omissions insurance (E&O) is a type of professional liability insurance that protects companies, their workers, and other professionals against claims of inadequate work or negligent actions.

Errors and omissions insurance often covers both court costs and any settlements up to the amount specified by the insurance contract. This kind of liability insurance is generally required for professional advice-giving or service-providing businesses.)

## How Professional Liability Insurance Works

Professional liability insurance policies are usually arranged on a claims-made basis, which means coverage is good only for claims made during the policy period. Typical professional liability policies will indemnify the insured against loss arising from any claim or claims made during the policy period by reason of any covered error, omission or negligent act committed in the conduct of the insured's professional business during the policy period. Incidents occurring before the coverage was activated may not be covered, although some policies may include retroactive date.

Coverage does not include criminal prosecution, nor all forms of legal liability under civil law, only those listed in the policy. Cyber liability, covering data breach and other technology issues, may not necessarily be included in core policies. However, insurance that covers data security and other technology security-related issues is available as a separate policy.

Some professional liability policies are worded more tightly than others. While a number of policy wordings are designed to satisfy a stated minimum approved wording, which makes them easier to compare, others differ dramatically in the coverages they provide. For example, breach of duty may be included if the incident occurred and was reported by the policy holder to the insurer during the policy period. Wordings with major legal differences can be confusingly. For instance, coverage for "negligent act, error or omission" indemnifies the policyholder against loss/circumstances incurred only as a result of any professional error or omission, or negligent act (i.e., the modifier "negligent" does not apply to all three categories, though any non-legal reader might assume that it did). Meanwhile, a "negligent act, negligent error or negligent omission" clause is a much more restrictive policy, which would deny coverage in a lawsuit alleging a non-negligent error or omission.



### General Liability Insurance v. Professional Liability Insurance

General Liability Insurance, like its name suggests, covers business from a few “general” lawsuits that any business could face. In a nutshell, it kicks in when a third party (i.e., anyone who doesn’t work for a company) sues business over.

- a) Bodily injuries they incurred on commercial premises.
- b) Damage caused to their property.
- c) Advertising injuries (e.g., slander, libel, misappropriation, and copyright infringement).

General Liability Insurance pays for legal expenses (lawyers’ fees, court costs, and settlements or judgments). Again, any small-business owner, no matter their industry or the size of their business, can face these claims. That’s why many consider this policy to be the keystone of a business protection plan.

Professional Liability Insurance (aka “Errors and Omissions Insurance” or “Malpractice Insurance”) also lives up to its moniker. Its coverage focuses specifically on the lawsuits that stem from professional services.

Though this policy is especially important for service providers to carry, most small-business owners can benefit from its coverage. That’s because Professional Liability Insurance shields from third-party lawsuits alleging.

- a) Providing negligent professional services.
- b) Failing to uphold contractual promises.
- c) Providing incomplete or shoddy work.
- d) Making mistakes or omissions.

These torts are among the most expensive any business owner can face. Professionals don’t have to be at fault to be sued, either. All it takes is one unhappy client to name such business in a lawsuit to try to recoup the “losses” they incurred because of work. The Professional Liability policy ensures that the professional won’t be on the hook for legal expenses, regardless of whether the claim holds water.

### Do General Liability and Professional Liability Ever Cover the Same Claims

In short, both policies cover certain liabilities, but they don’t cover the same liabilities. Here’s how General Liability and Professional Liability Insurance are alike:

- a) Both policies deal with (separate) unavoidable liabilities. It’s an unfortunate fact of being a small-business owner: you have a target on your back. In fact, small-business owners bear the brunt of civil tort costs in this country. Your General Liability and Professional Liability policies work together to mitigate your expenses when accidents and oversights land you in legal trouble.
- b) Either policy may be required by client contracts. Construction contractors: don’t be surprised if the general contractor requires you to carry your own General Liability (and Workers’ Compensation Insurance) coverage. Similarly, big contracted projects may mean that IT consultants, for example, need Professional Liability coverage to address potential lawsuits.

### Contrasting General Liability and Professional Liability Insurance

Here are some key differences to keep in mind:

- a) General Liability and Professional Liability cover different risk exposures. Only General Liability can spare your business from lawsuits over a visitor slipping and falling on your commercial property. And only Professional Liability Insurance can shield you from the high cost of alleged professional mistakes that cause a third party financial losses.

- b) Physical damages vs. financial damages. Sometimes, a General Liability policy includes Products-Completed Operations Liability Insurance, a coverage that benefits construction professionals, manufacturers, retailers, and more. This coverage protects the insured from lawsuits over finished work that physically harms someone. Though this may seem to be the domain of Professional Liability, physical damage is the dividing line. Professional Liability Insurance concerns itself with lawsuits over financial losses that result from someone's products or services.

### Professional Indemnity Insurance

Professional Indemnity Insurance is a type of business insurance, typically for organizations that provide consultation or any professional services to its clients. Professional indemnity insurance covers claims made by the businesses in case their clients have sued them for making them endure any significant financial loss due to their advices and services.

Professional indemnity insurance is also known as professional liability insurance and also as errors & omissions (E&O) in the United States. It is a type of liability insurance that works to protect businesses and individuals who provide consultation and services with the compensation for full and hefty costs arising from the loss that they have caused to their client. The coverage provided by the insurance company focuses on the alleged failure of the service delivery by the company, which has led to the financial loss due to errors and omissions in the service or consultation.

The insurance company handles the confidential data of its clients and their intellectual property to analyze before it provides consultation and required services. Keeping in mind the confidentiality of such information, it becomes very important for a business to take up professional indemnity insurance or professional liability insurance.

Some companies seek business with consultation and service providers demand that the individuals or businesses need to be covered by professional indemnity insurance. This is in order to lower the risk of not getting compensated for the losses caused by the business during the tenure of their service. Some individuals or organizations that need to have such insurance are accountants, financial advisors, healthcare professionals, solicitors, architects, chartered surveyors, etc.

Most organizations decide to take up professional indemnity insurance keeping in mind their own protection against coughing up a large sum of money, in case they have caused their clients a huge loss due to their own mistakes and have to compensate for that amount.

It does not matter if you share a good business relationship or bond with your clients. A mistake that may lead to a financial loss will disrupt the peace between you and your clients. Therefore, it is very important to take up professional indemnity insurance for the protection.

This insurance policy is based on the claims that are made. It means that the professional indemnity insurance policy will only cover the claims that are made during the tenure of the policy. So, make sure you get your renewals done on time. Also, any financial loss due to a false advice, the negligence, or the faulty analyses will only be covered if those mistakes were made during the tenure of the insurance policy. Claims made before or after the period of the policy will not be covered.

Some insurance companies have a retro - active date. The retro - active date is a period or number of days before the actual date of inception of the professional indemnity insurance policy. They might cover the claims made during the policy tenure but the event or incident that caused the significant financial loss happened before the period. So, events happened during the retro - active period could be claimed if the claim is made during the tenure of the insurance policy. Mistakes are inevitable and can happen anytime in any business. Professional indemnity insurance will be there by carrying the burden of the monetary compensation that is to be given to the clients by the organization. Such a policy is taken up by the following businesses and individuals –

- Consultants
- Brokers
- Agents
- Notary public
- Brokers from real estate
- Architects
- Insurance agents
- Landscape architects
- Appraisers
- Management consultants
- Third - party business administrators
- IT - Information technology service providers
- Attorneys
- Quality control specialists
- Engineers
- Non-destructive testing analysts

There are also some specific errors and omissions policies designed for software developers, website developers, home inspectors, etc.

Professional Indemnity (PI) insurance is the safety net that protects you if your practice's risk management strategies fail. If a client or third party is unhappy with your advice they may hold you, their accountant, legally responsible and make a claim for economic loss. Company Secretaries and Accountants can also be found liable for breach of contract, negligence or breach of statute, such as misleading and deceptive conduct in consumer protection laws.

PI Insurance will assist with protecting a professional personally, their employees and their business against claims. The Policy will indemnify the Insured in respect of ERRORS and / or OMISSIONS on behalf of self and employees covered in the policy, partners while rendering professional services.

The policy pays other parties for damages for which professional are legally liable to pay as a result of negligent acts, errors or omissions in the performance of professional services including defence cost, court attendance fee etc. The insurance company has an obligation to defend professional against such claims, even if the allegations ultimately are determined to be false or groundless.

Below are some exclusions under the professional indemnity policy copy:

- Contractual Liability.
- Loss arising directly or indirectly out of the actual, alleged or threatened discharge, dispersal release, seepage or escape of pollutants.
- Any claim based upon, arising out of, or attributable to the insolvency or bankruptcy of any insured.
- Any claim based upon, arising out of or attributable to any warranty, guarantee or estimate with respect to fees, costs, quantities, duration or date of completion.

## D & O POLICY

Almost 25 years have passed since India ushered in a new era of commercial liberalization and reform. This continuous and gradual opening up of the economy, driven by a robust growth in domestic consumer demand, has resulted in an influx of foreign investment, which in turn has strengthened private Indian companies. This impressive story of economic growth, however, also has its dark side. Like most jurisdictions, India is no stranger to corporate fraud and scams. Because of significant cultural differences in how Indian companies function vis-à-vis their international counterparts, Indian companies are often seen as less professional. Though the scenario may be changing, the “family business” outlook of many Indian enterprises and an occasionally lackadaisical approach to various compliance and disclosure requirements continue to prevail. Siphoning of funds through related-party transactions, accounting irregularities, and corruption are just a few of the common, unfortunate trends that are prevalent in Indian companies.

Be it Satyam, Lilliput, or NSEL, numerous instances of management and promoter-driven fraud have come to light. The concern surrounding director liability has also been highlighted by the arrests of Stefan Schlipf, the managing director of BMW India Financial Services, and William Pinckney, managing director and chief executive officer of Amway India, along with two other directors.

The ubiquitous issue of corruption and the high risk of internal fraud raise serious concerns about the liability of corporate directors. American litigators who represent Indian companies or advise clients interested in becoming corporate officers in India would do well to brush up on the changing landscape of director and officer liability under Indian law. India has learned a lot in recent years, and its laws have gradually evolved in this context. Director liability in India can be divided into two principal areas:

- (1) liability under the Companies Act of 1956 (the 1956 Act), which has now transitioned to the Companies Act of 2013 (the 2013 Act); and
- (2) liability under other Indian statutes. There has been a seminal shift in the Indian corporate legal regime with the enactment of the 2013 Act and more recent amendments.

For instance, penalties under the 1956 Act that were seen as ineffective have been significantly amplified under the 2013 Act. The 2013 Act also provides statutory recognition to the duties of a director, such as exercise of due and reasonable care, skill, diligence, and independent judgment. One of the key concepts of the Companies Act is the meaning of the term “officer who is in default.” Under the act, liability for default by a company has been imposed on an officer who is in default. By virtue of their positions in the company, the managing director, the whole-time director, and the company secretary directly fall within the scope of this term. Under the 1956 Act, certain key employees such as the chief executive officer and chief financial officer did not directly come within the ambit of the term, which raised serious concerns because these personnel were viewed as key officials in any company. The 2013 Act corrects this anomaly and significantly expands the scope of the expression “officer in default.”

“Officer who is in default”, for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:—

- (i) whole-time director;
- (ii) key managerial personnel;
- (iii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;
- (iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records,

authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;

- (v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;
- (vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;
- (vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer;

A critical failure of Indian corporate law was further highlighted during various corporate and financial scams, such as the Harshad Mehta episode or the Satyam fiasco. Various investors also discovered that money had been siphoned off by promoters through related-party or customer-vendor transactions. To address this issue, the 2013 Act now specifically defines “fraud” and states that a person who is guilty of it may be punished by imprisonment for up to 10 years, and where fraud involves the public interest, the minimum sentence prescribed is three years. Fraud, as defined under section 447 of the 2013 Act, includes any act or abuse of position committed with intent to deceive, to gain undue advantage from, or to injure the interests of a person, company, shareholders, or creditors, whether or not there is wrongful gain or loss.

Directors and officers (D&O) liability insurance is insurance coverage intended to protect individuals from personal losses if they are sued as a result of serving as a director or an officer of a business or other type of organization. It can also cover the legal fees and other costs the organization may incur as a result of such a suit.

Directors and officers liability insurance applies to anyone who serves as a director or an officer of a for-profit business or non-profit organization. A directors and officers liability policy insures against personal losses, and it can also help reimburse a business or non-profit for the legal fees or other costs incurred in defending such individuals against a lawsuit.

Directors and officers liability insurance is paid to directors and officers of a company, or to the organization(s) itself, for losses or reimbursement of defense costs if a legal action is brought against them. Such coverage can also extend to criminal and regulatory investigations/trials defense costs. Civil and criminal actions are often brought against directors and officers simultaneously. D&O insurance has become closely associated with broader management liability insurance, which covers liabilities of the corporation itself as well as the personal liabilities for the directors and officers of the corporation.

In the context of various shareholder disputes, the increased liability under the 2013 Act could be a useful tool to increase pressure on defaulting directors, nominating shareholders, or promoters. In addition, while resignation may protect a director from subsequent defaults, an erstwhile director may still continue to be liable for any defaults that took place during his or her tenure, as now clarified under section 168(2) of the 2013 Act. The 2013 changes to the act prompted concerns about the role, accountability, and responsibility of nonexecutive, nominee, and independent directors, who could be caught on the wrong side of the company’s disputes.

For example, the alleged confession by Ramalinga Raju, then the chairman of Satyam Computer Services Ltd., to financial irregularities and accounting fraud in excess of one billion dollars led to a number of prosecutions. Since then, independent directors have been accused in several similar cases and have faced a severe backlash given their failure to detect the fraud. In another example, Nimesh Kampani, one of the leading investment bankers in India and founder of the JM Financial Group, faced arrest stemming from his role as

an erstwhile independent director of Nagarjuna Finance, a company embroiled in fraud due to failure to return amounts collected from depositors.

Under section 150(12) of the 2013 Act, an independent director or a nonexecutive director can be held liable under the 2013 Act only for acts of omission or commission by a company that occurred with the director's knowledge—attributable through board processes—and the director's consent or connivance or where he or she failed to act diligently. This, to a certain extent, alleviates the concern surrounding independent director liability. However, questions such as whether a director acted diligently and whether knowledge could be attributed to a director by mere presence at board meetings still remain unanswered. Moreover, liability faced by independent and nominee directors under various other enactments remains a legitimate concern.

Directors may also face liability under other Indian laws. Such liability may not always be foreseeable, and actions such as the dishonour of cheques, offenses under the Income Tax Act of 1961, violation of foreign exchange regulations, breach of securities regulations, non-payment of provident fund contributions, violation of the Shops and Establishments Act, or food adulteration could result in liability that may not always be limited to the executive directors.

In addition, some statutes do not distinguish between executive and non-executive directors or base liability on the role a particular director was performing on the company's board. Consequently, liability may be difficult to foresee or predict.

D&O policies can take different forms, depending on the nature of the organization and the risks it faces, so it's best to seek out an insurance company with deep experience in this specialized field. The policies are generally purchased by the organization to cover a group of individuals rather than by the individuals themselves.

If a company fails to disclose material information or wilfully provides inaccurate information, the insurer may avoid payment due to misrepresentation. The "severability clause" in the policy conditions may be intended to protect against this by preventing misconduct by one insured from affecting insurance for other insured's; however, in certain jurisdictions, it may be ineffective.

Policies can be written to insure against a variety of hazards, but they generally make exclusions for fraud or other criminal activity.

Bollywood films which has talked about the Indian legal system. It is common to find an individual who is being sued by another. However, what if an individual or creditor sues an organization or its directors? Yes, it is a hard reality, the number of legal cases against companies, especially directors have seen an upward trend.

Imagine, you are a director or officer of a company and someone tells you that you can lose your personal belonging (including your car and house) due to your business decisions. But this situation would have not affected you much if you had purchased a director liability insurance.

It is essential for every company to have a director & office insurance (D&O), in order to have some peace of mind. If you haven't purchased the policy, we've put together the top reasons to buy a D&O insurance.

1. **Personal assets of directors are at risk:** If a director has been accused of breaching duties, their personal assets are at risk in case they don't have any D&O insurance.
2. **Defending a legal action is an expensive affair:** The legal costs and expenses in litigations involving directors are usually complex and costly.
3. **Investors can file a case against you:** It may sound unlikely, but things can go downward. If investors believe that they have incurred losses due to mismanagement of the company, they could approach the court to seek compensation. For instance, if any action of a director results in a drop-in share price, which leads to loss to shareholders and investors, then there is a high possibility that they may bring a class-action lawsuit against the company and directors.



4. **Employees can sue directors:** It is not only shareholders who can file a case against the directors as even employees reach the court to challenge the decision of the directors. It is a hard reality that in today's corporate world, there has been a rise in the number of cases filed by employees, related to sexual harassment or wrongful dismissal. For example, in 2016, a sacked software engineer won case against HCL Tech. The court called his dismissal unlawful and asked the company to reinstate the petitioner with continuity of service and paid full salary along with other benefits.
5. **Customers can take legal actions:** In some cases, customers also reach the court against misrepresentations made in the advertisement materials and deceptive trade practices.
6. **Enquiry initiated by regulatory authorities:** Regulatory bodies, like SEBI, Revenue Department, etc.; can initiate enquiry against directors.
7. **In case of bankruptcy or insolvency:** If faced with bankruptcy, creditors can pursue legal action against directors if they think that they have not acted in their best interest.
8. **Helps in attracting/retaining talent:** Not having a comprehensive D&O may discourage talented employees from joining the company as they know will not be guarded against any legal case if arise in future.
9. **D&O claims are not covered under any other policy:** Most of the people believe that D&O claims are also covered under other liability insurance plans like professional indemnity.

However, it is not true. In short, a director is expected to work with the following principals:

- **Duty of Care:** It requires directors and officers to act diligently with regard to the management of the company's affairs.
- **Duty of Loyalty:** It restricts directors and officers from using their position in their interest.
- **Duty of Obedience:** It requires directors and officers to ensure that the company is adhering to code of conduct.

Any deviation from the above principals could pose the threat of legal actions against directors.

Let's take a real life example. In 2016, Tata Sons sacked its director Cyrus Mistry who later made a statement that the company was taking some loss-making decisions on emotional grounds. As the company was listed in the USA, the risk of investor actions in that country was very high. However, the company had a director liability insurance, which covered the legal cost and other expenses.

In conclusion, we can say that in recent years, the role of directors and officers has become more stringent and challenging, given the increasing responsibilities and litigation pressure. In most of the cases, directors and officers carry personal responsibility and liability with respect to their acts.

As a result, it is pertinent to go with a director liability insurance, which can safeguard directors and officers against the monetary burden of litigation and damage to their reputation

The Indian economy presents myriad and growing opportunities, but would-be corporate directors and their lawyers should tread carefully.

While it is difficult to provide any particular standard that will determine an individual's exposure to liability, a person will generally be held liable for wrong doing committed by a company if he or she falls into either of the following categories:

1. any person who, at the time the offense was committed, was in charge of and responsible to the company for the conduct of its business; or
2. any director, manager, secretary, or other officer of the company:



- a. with whose consent and connivance the offense was committed, or
- b. whose negligence resulted in the offense.

The Indian Supreme Court has, in this context, ruled that a managing director is *prima facie* in charge of and responsible for the company's business and can be prosecuted for misdeeds by the company. But only those officers of the company who fall within the scope of the definition "officer who is in default" under section 2(60) of the Companies Act, 2013 are covered. See e.g., *Nat'l Small Indus. Corp. Ltd. v. Harmeet Singh Paintal & Anr.*, (2010) 3 S.C.C. 330 (India); *K.K. Ahuja v. V.K. Vora*, (2009) 10 S.C.C. 48 (India). A simple averment in a complaint that a director was in charge of and responsible for the conduct of the business of the company is sufficient to state a claim against an officer who is in default.

In cases of fraud, it may be difficult to have a clear line of demarcation as to whether the director could have prevented the fraud if he or she had used due diligence. While the role of non-executive directors may consist of providing strategic guidance, this more limited status may not protect them from liability nor will being a nonparticipant at board meetings. The law now requires directors to adopt an inquisitive approach and question the company's background information, how it was obtained, and the decisions that are taken based on such information.

With increasing global interest in Indian companies and a changing legal landscape, new players will continue to enter the domain unaware of the possible consequences. Consequently, director indemnification clauses in shareholder and director agreements should be cautiously and thoroughly negotiated. Directors' and officers' liability insurance is also a tool that is becoming increasingly popular in India. Such insurance and indemnification should sufficiently cover the director even after resignation.

The Indian economy presents myriad and growing opportunities, but would be corporate directors and their lawyers should tread carefully. Rapidly modernizing laws on director and officer liability require their full attention.

A rising trend in demand for D&O cover in India has been witnessed recently; with directors increasingly being held personally responsible for the management decisions made during every working day. While a Company's liability is limited by shares or by guarantee; the personal liability of a Director and/or Officer of a Company is unlimited. Hence every time a claim or allegation arises, a Director's personal assets are at risk. It has become a core component of corporate insurance. Various insurance companies have witnessed a rising demand from Indian companies in the past few years. Moreover there seems to be a shift from concept selling to an increased general awareness amidst companies about D&O insurance. Most demand in India is from the IT sector, followed by pharmaceutical and auto companies. Factors which have contributed to this rising trend include- strict regulations, complex listing requirements, increasing legal fees and a litigious environment.

An increasing demand for this policy is seen in private firms as well as large public sector companies. Indian multinationals, listed companies or those planning to list their securities are keen on getting the policy. Also companies planning an acquisition/ merger or raising capital through private equity; are increasing looking out for a good D&O cover.

### **Directors and Officers Liability Insurance**

Directors and Officers Liability Insurance (D&O) covers the cost of legal defense of directors, even in their individual capacity, when the company is unable to defend them. The D&O cover applies to former, present, and future members of the board of directors or any employee performing a managerial role.

Usually, the policy covers the following:

- Management Liability
- Management indemnification
- Non-Profit Outside Directorship Liability

- Estates and legal representatives of incapacitated or deceased insured individuals covered
- Spousal Liability extension
- Cover for the creation or acquisition of new Subsidiary companies (effective from the date of acquisition or creation)

The D&O policy offers the following coverages:

- It covers any loss or damage that the company may incur because of actions mistakenly taken in the individual capacity as directors and officers under the Memorandum and Articles of Association
- It includes loss or damage arising from claims made against directors and officers for any wrongful act done in their official capacity
- It covers legal expenditure incurred with the written consent of the insurance companies arising out of the prosecution of any director or officer at any investigation, enquiry or other proceedings by the authority empowered to do so
- It covers expenses incurred by the company's shareholders in pursuance of a claim against a director/officer for which the insurance company is legally obliged to pay, as per the court's direction
- It provides indemnity to the legal heirs or legal representatives of the director/officer if the director or officer becomes insolvent

### Real Case: TATA vs. Mistry 2016

The sacking of Cyrus Mistry as the chairman of Tata Group<sup>1</sup> and its fallout with the company may trigger a claim under the Directors and Officers Liability Insurance (D&O) policy which the company had purchased in 2013.

Tata Sons has a D&O cover offering over \$50 million coverage. Besides offering cover to the directors of the company, the policy also acts as a cover for a group of companies.

The ousted Mistry raised issues of impairment and made a statement that Tata Motors was taking various loss-making decisions on emotional grounds. As the company is also listed in the USA, the risks of investor actions are very high there, and in the case of proceedings in the USA, the defense cost will run into millions of dollars. In that situation, the D&O policy will help. The policy will cover the costs incurred by the company in defending itself in the court.

Similarly, if due to any action of the board, there is a drop in shares prices and erosion of market cap, which results in loss to shareholders, there is a high possibility that they may take an action lawsuit against the company or the individual directors.

In this case, the D&O policy will safeguard the company and its directors. Apart from the shareholder action, the cover could also be activated if an ousted board member brings a retaliatory suit against other board members.

### Trigger for buying D&O Cover in India

The Regulations 25(10) of the SEBI (LODR) Regulations, 2015 provide that with effect from October 1, 2018, the top 500 listed entities by market capitalization calculated as on March 31 of the preceding financial year, shall undertake Directors and Officers insurance ('D and O insurance') for all their independent directors of such quantum and for such risks as may be determined by its board of directors.

1. Note to Students: In a recent development in this case, the National Company Law Appellate Tribunal said on Dec. 18 that Cyrus Mistry was improperly removed in October 2016 at the behest of Ratan Tata, chairman-emeritus of the group, whose actions were 'oppressive' for minority investors. Meanwhile, Mistry said that he doesn't want to return, but will fight to protect shareholder rights. To which, Tata Sons had moved the Supreme Court challenging the NCLAT order, saying the verdict "undermined corporate democracy" and the "rights" of its board of directors. In January, 2020, Supreme Court stayed the NCLAT order.

"Restoring Cyrus Mistry to the position as Chairman has undermined corporate democracy and the rights of the board of directors,"

However, Several Indian companies are getting themselves listed on foreign stock exchanges, acquiring or merging with non-Indian companies. This creates a litigious environment in overseas jurisdictions; also the high legal costs are making getting D&O insurance imperative for the companies.

With more Indian companies becoming globalized; it is highly likely that the risk of claims and litigation for the directors and officers of a company will continue to see a major increase, both in the present as well as in the future.

Stricter regulations is also one of the strongest reasons behind firms increasing their requirement for purchasing insurance for the company. Moreover the purchase of getting D&O liability cover seems to be driven more by regulatory requirements rather than due to a risk management approach.

With increased awareness about the exposure to risk; the Indian perception that a claim cannot happen has changed to it can happen. Indian companies are becoming more global and entrepreneurs are moving up the value chain in the supply of goods and services; which has increased the demand for liability insurance.

With Indian companies gaining a greater understanding of the benefits of D&O insurance, the demand for the cover is expected to increase further. In fact as private company D&O insurance policies provide broader coverage at a relatively low cost compared to publicly listed companies; D&O cover ought to further increase among private companies.

The general liability risks scenario for India is viewed as low. However, this can be deceiving if applied across all of liability exposures as certain exposures at a primary level such as Directors & Officers Liability (D&O)/ Employment Practice Liability (EPL) in the United States of America (USA) that can cause a multitude of problems. Coupled with the legal system in certain countries, that can be drawn out when making final decisions and also with the fact that there is no case law in certain countries, reactionary decisions can be made.

It is important to note that as all Asian countries continue to grow their respective economy's gross domestic product (GDP), the necessity of liability insurance will grow alongside this economic growth. The foreign shareholders and foreign owners of companies will demand that the manufacturers, exporters of companies, are adequately covered by insurance for negligence, and wrongful acts.

### The Caselets on D&O Policy

#### i) Double Trouble

When Elisa complained to Joe, the executive director, that her manager, Roger, was sexually harassing her, Joe told her he would look into it; but he was overwhelmed with work and put off any investigation. Elisa complained again, this time in writing. Once again, Joe did not take action. Elisa quit and threatened to sue. Now, faced with a possible lawsuit, Joe investigated the allegations and determined that they were true. He fired Roger. But, that is not the end of the story. Elisa sued Joe and the nonprofit organization and its board of directors for allowing sexual harassment in the workplace and failing to investigate in a timely manner. She argued that she was constructively terminated. To add to the misery, Roger also sued for wrongful termination. He alleged that his behavior had been tolerated for many years, and that he was given no warning that his behavior was no longer appropriate.

#### ii) Misrepresentation or Market Forces?

A small nonprofit housing advocacy group helped a group of twenty low income families obtain government subsidized loans to purchase a group of low-income condominiums. Not long after the purchases were completed, the real estate market took a serious downturn. Many of the condos were worth less than the outstanding amount of the loans. Several of the homeowners sued the nonprofit and its board of directors for misrepresentation of the benefits of home ownership and failing to warn them of the possible loss in home value.

### iii) Disability or Inconvenience?

Sarah worked as a counselor at a group home for teens. She took insulin regularly for diabetes, but from time to time fainted while on duty. The nonprofit for which she worked accommodated her schedule so that she could take her insulin shots in a timely manner. However, Sarah was also a part-time student and during the second semester of the year her class schedule dramatically changed. She was not able to work the hours previously arranged, and the nonprofit was not able to accommodate her new hours. She was terminated. Sarah sued the nonprofit organization and its board of directors for discrimination under the ADA, alleging that the real reason for her termination was her diabetes.

## Key Takeaways – Ten Things a Director should be conversant about his / her D&O Policy- An Universal Approach

- 1) *How Much Insurance Do We Have How And Much Do One Need?:* There is no exact science to determining the limits of D&O insurance a particular company should maintain. However, reputable commercial insurance brokers and other vendors have developed benchmarking data based on market caps, annual revenues, industry, etc. that provide insight regarding how your company's limits stack up against similar/peer companies. You should ask the individual responsible for placing your D&O insurance for this data and review it to determine where your limits are at versus your peer companies. Ask questions if there are deviations in your limits versus those of your peers.
- 2) *Who Shares the Insurance Policies?:* D&O insurance often covers all directors, officers and employees, as well as the company. This means that significant claims against the company and employees may deplete the limits available for individual officers and directors. You should determine if there are certain limits available only to directors and officers (often referred to as "Side A" or "Side A DIC" coverage) and whether your coverage contains a "priority of payments" clause that provides that in the event of claims against both the directors/ officers and the companies, losses attributable to the directors/officers are entitled to payment before losses of the company.
- 3) *When is Coverage Triggered?* D&O insurance coverage triggers have become much broader in recent years. In addition to coverage for lawsuits by shareholders, policies often now cover individual directors and officers for investigations by regulatory bodies, upon receipt of a summons, etc. Therefore, one should inquire, particularly with respect to regulatory body (SEC) investigations and summons, at what point coverage is triggered.
- 4) *What is Covered Under the D&O Policy?:* As noted above, in addition to defence costs and the costs of settlements/judgments arising from shareholder actions, many policies now cover attorneys' fees and other expenses related to responding to both formal and informal investigations and summons. Again, one should inquire at what point one coverage is triggered, and what costs associated with such events are covered under one policy.
- 5) *Who are Insurers?:* One has to look at their claims paying ability ratings issued by reputable independent ratings services. The individual responsible for procuring one coverage need to be consulted if they have had a conversation with your insurance broker regarding the claims payment philosophy of the insurers, and what those insurers' reputations are in the marketplace when it comes to claims handling procedures.
- 6) *How Do Other Insurers Impact Coverage?:* Take concern what happens to the coverage if another insured engages in fraud or criminal activity, but one is still named as a defendant in a lawsuit. Make sure that the bad acts of a "black hat" don't negate one coverage. Also, ask what happens to your coverage if someone else makes a misrepresentation in the application for the D&O policy. Try to ensure that someone else's misstatements don't lead to your loss of coverage.
- 7) *What is not Covered?:* Make sure you understand significant exclusions in your policy (exclusions for

major shareholders, M&A activity, etc., are becoming more common). Have your policy reviewed by an outside professional to determine the scope of items that may not be covered under the policy.

- 8) *How to Protect in a Crisis?* : Understand the claim notice requirements under the policy. One of the worst things that can occur is a loss of coverage due to inadequate or untimely notice.
- 9) *What is Side A Insurance and Why is it Needed?*: Side A coverage is effectively the last line of defence against a director or officer having to pay their own costs related to a claim. It kicks in when the company is unable to provide indemnification (usually due to bankruptcy or a statutory prohibition on indemnification). Therefore, it is one of the most important coverages for individual directors and officers, as it directly protects against loss of personal assets as a result of claims.
- 10) *What is Independent Director Insurance?*: Independent Director Insurance has been around for some time and provides a separate set of coverage limits dedicated solely to independent/outside directors of a company. To date, it has been purchased by very few companies. Generally, if adequate Side A coverage is already in place, this coverage should not be necessary.

### **D&O Insurance for Non-Profit Organizations**

It's a misnomer to believe that only large nonprofit organizations need D&O insurance. Directors and officers of every-sized nonprofit organization have meaningful exposure to personal liability. About 20% of all U.S. corporations are nonprofits. The liability for directors and officers of small corporations is at least as high as that of for-profit corporations.

Large numbers of directors and officers for non-profit organizations lack experience. Often times, they also lack sufficient knowledge of their legal duties and responsibilities regarding the non-profit they serve. Directors and officers of non-profit organizations who do have knowledge or experience sometimes take advantage of the less formal approach of non-profits and fail to take the same business approaches to decision-making as they would when working for a for-profit corporation.

It's critical for non-profit board directors and officers of all types and sizes of non-profit organizations to understand that not all of their actions are covered by the federal Volunteer Protection Act. Non-profit boards that fail to protect their organizations with a D&O insurance policy may find that the cost of just one claim is far larger than the cost of any insurance premiums they would have paid, if they had purchased a D&O insurance policy.

D&O insurance will not prevent claims from occurring; however, it does mitigate the high costs associated with defending claims. Lawsuits and potential claims may originate with vendors, donors, competitors, employees, government regulators or others.

According to Massnonprofit.org, D&O insurance protects against, "Any actual or alleged act or omission, error, misstatement, misleading statement, neglect or breach of duty by an insured person in the discharge of his/her duties." It also covers personnel issues, including discrimination, wrongful termination, harassment, failure to provide services and mismanaging assets.

D&O insurance policies are common and necessary to cover the actions and decisions of board directors and officers. D&O insurance policies offer coverage for defence costs, settlements, judgments arising from lawsuits and wrongful allegations brought against the nonprofit.

The cost of D&O insurance policies is determined by many factors, including the potential degree of risk and the size of the nonprofit. Boards may also reduce some of the costs of the policy by working with insurance companies to mitigate certain risks. Boards that have clearly written policies for hiring, firing and other issues will be viewed as less risky by insurance companies. Lower risk factors typically equate to lower insurance premiums.



Board directors should take care to understand their D&O insurance policies. Specifically, they need to be familiar with policy wording for directors and officers, as well as any additions, conditions and exclusions listed within the policy wording.

Non-profits may consider inviting an insurance professional to make a presentation to the board on D&O insurance as part of board development.

In summary, regardless of the organization's size and board experience, all non-profit organizations need to purchase D&O insurance protection. In addition to a D&O insurance policy, all non-profit boards should develop an effective risk management plan to protect individual directors, protect the organization and prevent claims against the D&O insurance policy.

## OTHER RISK MITIGATION APPROACHES

### The Risk Oversight Function of the Board of Directors- Global Scenario

A board's risk oversight responsibilities derive primarily from state law fiduciary duties, federal and state laws and regulations, stock exchange listing requirements and certain established (and evolving) best practices, both domestic and worldwide.

#### Fiduciary Duties

The Delaware courts have taken the lead in formulating the national legal standards for directors' duties for risk management. Under the *Caremark* line of cases, these courts have held that directors can be liable for a failure of board oversight only where there is "sustained or systemic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists," noting that this is a "demanding test." *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 971 (Del. Ch. 1996). Delaware Court of Chancery decisions since *Caremark* have expanded upon that holding, while reaffirming its fundamental standard. The plaintiffs in *In re Citigroup Inc. Shareholder Derivative Litigation*, decided in 2009, alleged that the defendant directors of Citigroup had breached their fiduciary duties by not properly monitoring and managing the business risks that Citigroup faced from subprime mortgage securities, and by ignoring alleged "red flags" that consisted primarily of press reports and events indicating worsening conditions in the subprime and credit markets. The court dismissed these claims, reaffirming the "extremely high burden" plaintiffs face in bringing a claim for personal director liability for a failure to monitor business risk and that a "sustained or systemic failure" to exercise oversight is needed to establish the lack of good faith that is a necessary condition to liability.

In *In re The Goldman Sachs Group, Inc. Shareholder Litigation*, decided in October 2011, the court dismissed claims against directors of Goldman Sachs based on allegations that they failed to properly oversee the company's alleged excessive risk taking in the subprime mortgage securities market and caused reputational damage to the company by hedging risks in a manner that conflicted with the interests of its clients. Chief among the plaintiffs' allegations was that Goldman Sachs' compensation structure, as overseen by the board of directors, incentivized management to take on ever riskier investments with benefits that inured to management but with the risks of those actions falling to the shareholders. In dismissing the plaintiffs' *Caremark* claims, the court reiterated that, in the absence of "red flags," the manner in which a company evaluates the risks involved with a given business decision is protected by the business judgment rule and will not be second-guessed by judges.

In a 2017 decision dismissing *Caremark* claims, *Oklahoma Firefighters Pension & Retirement System v. Corbat*, the court emphasized that directors can only be held liable for a failure to act in the face of red flag where the inaction suggests "not merely inattention, but actual scienter. In other words, the conduct must imply that the directors are knowingly acting for reasons other than the best interest of the corporation." The

Delaware Supreme Court reaffirmed this standard and reached the same result in its 2017 majority decision in *City of Birmingham Retirement and Relief System v. Good*, which grew out of major environmental damage resulting from the collapse of a Duke Energy storm water pipe that caused extensive contamination of the Dan River and resulted in sanctions against the company. As the Court aptly put it: “[T]he question before us is not whether Duke Energy should be punished for its actions. That has already happened. What is before us is whether a majority of Duke Energy directors face a substantial likelihood that they will be found personally liable for intentionally causing Duke Energy to violate the law or consciously disregarding the law. We find, as the Court of Chancery did, that the plaintiffs failed to meet this pleading requirement.” Nonetheless, a word of caution is warranted, as Chief Justice Strine in dissent would have reversed, concluding that at the pleading stage, the plaintiff had pleaded “facts supporting an inference that Duke consciously was violating the law, taking steps that it knew were not sufficient to come into good faith compliance, but which it believed would be given a blessing by a regulatory agency whose fidelity to the law, the environment, and public health, seemed to be outweighed by its desire to be seen as protecting Duke and the jobs it creates.”

Another situation that tested the limits of the *Caremark* doctrine presented itself in *In re Wells Fargo & Company Shareholder Derivative Litigation*, also decided in 2017. There, a California court applying Delaware law, denied the defendants’ motion to dismiss because the plaintiffs pointed to numerous “red flags” of which the company’s directors allegedly were or should have been aware and took no substantial remedial steps. The plaintiffs asserted that Wells Fargo’s directors knew or consciously disregarded that Wells Fargo employees were creating millions of deposit and credit card accounts for customers without the customers’ knowledge or consent. The court rejected defence efforts to explain away the alleged “red flags” as “insignificant when viewed in their larger context.” Rather than look at the “red flags” in isolation, as the defendants urged, the court viewed them collectively, finding that “Defendants ignore the bigger picture by addressing each of these ‘red flags’ in piecemeal fashion.” The court concluded that while the “red flags” might “appear relatively insignificant to a large company like Wells Fargo when viewed in isolation, when viewed collectively they support an inference that a majority of the Director Defendants consciously disregarded their fiduciary duties despite knowledge regarding widespread illegal account-creation activities, and . . . that there is a substantial likelihood of directors oversight liability.”

Thus, while it is true that the Delaware Supreme Court has not indicated a willingness to alter the strong protection afforded to directors under the business judgment rule that underpins *Caremark* and its progeny, cases such as *In re Wells Fargo* and Chief Justice Strine’s dissent in *Good* should serve as reminders that board processes and decision-making may still be questioned where there are specific allegations that directors ignored “red flags,” particularly when the “red flags” pointed to issues that, often with the benefit of hindsight, could be viewed as reflecting significant problems. Companies should adhere to reasonable and prudent practices and should not structure their risk management policies around only the minimum requirements needed to satisfy the business judgment rule.

## **Laws and Regulations: International Perspective**

### **Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010**

The Dodd–Frank Wall Street Reform and Consumer Protection Act (commonly referred to as Dodd–Frank) is a United States federal law that was enacted on July 21, 2010. The law overhauled financial regulation in the aftermath of the The Great Recession, and it made changes affecting all federal financial regulatory agencies and almost every part of the nation’s financial services industry.

The Dodd-Frank Act created new federally mandated risk management procedures principally for financial institutions. Dodd-Frank requires bank holding companies with total assets of \$10 billion or more, and certain other non-bank financial companies as well, to have a separate risk committee which includes at least one risk management expert with experience managing risk of large companies.



## Securities and Exchange Commission

The U.S. Securities and Exchange Commission (SEC) is an independent federal government agency responsible for protecting investors, maintaining fair and orderly functioning of the securities markets, and facilitating capital formation. It was created by Congress in 1934 as the first federal regulator of the securities markets. The SEC promotes full public disclosure, protects investors against fraudulent and manipulative practices in the market, and monitors corporate takeover actions in the United States. It also approves registration statements for bookrunners among underwriting firms.

The SEC requires companies to disclose in their annual reports “factors that make an investment in a registrant’s securities speculative or risky.” While the SEC has emphasized that risk factor disclosures should be concise, there is a growing concern that the SEC’s increasing disclosure requirements have made companies feel compelled to over disclose and to provide “boilerplate” risk factors that have limited the utility of the disclosures. On April 3, 2016, the SEC began seeking public comment on a concept release to modernize and simplify business and financial disclosure requirements in Regulation S-K. In this regard, the SEC has proposed eliminating the risk factor examples provided in Item 503(c) of Regulation S-K, because “the inclusion of these examples could suggest that a registrant must address each one of its risk factor disclosures, regardless of the significance to its business.” According to the SEC, eliminating such examples will encourage companies to provide less boilerplate risk factor disclosure.

The SEC also requires companies to disclose the board’s role in risk oversight, the relevance of the board’s leadership structure to such matters and the extent to which risks arising from a company’s compensation policies are reasonably likely to have a “material adverse effect” on the company. A company must further discuss how its compensation policies and practices, including those of its non-executive officers, relate to risk management and risk-taking incentives.

## Foreign Corrupt Practices Act, 1977

In November 2017, the Department of Justice announced a new FCPA enforcement policy that codified and enhanced a pilot program launched in April 2016. Under the pilot program, companies were eligible for a range of mitigation credit if they voluntarily self-reported FCPA misconduct; fully cooperated with the DOJ’s investigation, including disclosing all relevant facts and identifying culpable individuals; and implemented timely and appropriate remedial measures. The pilot program, as intended, appears to have sparked an increase in the number of companies voluntarily disclosing FCPA-related misconduct to the DOJ, with seven companies receiving DOJ decisions not to prosecute due to their participation in the pilot program.

As a result of the pilot program’s success, the DOJ formally adopted an enhanced version of the program to further encourage companies to voluntarily disclose FCPA-related misconduct. Under the revised policy, when a company voluntarily self-discloses misconduct, fully cooperates, timely and appropriately remediates and agrees to disgorge any ill-gotten profits, there is a presumption that the DOJ will decline to prosecute the company. That presumption will be overcome only if there are aggravating circumstances related to the nature and seriousness of the offense, such as where the company was a repeat offender or where the misconduct was pervasive, involved executive management or resulted in significant corporate profits. Recently, DOJ officials indicated that they are applying the principles of the FCPA enforcement policy as “non-binding guidance” in corporate investigations outside the FCPA arena.

Meanwhile, commitment to anti-corruption enforcement is on the rise across the globe. Trump Administration officials at the DOJ and the SEC have pledged continued vigorous enforcement of the FCPA, and have brought significant enforcement actions against both individuals and corporations. In countries from Europe to South America to Asia, new anti-corruption laws are taking effect, and enforcement actions are being pursued. And corruption investigations have become increasingly international in nature, with the most significant FCPA resolutions of 2017 involving coordinated international resolutions, where multiple countries imposed penalties and shared penalty proceeds.

## Cyber security

As mentioned above, the EU's General Data Protection Regulation (GDPR), which takes effect in May 2018, raises the regulatory bar, and it sweeps more broadly than some non-EU-based companies may realize. The GDPR imposes stringent requirements on both data collection and data processing, including increased data security mandates, enhanced obligations to obtain data owner consent, and strict breach notification requirements. Importantly, the GDPR is extra territorial in its reach, and carries severe penalties for noncompliance—up to 4% of worldwide revenue. In the United States, the New York State Department of Financial Services (DFS) has implemented detailed and prescriptive regulations of its own, requiring covered institutions—entities authorized under New York State banking, insurance or financial services laws to meet strict minimum cybersecurity standards. The revised regulations require, among other things, that covered institutions have in place a cyber security program designed to protect consumers' private data, approved by boards of directors or senior corporate officers and accompanied by annual compliance certifications, the first of which was required to be filed on February 15, 2018.

Meanwhile, the SEC has turned its attention to market disclosure and breach notification. Since 2011, when the SEC's Division of Corporation Finance issued interpretive guidance regarding cyber security disclosures, public companies have been required to "disclose the risk of cyber incidents if they are among the most significant factors that make an investment in the company speculative or risky." In February 2018, the SEC issued new guidance to clarify its expectations on such disclosures. The majority of the 2018 guidance focuses on "reinforcing and expanding upon" the 2011 guidance, advising public companies to evaluate the materiality of cyber risks and incidents and make necessary disclosures in a timely fashion, while warning that the SEC is watching closely. However, the 2018 guidance delves into some new areas—particularly board oversight, disclosure controls and procedures, insider trading and selective disclosures. As it regards risk oversight, the 2018 guidance advises that public companies should disclose the role of boards in cyber risk management, at least where cyber risks are material to a company's business. Therefore, while most boards are likely already engaged in some form of cyber risk oversight, the call by the SEC for more public disclosure may prompt consideration of whether to deepen or sharpen that engagement.

On the enforcement side, the SEC has signalled that it may move towards a more aggressive approach, alluding to the feasibility of disclosure-based enforcement actions, amid reports that it is engaged in investigations of companies like Yahoo! and Equifax. In its newly issued guidance, the SEC warns that "directors, officers, and other corporate insiders must not trade a public company's securities while in possession of material nonpublic information, which may include knowledge regarding a significant cybersecurity incident experienced by the company." And with the SEC, DOJ and the Federal Trade Commission reportedly investigating the sale of shares by Equifax executives after the Equifax breach, companies would be wise to examine their insider trading policies to ensure they operate effectively in the wake of cyber incidents, including by ensuring that consideration is given in any specific situation whether to restrict trading by insiders before public disclosure.

## Third-Party Guidance on Best Practices

Various industry-specific regulators and private organizations publish suggested best practices for board oversight of risk management. Examples include reports by the National Association of Corporate Directors (NACD)—Blue Ribbon Commission on Risk Governance and the Committee of Sponsoring Organizations of the Tread way Commission (COSO).

In September 2017, COSO released the final version of its updated internationally recognized enterprise risk management framework, which it originally released in 2004. As revised, the COSO approach presents five interrelated components of risk management: risk governance and culture (the tone of the organization); setting objectives; execution risk (the assessment of risks that may impact achievement of strategy and business objectives); risk information, communication and reporting; and monitoring enterprise risk management performance. Additional changes adopted in the revised framework are a simplified definition of enterprise risk

management designed to be accessible to personnel not directly involved in risk management roles; a clear examination of the role of culture; an elevated discussion of strategy; a renewed emphasis between risk and value; an enhanced alignment between performance and enterprise risk management; a more explicit linking of enterprise risk management to decision-making; an enhanced focus on the integration of enterprise risk management; a refined explanation of the concept of risk appetite and acceptable variation in performance (i.e., risk tolerance); and a clear delineation between enterprise risk management and internal controls. By understanding and emphasizing the relationship between critical assumptions underlying business strategy and risk management, the board can strengthen its risk oversight role.

In June 2015, The Conference Board Governance Center published a report, *The Next Frontier for Boards: Oversight of Risk Culture* that contains useful recommendations for board-driven risk governance. Among other useful suggestions, the report suggests that boards receive periodic briefings (whether from chief internal auditors, outside subject matter experts or consulting firms) on board oversight of risk culture expectations.

### Recommendations for Improving Risk Oversight

As an oversight matter, the board should seek to promote an effective, on-going risk dialogue with management, design the right relationships between the board and its standing committees as to risk oversight and ensure appropriate resources support risk management systems. Risk management should be tailored to the specific company, but, in general, an effective risk management system will (1) adequately identify the material risks that the company faces in a timely manner; (2) implement appropriate risk management strategies that are responsive to the company's risk profile, business strategies, specific material risk exposures and risk tolerance thresholds; (3) integrate consideration of risk and risk management into strategy development and business decision-making throughout the company; and (4) adequately transmit necessary information with respect to material risks to senior executives and, as appropriate, to the board or relevant committees.

Specific types of actions that the board and appropriate board committees may consider as part of their risk management oversight include the following:

- a) review with management the company's risk appetite and risk tolerance and assess whether the company's strategy is consistent with the agreed-upon risk appetite and tolerance for the company;
- b) establish a clear framework for holding the CEO accountable for building and maintaining an effective risk appetite framework and providing the board with regular, periodic reports on the company's residual risk status;
- c) review with management the categories of risk the company faces, including any risk concentrations and risk interrelationships, as well as the likelihood of occurrence, the potential impact of those risks, mitigating measures and action plans to be employed if a given risk materializes;
- d) review with management the ways in which risk is measured on an aggregate, company-wide basis, the setting of aggregate and individual risk limits (quantitative and qualitative, as appropriate), the policies and procedures in place to hedge against or mitigate risks and the actions to be taken if risk limits are exceeded;
- e) review with management the assumptions and analysis underpinning the determination of the company's principal risks and whether adequate procedures are in place to ensure that new or materially changed risks are properly and promptly identified, understood and accounted for in the actions of the company;
- f) review with committees and management the board's expectations as to each group's respective responsibilities for risk oversight and management of specific risks to ensure a shared understanding as to accountabilities and roles;
- g) review the company's executive compensation structure to ensure it is appropriate in light of the company's articulated risk appetite and risk culture and to ensure it is creating proper incentives in light of the risks the company faces;

- h) review the risk policies and procedures adopted by management, including procedures for reporting matters to the board and appropriate committees and providing updates, to assess whether they are appropriate and comprehensive;
- i) review management's implementation of its risk policies and procedures, to assess whether they are being followed and are effective;
- j) review with management the quality, type and format of risk-related information provided to directors;
- k) review the steps taken by management to ensure adequate independence of the risk management function and the processes for resolution and escalation of differences that might arise between risk management and business functions;
- l) review with management the design of the company's risk management functions, as well as the qualifications and backgrounds of senior risk officers and the personnel policies applicable to risk management, to assess whether they are appropriate given the company's size and scope of operations;
- m) review with management the primary elements comprising the company's risk culture, including establishing "a tone from the top" that reflects the company's core values and the expectation that employees act with integrity and promptly escalate non-compliance in and outside of the organization; accountability mechanisms designed to ensure that employees at all levels understand the company's approach to risk as well as its risk-related goals; an environment that fosters open communication and that encourages a critical attitude towards decision-making; and an incentive system that encourages, rewards and reinforces the company's desired risk management behaviour;
- n) review with management the means by which the company's risk management strategy is communicated to all appropriate groups within the company so that it is properly integrated into the company's enterprise-wide business strategy;
- o) review internal systems of formal and informal communication across divisions and control functions to encourage the prompt and coherent flow of risk-related information within and across business units and, as needed, the prompt escalation of information to senior management (and to the board or board committees as appropriate); and
- p) review reports from management, independent auditors, internal auditors, legal counsel, regulators, stock analysts and outside experts as considered appropriate regarding risks the company faces and the company's risk management function, and consider whether, based on each individual director's experience, knowledge and expertise, the board or committee primarily tasked with carrying out the board's risk oversight function is sufficiently equipped to oversee all facets of the company's risk profile—including specialized areas such as cyber security—and determine whether subject-specific risk education is advisable for such directors.

In connection with the above, the board should formally undertake an annual review of the company's risk management system, including a review of board- and committee-level risk oversight policies and procedures, a presentation of "best practices" to the extent relevant, tailored to focus on the industry or regulatory arena in which the company operates, and a review of other relevant issues. To this end, it may be appropriate for boards and committees to engage outside consultants to assist them in both the review of the company's risk management systems and also assist them in understanding and analyzing business-specific risks. But because risk, by its very nature, is subject to constant and unexpected change, boards should keep in mind that annual reviews do not replace the need to regularly assess and reassess their own operations and processes, learn from past mistakes and external events, and seek to ensure that current practices enable the board to address specific major issues whenever they may arise. Where a major or new risk comes to fruition, management should thoroughly investigate and report back to the full board or the relevant committees as appropriate.

In addition to considering the foregoing measures, the board may also want to focus on identifying external

pressures that can push a company to take excessive risks and consider how best to address those pressures. In particular, companies have come under increasing pressure in recent years from hedge funds and activist shareholders to produce short-term results, often at the expense of longer-term goals. These demands may include steps that would increase the company's risk profile, for example, through increased leverage to repurchase shares or pay out special dividends, spinoffs that leave the resulting companies with smaller capitalizations or underinvestment in areas important to the future competitiveness of the company. While actions advocated by activists may make sense for a specific company under a specific set of circumstances, the board should focus on the risk impact and be ready to resist pressures to take steps that the board determines are not in the company's or shareholders' best interest, as well as to explain its decisions to its shareholders.

### **Legal Compliance Programs**

Senior management should provide the board or committee with an appropriate review of the company's legal compliance programs and how they are designed to address the company's risk profile and detect and prevent wrongdoing. While compliance programs will need to be tailored to the specific company's needs, there are a number of principles to consider in reviewing a program. As noted earlier, there should be a strong "tone at the top" from the board and senior management emphasizing the company's commitment to full compliance with legal and regulatory requirements, as well as internal policies. This cultural element is taking on increasing importance and receiving heightened attention from regulators as well. A well-tailored compliance program and a culture that values ethical conduct continue to be critical factors that the DOJ will assess under the Federal Sentencing Guidelines in the event that corporate personnel engage in misconduct. In addition, while Deputy Attorney General Rosenstein has announced a review of all DOJ enforcement guidance memos, including the 2015 "Yates memo" on holding individuals accountable for wrongdoing, we expect that an emphasis on individual accountability will remain a key feature of the enforcement landscape, highlighting the continued importance of companies swiftly and responsibly investigating and remediating indications of possible misconduct.

A compliance program should be designed by persons with relevant expertise and will typically include interactive training as well as written materials. Compliance policies should be reviewed periodically to assess their effectiveness and to make any necessary changes. Policies and procedures should fit with business realities. A rulebook that looks good on paper but is not followed will end up hurting rather than helping. There should be consistency in enforcing stated policies through appropriate disciplinary measures. Finally, there should be clear reporting systems in place both at the employee level and at the management level so that employees understand when and to whom they should report suspected violations and so that management understands the board's or committee's informational needs for its oversight purposes. A company may choose to appoint a chief compliance officer and/or constitute a compliance committee to administer the compliance program, including facilitating employee education and issuing periodic reminders. If there is a specific area of compliance that is critical to the company's business, the company may consider developing a separate compliance apparatus devoted to that area.

### **Special Considerations Regarding Cyber security Risk**

The ever-increasing dependence on technological advances that characterizes all aspects of business and modern life has been accompanied by a rapidly growing threat of cybercrime, the cost of which, according to a 2017 report by Herjavec Group, is expected to grow to more than \$6 trillion annually by 2021. As recent examples (e.g., the hacking of computer networks belonging to the SEC and to Equifax) have highlighted, network security breaches, damage to IT infrastructure and theft of personal data, trade secrets and commercially sensitive information are omnipresent risks that pose a significant financial and reputational threat to companies of all kinds. With computing devices increasingly embedded in everyday items and connected to the "Internet of Things," virtually all company functions across all industries are exposed to cybersecurity risk.

In light of the growing number of successful cyber-attacks on even the most technologically sophisticated entities,



lawmakers and regulators in the United States and abroad have increased their attention to cybersecurity risk. In the United States, regulatory and enforcement activity relating to cybersecurity has continued to ramp up at the state level. Internationally, the European Union's General Data Protection Regulation (GDPR) will take effect in May 2018, significantly increasing data handling requirements for companies with even a minimal European nexus. Companies are thus facing a two-front storm, with regulatory risks compounding the security threat.

In response, engaged corporate leaders should implement comprehensive cyber security risk mitigation programs, deploying the latest defensive technologies without losing focus on core security procedures like patch installation and employee training, executing data and system testing procedures, implementing effective and regularly exercised cyber incident response plans, and ensuring that the board is engaged in cyber risk oversight.

As cyber security risk continues to rise in prominence, so too has the number of companies that have begun to specifically situate cyber security and cyber risk within their internal audit function. A recent Internal Audit Capabilities and Needs Survey, conducted by Protiviti, found that 73% of the companies surveyed now include cyber security risk as part of their internal audit function, up from 53% in 2015. Directors should assure themselves that their company's internal audit function is performed by individuals who have appropriate technical expertise and sufficient time and resources to devote to cyber security risk. Further, the internal audit team should understand and periodically test the company's risk mitigation strategy, and provide timely reports on cyber security risk to the board's audit committee.

In satisfying their risk oversight function with respect to cyber security, boards should evaluate their company's preparedness for a possible cyber security breach, as well as the company's action plan in the event that a cyber security breach occurs. With respect to preparation, boards should consider the following actions, several of which are also addressed in The Conference Board's "A Strategic Cyber-Roadmap for the Board" released in November 2016:

- identify the company's "Crown Jewels"—i.e., the company's mission-critical data and systems—and work with management to apply appropriate measures outlined in the National Institute of Standards and Technology (NIST) Framework;
- ensure that an actionable cyber incident response plan is in place that, among other things, identifies critical personnel and designates responsibilities; includes procedures for containment, mitigation and continuity of operations; and identifies necessary notifications to be issued as part of a pre-existing notification plan;
- ensure that the company has developed effective response technology and services (e.g., off-site data back-up mechanisms, intrusion detection technology and data loss prevention technology);
- ensure that prior authorizations are in place to permit network monitoring;
- ensure that the company's legal counsel is conversant with technology systems and cyber incident management to reduce response time; and
- establish relationships with cyber information sharing organizations and engage with law enforcement before a cyber-security incident occurs.

### **Special Considerations Regarding Environmental, Social and Governance (ESG) Risks**

ESG risks represent a specific subset of general risks that a company must manage where relevant, by identifying and mitigating company-specific risks, such as environmental liabilities, labor standards, consumer and product safety and leadership succession, and contingency planning for macro-level risks, including by identifying supply chain and energy alternatives and developing backup recovery plans for climate change and other natural disaster scenarios. While boards have been overseeing management of such material risks for

as long as they have existed, increasing scrutiny in 2017 to ESG issues by the public and some of the largest institutional investors in the world now call for special attention to be paid to ensuring that the board is satisfied as to how ESG-related risks specifically are being evaluated, disclosed and managed. As stated in a letter by Chairman and CEO of BlackRock, Laurence D. Fink, “In the current environment ... stakeholders are demanding that companies exercise leadership on a broader range of issues. And they are right to: a company’s ability to manage environmental, social, and governance matters demonstrates the leadership and good governance that is so essential to sustainable growth. State Street has been a vocal advocate of ESG risk oversight, and in 2016 and 2017 issued a series of frameworks and reports for directors regarding such matters, especially as to integrating sustainability and ESG-related risk matters into corporate strategy.

In the 2017 proxy season, the most common shareholder proposal topics related to social and environmental issues, and in certain instances, these proposals were backed for the first time by major institutional investors, whose voting positions on such issues have evolved. A 2018 proxy season report by Ernst & Young revealed that, of the 79% of investors who believe climate change is a significant risk factor, 61% believe that enhanced reporting should be the biggest priority for companies (over changes in company strategy or business practices). Boards and management teams can therefore expect that major investors will continue to assess companies’ posture toward climate change-related matters and risks. It is also notable that, for the 2018 proxy season, ISS expanded the conditions under which it will recommend voting in favor of shareholder proposals requiring such disclosures.

As the public conversation on the role of companies in addressing environmental and social issues continues to evolve, boards should consider how their risk oversight role specifically applies to ESG-related risk. In large part, the board’s function in overseeing management of ESG-related risks, such as supply chain disruptions, energy sources and alternatives, labor practices and environmental impacts involves issue-specific application of the risk oversight practices discussed in this memo. However, due to the fact that the public and investors have increasingly begun to scrutinize how a company addresses ESG issues, the board should ensure that its risk oversight role is satisfied in regards to ESG risk management.

ESG matters often have important public, investor and stakeholder relations dimensions. The board should work with management to identify ESG issues that are pertinent to the business and its customers and decide what policies and processes are appropriate for assessing, monitoring and managing ESG risks. The board should also be comfortable with the company’s approach to external reporting of the company’s overall approach, response and progress on ESG issues. It is also increasingly important for directors and management who engage with shareholders to educate themselves and become conversant on the key ESG issues facing the company.

In certain cases, the board may wish to consider receiving regular briefing on relevant ESG matters and the company’s approach to handling them. Creating more focused board committees or sub-committees, such as a “corporate responsibility and sustainability” committee that is specifically tasked with oversight of specified ESG matters or updating existing committee charters and board-level corporate governance guidelines to address the board’s approach to such topics may also be considered. Of course, the board should ensure that any committee tasked with ESG risk oversight properly coordinates with any other committees tasked with other types of risk oversight (i.e., the audit committee) so that the board as a whole is satisfied.

### Anticipating Future Risks

The company’s risk management structure should include an ongoing effort to assess and analyze the most likely areas of future risk for the company, including how the contours and interrelationships of existing risks may change and how the company’s processes for anticipating future risks are developed. This includes understanding risks inherent in the company’s strategic plans, risks arising from the competitive landscape and the potential for technology and other developments to impact the company’s profitability and prospects for sustainable, long-term value creation. Anticipating future risks is a key element of avoiding or mitigating those



risks before they escalate into crises. In reviewing risk management, the board or relevant committees should ask the company's executives to discuss the most likely sources of material future risks and how the company is addressing any significant potential vulnerability.

### **Risk Mitigation Approaches- Enterprise Risk Management**

Risk management, also known as Enterprise Risk Management ("ERM"), is a systematic and holistic approach for firms to address all their risks, whether operational, strategic or financial, comprehensively. ERM focuses on identifying risks, developing and monitoring a risk management system and reacting to risk events, when they occur. As ERM is a firm wide effort to manage all the firm's risks, involvement by the company's board of directors and senior management is imperative. In India, both the Companies Act, 2013 and the Listing Guidelines view risk management practices as one of the fundamental functions of the board of directors.

Beginning in the mid-1980s, the Committee of Sponsoring Organizations of the Treadway Commission (COSO), initially formed in part to study fraudulent financial reporting, began to articulate a risk management framework. In 2004, following several corporate governance scandals around the world, COSO issued a detailed report defining ERM as "... a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives." The COSO approach presents eight interrelated components of ERM:

- internal environment (the tone of the organization),
- setting objectives,
- event identification,
- risk assessment,
- risk response,
- control activities,
- information and communications, and
- monitoring

The significance of ERM can be seen in the value it creates when effectively implemented and the value it destroys when there are shortcomings in leadership and implementation.

- i) *Value creation*: ERM is a critical component of value creation. To create value successfully, ERM must play a central role in every substantive business decision. Effective ERM can enable a company to manage potential future events that create uncertainty, and respond to uncertainty in a manner that reduces the likelihood of downside surprises. ERM can also help a company improve the quality of risk taking and thereby, give the company a competitive advantage.
- ii) *Avoiding value destruction*. A company cannot preserve its value if its ERM is below standard. This role of preserving corporate value is far more visible when ERM fails than when it succeeds. Failures in risk management have contributed to some of the most significant scandals and losses suffered by companies. Recent significant failures include environmental disasters (e.g. BP), financial fraud (e.g. Enron, WorldCom, Satyam), foreign bribery (e.g. Siemens) and massive trading losses (e.g. JP Morgan). According to the OECD, these risk management failures were often "facilitated by corporate governance failures, where boards did not fully appreciate the risks that the companies were taking (if they were not engaging in reckless risk-taking themselves), and/or deficient risk management systems.

**Case Study: BP's deep water oil spill**

On April 20, 2010, an explosion at BP's offshore oil drilling rig caused by a blowout resulted in the death of 11 people and ignited a fireball that continued for 36 hours until the rig sank. This left the well gushing at the seabed for 87 days, resulting in the largest oil spill in U.S. waters and devastating the economy and coastline in the Gulf of Mexico Region. BP itself suffered considerably as a result of the spill; criminal and civil settlements to date have cost the company tens of billions of dollars. The accident was not a first for BP which only 5 years previously had sustained a deadly explosion at a Texas refinery. Several investigative reports generated after the 2005 explosion identified significant risk issues including lack of uniform safety culture, lack of effective early warning systems, lack of effective education and training, and inadequate senior management oversight. By the time the deep water horizon spill occurred 5 years later, BP's board and senior management had still not created systems for addressing many of these issues, according to BP's own accident report in 2010. The failure of the BP Board to implement an effective ERM system, even 5 years after its ERM weaknesses were exposed by the 2005 explosion, demonstrates the Board's shortcomings. BP's ERM failure proved to be disastrous not only for BP, but also for the environment.

**Corporate Governance and Risk Management: The Role of the Board**

Corporate governance and effective ERM go hand in hand. While directors are not involved in the everyday management of risk, the board plays an important oversight role in ERM by guiding and reviewing the company's risk policy and ensuring that an effective risk management system is in place. The enhanced communication between board and business units that underlies ERM can facilitate and strengthen the board's role in both decision-making and monitoring. Particularly since the onset of the global financial crisis in 2008, ERM has come to the forefront of board discussions. Recognizing that risk management failures can severely impact the board's reputation, shareholder advisory groups in some jurisdictions, such as the US, include risk oversight as a criteria for voting recommendations regarding board members. Further, board members may also be subject to liability for failure to monitor risks. US courts have found that directors can be liable where there is "sustained or systemic failure of the board to exercise oversight such as an utter failure to attempt to assure [that] a reasonable information and reporting system exists."

**Challenges facing Boards of Directors in developing ERM**

Over the past several years, corporate India has become much more engaged with and sensitized to ERM. Leading companies have formed risk management and compliance teams that are integrated within the firm and that provide valuable information to the board. Nevertheless, there is room for improvement.

Indian boards face significant challenges in designing and implementing an effective ERM system, including:

- a) *Effectively linking risk and strategy*: Integrating risk management into the overall corporate strategy is a challenge for many India firms. The challenge is to have an ERM system that encompasses a process capable of being applied in strategy setting across the enterprise. "Effective risk management is not about eliminating risk taking, which is a fundamental driving force in business and entrepreneurship." In other words, taking appropriate risk needs to be at the heart of corporate strategy. For this to happen, the board must understand and guide the company's appetite and ability to take risk, and communicate the same to the company's risk management team. Operationally, what does 'tying risk with strategy' mean for management? It means that risk managers must be integrated in implementing the company's strategy and must not be separated from the board and management, so that the actual risk taken is tied to the company's risk appetite and ability. Moreover, the ERM programs must be developed with input from various functions in the organization, such as finance, sales, legal etc.
- b) *Implementing cost-effective risk management for small and medium-sized enterprises*: While the costs of risk management failures can be high, designing and implementing efficient ERM can also be quite costly, especially for small and medium-sized firms. For example, hiring consultants or the necessary

staff to develop stress-testing and early warning systems to alert the board regarding significant risks can be difficult to do in smaller companies. In addition, while large firms can establish a 'chief risk officer' function with direct report to the board, doing so is much harder for smaller companies.

- c) *Addressing all major areas of risk:* ERM requires a firm to take a portfolio view of risk; boards must consider how various risks inter-relate, rather than treating each business and risk individually. This is a significant challenge for many boards.
- d) *Mitigating new risks:* In India, many complex areas of risks have emerged in the last decade or so, which has made risk management particularly challenging. For example, some traditional areas of risk, such as political instability and strikes and unrest, appear to have subsided while others, such as information and cyber security as well as terrorism and insurgency, have increased in prominence. Companies in a wide variety of industries have experienced the theft of data and sensitive information. For companies in major cities, the threat of terror attacks has become a growing cause for concern, which can be hard to manage by the company itself. According to a 2015 survey, the top five risks for Indian firms include:
  - corruption, bribery and corporate fraud;
  - information and cyber security;
  - terrorism and insurgency;
  - business espionage; and
  - Crime;

### ***Enhancing the Board's risk management role***

There are important steps that boards need to take to enhance the risk management system of a firm and the board's own role in risk oversight. A COSO 2009 enterprise risk management release recommends that board members must:

- Understand the company's risk philosophy and concur with its risk appetite.
- Review the company's risk portfolio against that appetite.
- Know the extent to which management has established effective enterprise risk management.
- Be apprised of the most significant risks and whether management is responding appropriately.

To accomplish all these, certain review mechanisms are necessary on the part of the board, which have been detailed in COSO's 2010 progress report; the board must, inter alia, review:

- The company's procedures for (a) identifying when risks arise and (b) the actions to be taken if material risks arise;
- The quality and types of risk-related information provided to the board;
- Management's implementation of the company's risk policies and procedures and their communication across the firm;
- The company's risk management functions;
- Reports from internal and external experts, such as auditors, legal counsel and analysts, to ensure that appropriate risks are being considered;
- Whether the board members primarily tasked with risk oversight have the necessary experience, knowledge and expertise to oversee the company's risk management matters, and provide directors risk education as necessary;

- The qualifications and backgrounds of risk management personnel and policies applicable to the risk management personnel, to assess whether they are appropriate in their positions while giving consideration to the companies size and scope of operations;

The importance of corporate governance in risk management is amply supported by the reasoning of the Kumar Mangalam Birla – member of the Committee on Corporate Governance to implement corporate governance in India. Risk Management is thus an integral component of corporate governance and good management. There is a growing realization that corporate governance has an impact on enterprise risk management. Several large companies and financial institutions worldwide no longer exist or have been taken over precisely because they neglected the basic rules of risk management and control. Some common risk management problems in relation to corporate governance that appeared in many financial institutions before and during the crisis according to the OECD (2009) was because:

- Risks were frequently not linked to strategy which is a key issue to ensuring that risk management has a focus on the business context;
- Risk definitions are often poorly expressed. Better risk definitions (context, event, consequence) are contrary to a lot of current thinking in risk management which has shorten risk descriptions to the smallest number of words possible;
- Organizations weren't always in a position to develop intelligent responses to risks;
- Boards didn't take stakeholders and guardians into account in detailing responses to risk;
- Important parts of the value chain were outsourced to others.

### LESSON ROUND UP

- Crisis management is the identification of threats to an organization and its stakeholders, and the methods used by the organization to deal with these threats.
- Any business, large or small, may run into problems that may negatively impact its normal course of operations. Crises such as a fire, death of a CEO, terrorist attack, data breach, or natural disasters can lead to tangible and intangible costs to a company in terms of lost sales, customers, and a decrease in the firm's net income.
- Types of Crisis- Natural Crisis; Technological Crisis; Confrontation Crisis; Crisis of Malevolence; Crisis of Organisational Misdeeds; Crisis due to Workplace Violence; Crisis due to Rumours; Bankruptcy; Crisis due to Natural Factors; Sudden Crisis and Smouldering Crisis.
- Professional liability insurance protects professionals such as accountants, lawyers and physicians against negligence and other claims initiated by their clients. It is required by professionals who have expertise in a specific area because general liability insurance policies do not offer protection against claims arising out of business or professional practices such as negligence, malpractice or misrepresentation.
- Professional Indemnity Insurance is a type of business insurance, typically for organizations that provide consultation or any professional services to its clients. Professional indemnity insurance covers claims made by the businesses in case their clients have sued them for making them endure any significant financial loss due to their advices and services.
- Directors and officers (D&O) liability insurance is insurance coverage intended to protect individuals from personal losses if they are sued as a result of serving as a director or an officer of a business or other type of organization (see How to Protect Your Assets from a Lawsuit or Creditors). It can also cover the legal fees and other costs the organization may incur as a result of such a suit.

### TEST YOURSELF

*(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)*

1. Crisis Management is not a Choice but an indispensable component of the business organisation. Discuss.
2. Taking a case of crisis management in corporate houses, throw light on its significance.
3. Write a short note on "Scenario of D&O Policy in India".
4. Discuss various risk management approaches from a company's perspective.

### LIST OF FURTHER READINGS

- 1) The D&O Book: A Comparison Guide To Directors & Officers Liability Insurance Policies Ring-bound – November 1, 1998 by Gary W., ARM Griffin (Editor), C.C., CPCU Griffin (Editor).
- 2) Directors and Officers Liability Insurance Deskbook, Fourth Edition by American Bar Association.
- 3) D&O 101: Understanding Directors and Officers Liability Insurance - A Holistic Approach by Larry Goanos.
- 4) Jackson & Powell on Professional Liability (Common Law Library).
- 5) The Backup Book: Disaster Recovery from Desktop to Data Center by Dorian Cougias, E. L. Heiberger, Karsten Koop, Schaser-Vartan Books.
- 6) Risk: A Practical Guide for Deciding What's Really Safe and What's Really Dangerous in the World Around You by David Ropeik, George Gray, Mariner Books

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- 1) <https://www.investopedia.com/terms/c/crisis-management.asp>
- 2) <https://www.managementstudyguide.com/types-of-crisis.htm>
- 3) <https://www.investopedia.com/terms/p/professional-liability-insurance.asp>
- 4) <https://www.insureon.com/products/policy-comparisons/general-liability-vs-professional-liability>
- 5) <http://www.cxotoday.com/story/9-reasons-directors-officers-insurance-is-must-for-organizations/>
- 6) [http://www.nishithdesai.com/fileadmin/user\\_upload/pdfs/Research%20Articles/Director\\_and\\_Officer\\_Liability\\_in\\_India.pdf](http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Articles/Director_and_Officer_Liability_in_India.pdf)
- 7) <https://www.indiablooms.com/finance-details/4531/rising-trend-in-uptake-of-d-and-o-insurance.html>
- 8) [http://asiainsurancepost.com/non\\_life-news/china-and-india-have-seen-growth-demand-liability-insurance](http://asiainsurancepost.com/non_life-news/china-and-india-have-seen-growth-demand-liability-insurance)
- 9) <https://www.foley.com/files/Event/1f2ed3ab-0356-4f69-83e8-082494863fd9/Presentation/EventAttachment/e47bcc69-7d79-4fc7-ad9a-342525a4dff6/Top%20Takeaways%20-%20Ten%20Things%20a%20Director%20Should%20Know%20About%20Her%20D%26O%20Policy.pdf>
- 10) <https://www.boardeffect.com/blog/do-insurance-nonprofit-boards/>
- 11) <https://corpgov.law.harvard.edu/2018/03/20/risk-management-and-the-board-of-directors-5/>
- 12) <https://corpgov.law.harvard.edu/2018/03/20/risk-management-and-the-board-of-directors-5/>
- 13) [https://www.nseindia.com/research/content/res\\_QB14.pdf](https://www.nseindia.com/research/content/res_QB14.pdf)

- 14) <https://researchleap.com/corporate-governance-and-risk-management-an-indian-perspective/>
- 15) <https://glean.info/case-study-coca-cola-pr-crisis-management/>
- 16) <https://www.semrush.com/blog/three-biggest-social-media-management-nightmares-2017/>

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# Lesson 9\*

## Misrepresentation and Malpractices – Civil and Criminal Trial Procedure

### LESSON OUTLINE

- Object of Trial
- Criminal Proceeding vis-a-vis Civil Proceeding
- Criminal Courts and Civil Courts
- Public Prosecutors and Company Prosecutors
- Criminal Courts and their Powers
- Courts under the Companies Act, 2013
- Trial Procedure for Summon Cases
- Framing of Charge
- Summoning of Witnesses of Prosecution
- Can a Person be Prosecuted again for the Same Offence?
- Trial Procedure before a Sessions Court
- Wrongful Conviction – A Case Study
- Erroneous Interpretations and Consequent Effects – A Case Study
- Offences Relating to Perjury
- Appeals under CRPC
- Appeal in Case of Acquittal
- Powers of the Appellate Court
- Powers of the Supreme Court
- Continuing Offences
- Diverting Properties of the Company
- LESSON ROUND UP
- TEST YOURSELF

### LEARNING OBJECTIVES

The lesson cover –

- Various aspects under Code of Criminal Procedures relevant for dealing with the various judicial authorities.
- Courts under the Companies Act, 2013
- Appeals under various forums
- Continuing Offences

\* The content of the Lesson has been adopted from OFFENCES UNDER CORPORATE LAWS (2016) by Dr. K.S. Ravichandran, published by BLOOMSBURY, NEW DELHI

## REGULATORY FRAMEWORK

### 1. Companies Act, 2013

Section	Heading
408	Constitution of National Company Law Tribunal
409	Qualification of President and Members of Tribunal
410	Constitution of Appellate Tribunal
411	Qualifications of Chairperson and Members of Appellate Tribunal
412	Selection of Members of Tribunal and Appellate Tribunal
413	Term of Office of President, Chairperson and Other Members
414	Salary, Allowances and Other Terms and Conditions of Service of Members
415	Acting President and Chairperson of Tribunal or Appellate Tribunal
416	Resignation of Members
417	Removal of Members
417A	Qualifications, terms and conditions of service of Chairperson and Member.
418	Staff of Tribunal and Appellate Tribunal
419	Benches of Tribunal
420	Orders of Tribunal
421	Appeal from Orders of Tribunal
422	Expeditious Disposal by Tribunal and Appellate Tribunal
423	Appeal to Supreme Court
424	Procedure Before Tribunal and Appellate Tribunal
425	Power to Punish for Contempt
426	Delegation of Powers
427	President, Members, Officers, etc., to be Public Servants
428	Protection of Action Taken in Good Faith
429	Power to Seek Assistance of Chief Metropolitan Magistrate, etc.
430	Civil Court Not to Have Jurisdiction
431	Vacancy in Tribunal or Appellate Tribunal Not to Invalidate Acts or Proceedings

432	Right to Legal Representation
433	Limitation
434	Transfer of Certain Pending Proceedings
435	Establishment of Special Courts
436	Offences Triable by Special Courts
437	Appeal and Revision
438	Application of Code to Proceedings Before Special Court
439	Offences to be Non-cognizable
440	Transitional Provisions
441	Compounding of Certain Offences
442	Mediation and Conciliation Panel
443	Power of Central Government to Appoint Company Prosecutors
444	Appeal Against Acquittal
445	Compensation for Accusation Without Reasonable Cause
446	Application of Fines
446A	Factors for determining level of punishment
446B	Lesser penalties for One Person Companies or small companies.
447	Punishment for Fraud
448	Punishment for False Statement
449	Punishment for False Evidence
450	Punishment Where No Specific Penalty or Punishment is Provided
451	Punishment in Case of Repeated Default
452	Punishment for Wrongful Withholding of Property
453	Punishment for Improper Use of “Limited” or “Private Limited”
454	Adjudication of Penalties
454A	Penalty for repeated default.

2. The National Company Law Tribunal Rules, 2016
3. The National Company Law Appellate Tribunal Rules, 2016
4. Companies (Adjudication of Penalties) Rules, 2014

## 5. The Code of Criminal Procedure, 1973 (CrPc)

Section	Heading
4	Trial of offences under the Indian Penal Code and other laws..
5	Saving
28	Sentences which High Courts and Sessions Judges may pass.
29	Sentences which Magistrates may pass
30	Sentence of imprisonment in default of fine
31	Sentence in cases of conviction of several offences at one trial.
32	Mode of conferring powers.
33	Powers of officers appointed
34	Withdrawal of powers.
35	Powers of Judges and Magistrates exercisable by their successors-in-office.
61	Form of summons
62	Summons how served
63	Service of summons on corporate bodies and societie
64	Service when persons summoned cannot be found
154	Information in cognizable cases
155	Information as to non-cognizable cases and investigation of such cases.
195	Prosecution for contempt of lawful authority of public servants, for offences against public justice and for offences relating to documents given in evidence
197	Prosecution of Judges and public servants
204	Issue of process
205	Magistrate may dispense with personal attendance of accused
206	Special summons in cases of petty offence
220	Trial for more than one offence
225	Trial to be conducted by Public Prosecutor
226	Opening case for prosecution
227	Discharge
228	Framing of charge
229	Conviction on plea of guilty

230	Date for prosecution evidence
231	Evidence for prosecution
232	Acquittal
233	Entering upon defence
234	Arguments
235	Judgment of acquittal or conviction
236	Previous conviction
237	Procedure in cases instituted under section 199(2).
238	Compliance with section 207
239	When accused shall be discharged
240	Framing of charge
241	Conviction on plea of guilty
242	Evidence for prosecution
243	Evidence for defence
244	Evidence for prosecution
245	When accused shall be discharged
246	Procedure where accused is not discharged
247	Evidence for defence
248	Acquittal or conviction
249	Absence of complainant
250	Compensation for accusation without reasonable cause
251	Substance of accusation to be stated
252	Conviction on plea of guilty
253	Conviction on plea of guilty in absence of accused in petty cases
254	Procedure when not convicted
255	Acquittal or conviction
256	Non-appearance or death of complainant
257	Withdrawal of complaint
258	Power to stop proceedings in certain cases

259	Power of Court to convert summons-cases into warrant-cases
260	Power to try summarily
261	Summary trial by Magistrate of the second class
262	Procedure for summary trials
263	Record in summary trials
264	Judgment in cases tried summarily
265	Language of record and judgment
273	Evidence to be taken in presence of accused
274	Record in summons-cases and inquiries
279	Interpretation of evidence to accused or his pleader
300	Person once convicted or acquitted not to be tried for same offence
313	Power to examine the accused
314	Oral arguments and memorandum of arguments
340	Procedure in cases mentioned in section 195
372	No appeal to lie unless otherwise provided
374	Appeals from convictions
375	No appeal in certain cases when accused pleads guilty
376	No appeal in petty cases
378	Appeal in case of acquittal
386	Powers of the Appellate Court
395	Reference to High Court.
397	Calling for records to exercise powers of revision
398	Power to order inquiry
401	High Court's powers of revision
421	Warrant for levy of fine
482	Saving of inherent power of High Court

## INTRODUCTION

Section 408 and 410 of Companies Act, 2013 deals with the provisions of constitution of National Company Law Tribunal ("NCLT" or "the Tribunal and National Company Law Appellate Tribunal ("NCLAT" or "the Appellate Tribunal").

The Central Government has constituted National Company Law Tribunal (NCLT) under section 408 of the Companies Act, 2013 (18 of 2013) w.e.f. 01st June 2016. The setting up of the NCLT as a specialized institution for corporate justice is based on the recommendations of the Justice Eradi Committee. This committee was set up to examine the existing law relating to winding up proceedings of companies in order to re-model it in line with the latest developments and innovations in the corporate law and governance and to suggest reforms in the procedure at various stages followed in the insolvency proceedings of companies to avoid unnecessary delays in tune with the international practice in this field.

In the first phase the Ministry of Corporate Affairs have set up eleven Benches, one Principal Bench at New Delhi and ten Benches at New Delhi, Ahmadabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai. These Benches will be headed by the President and 16 Judicial Members and 09 Technical Members at different locations.

NCLT works on the lines of a normal Court of law in the country and is obliged to fairly and without any biases determine the facts of each case and decide with matters in accordance with principles of natural justice and in the continuance of such decisions, offer conclusions from decisions in the form of orders. The orders so formed by NCLT could assist in resolving a situation, rectifying a wrong done by any corporate or levying penalties and costs and might alter the rights, obligations, duties or privileges of the concerned parties. The Tribunal is exempted from the requirement to adhere severe rules with respect to appreciation of any evidence or procedural law.

Section 424 of the Companies Act, 2013 provides that the Tribunal and the Appellate Tribunal shall not, while disposing of any proceeding before it or, as the case may be, an appeal before it, be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice, and, subject to the other provisions of this Act or of the Insolvency and Bankruptcy Code, 2016 and of any rules made thereunder, the Tribunal and the Appellate Tribunal shall have power to regulate their own procedure.

The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging their functions under this Act or under the Insolvency and Bankruptcy Code, 2016, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:—

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or a copy of such record or document from any office;
- (e) issuing commissions for the examination of witnesses or documents;
- (f) dismissing a representation for default or deciding it ex parte;
- (g) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and
- (h) any other matter which may be prescribed.

All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.



- (a) in the case of an order against a company, the registered office of the company is situate; or
- (b) in the case of an order against any other person, the person concerned voluntarily resides or carries on business or personally works for gain.

All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Students are advised to refer the study material of the subject Corporate Restructuring, Insolvency, Liquidation & Winding-Up & for reading of the NCLT Rules, 2016 and the Jurisprudence, interpretation and general laws to understand the matters to be dealt by NCLT. However the some of the important rules are listed hereunder:

- Authorised Representative and Dress Code
- Code of Conduct
- Transferred Applications and Petitions
- Computation of Time Period
- Pleadings
- Inherent Powers of NCLT / NCLAT
- Powers to Exempt
- Procedure for Filing; size of paper; language; translation requirements and payment of fee
- Interlocutory Application
- Evidence by Affidavit
- Cross Examination
- Forfeiture of Right in certain cases relating Inspection / Investigation
- Counter / Rejoinder
- Right of Parties / Authorised Representative / Legal Practitioner and Prescribed Form for Memorandum of Appearance
- Registration of Interns
- Non – appearance and consequences – Petitioner / Respondent
- Ex-parte Hearing and Disposal
- Difference between Rule 49 and 110
- Substitution of Legal Representatives
- Effect of Noncompliance of Orders of NCLT
- Procedure for imposing penalty
- Amicus Curiae
- Recusal Matters earlier dealt with CLB
- Reference to the Tribunal

- Steps for Issue of Fresh Notice
- Award of Costs
- Inspection
- Discovery Production and Return of documents
- Examination of Witnesses and Issue of Commission
- Specimen Handwriting
- Enlargement of time

Since, The Tribunal and the Appellate Tribunal for the purposes of discharging their functions under the Companies Act or under the Insolvency and Bankruptcy Code, 2016 are having the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit.

Further, the proceedings before the Tribunal or the Appellate Tribunal are deemed to be judicial proceedings within the meaning of sections 193 (Punishment for false evidence). and 228 (Intentional insult or interruption to public servant sitting in judicial proceeding), and for the purposes of section 196 (Using evidence known to be false) of the Indian Penal Code, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 (*Prosecution for contempt of lawful authority of public servants, for offences against public justice and for offences relating to documents given in evidence*) and Chapter XXVI of the Code of Criminal Procedure, 1973(*Provisions as to offences affecting the administration of justice*).

### **CODE OF CRIMINAL PROCEDURE, 1973**

Code of Criminal Procedure, 1973 [CrPC] is a procedural law which came into force from 1 April 1974. CrPC applies to every offence punishable under the IPC or any other special or local law. The substantive law relating to offences could be any other law under which any commission or omission may create offences of various categories such as the *Indian Penal Code, 1860 [IPC]*, the *Prevention of Food Adulteration Act* etc. However, for offences under the *Companies Act, 2013* or the *Companies Act, 1956*, the substantive law is that Act itself. The trial procedure for offences under any law in India will be only in accordance with the provisions of CrPC, unless the law concerned has a different provision that provides a different procedure in any respect.

For instance, the *Companies Act, 2013* provides whether an offence is cognizable or not. It enables even the special courts to try the offences summarily. The nature of offence and the persons who are liable for the offence as well as punishment thereto have been prescribed under the *Companies Act, 2013*. However, the trial procedure is contained in the CrPC only.

CrPC is the law in relation to trial procedure and is applicable universally to the criminal activities, unless there is any express provision that introduces a non obstante clause to override CrPC.

While the substantive law creates and defines offences and prescribes penalties for commission of offences, CrPC contains a complete procedural code for trial of offences. It creates the machinery for detection of crime, apprehension of suspected criminals, collection of evidence, determination of the guilt or innocence of the suspected persons and the imposition of the suitable punishment on the guilty person. CrPC provides a clear mechanism for investigation and trial of offences through an effective administrative and judicial process enabling a speedy and less costly trial of offences.

Section 4 deals with trial of offences under the Indian Penal Code and other laws, it states that:

- (1) All offences under the Indian Penal Code shall be investigated, inquired into, tried, and otherwise dealt with according to the provisions hereinafter contained.
- (2) All offences under any other law shall be investigated, inquired into, tried, and otherwise dealt with

according to the same provisions, but subject to any enactment for the time being in force regulating the manner or place of investigating, inquiring into, trying or otherwise dealing with such offences.

According to Section 5 of the Act, nothing contained in this Code shall, in the absence of a specific provision to the contrary, affect any special or local law for the time being in force, or any special jurisdiction or power conferred, or any special form of procedure prescribed, by any other law for the time being in force.

As per section 4 of CrPC, offences under any other law other than the IPC shall be investigated, inquired into, tried and otherwise dealt with according to the provisions contained in CrPC, but subject to any enactment for the time being in force regulating the manner or place of investigating, inquiring into, trying or otherwise dealing with such offences. Section 5 of CrPC provides that nothing contained in this CrPC shall, in the absence of a specific provision to the contrary, affect any special or local law for the time being in force, or any special jurisdiction or power conferred, or any special form of procedure prescribed, by any other law for the time being in force. As such the jurisdiction given to ordinary criminal courts under section 4 read with section 5 would be excluded only when a special act applies. When the special act does not contain any different procedure for trial of offences under the said act, the procedure provided by CrPC should be followed.

## OBJECT OF TRIAL

The main object of a trial is to find out the truth and determine the innocence or the guilt of the accused. The concept of criminal justice system is to ensure that not even one innocent gets punished, though due to various reasons, many offenders would have escaped the clutches of law. Defaulters and offenders who have committed the default and the offence should not be spared even while providing a free and fair trial procedure.

Article 21 of the Constitution of India provides that no person shall be deprived of his life or personal liberty except according to procedure established by law. The object of Article 21 is to prevent encroachment upon personal liberty of a person save in accordance with law and in conformity with the provisions thereof. Hence, depriving the personal liberty of a person should be strictly in accordance with the provisions of natural justice and such deprivation should be in accordance with the procedure established by law.

Except with respect to offences involving fraud or *mens rea* or requiring proof of knowledge of involvement or consent or connivance, the general criminal law system of deeming that the accused is innocent until prosecution proves the guilt, does not apply. As rightly held by Supreme Court in *Chairman, SEBI v. Shriram Mutual Fund and Anor.*, AIR 2006 SC 2287, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the act and the regulation is established and hence, the intention of the parties committing such violation becomes wholly irrelevant.

Though the above decision was rendered in the context of securities laws such as the SEBI Act which provides for levy of penalty, it must be understood that levy of penalty has no criminal connotation and it is certainly different from a sentence or fine that a criminal court may pass within the limits of the penal clause of the *Companies Act, 2013* (or for that matter on the basis of the *Companies Act, 1956*). Most of the offences under the *Companies Act, 1956 or 2013* invite strict liability for the company and also for its Officers in Default without any proof of guilty frame of mind. Therefore, there is no role for the principle that the accused is innocent until proved guilty by the prosecution. It is another story that despite such technical offences and summary trials, a number of criminal cases filed in several courts across the country have never reached their logical conclusion at all, for years together. Moreover, the general principle that the pecuniary circumstances or as the case may be the solvency or financial status of the company and its directors and officers in default do not matter as the penal provision seeks to impose a minimum fine in many cases.

If a director or officer deserves relief, he has to apply to the Court as enabled under section 463 of the *Companies Act, 2013* or section 633 of the *Companies Act, 1956*, whichever is applicable. In exercise of powers under section 463 of the *Companies Act, 2013* or section 633 of the *Companies Act, 1956*, whichever is applicable, it is possible for the Court trying the offence to reduce the fine to an amount which is less than the minimum fine

prescribed under the relevant penal clause of the *Companies Act*. Therefore, it would be absolutely necessary to make an application to the Court seeking necessary relief invoking section 463 of the *Companies Act, 2013* or section 633 of the *Companies Act, 1956*, whichever is applicable, so that the court or the special court is able to exercise its power under the said section and grant complete or partial relief.

## **CRIMINAL PROCEEDING VIS-A-VIS CIVIL PROCEEDING**

A civil proceeding is concerned with a civil right, whether with reference to common law or a law created by any statute. A civil proceeding is distinguished from a criminal proceeding by the fact that if the criminal proceeding is taken to a logical conclusion and if the accused is found guilty, there may be imposition of a sentence of fine or imprisonment or both including a capital punishment, if the statute so provides. In civil proceeding there may be an award of compensation and damages. A criminal proceeding includes all proceedings which are capable of being instituted under ordinary criminal law of land and is not confined to proceedings under CrPC. Prosecution of an offence under the *Companies Act, 2013* or for that matter those under the *Foreign Exchange Management Act, 1999* or the *Securities and Exchange Board of India Act, 1992* or the *Securities Contracts (Regulation) Act, 1956* and other statutes are criminal proceedings and the complaints filed are criminal cases and, subject to provisions of such statutes, CrPC will apply to regulate the trial of offences under such laws.

In *M.S. Sheriff v. The State of Madras and Ors.* AIR 1954 SC 397, the following propositions were laid down: In Para 16:

“We are informed at the hearing that the two further sets of proceedings arising out of the same facts are now pending against the appellants. One is two civil suits for damages for wrongful confinement. The other is two criminal prosecutions under section 344, Indian Penal Code for wrongful confinement, one against each Sub-Inspector. It was said that the simultaneous prosecution of these matters will embarrass the accused. But after the hearing of the appeal we received information that the two criminal prosecutions have been closed with liberty to file fresh complaints when the papers are ready, as the High Court records were not available on the application of the accused. As these prosecutions are not pending at the moment, the objection regarding them does not arise but we can see that the simultaneous prosecution of the present criminal proceedings out of which this appeal arises and the civil suits will embarrass the accused. We have therefore to determine which should be stayed”.

In Para 17:

“As between the civil and the criminal proceedings we are of the opinion that the criminal matters should be given precedence. There is some difference of opinion in the High Courts of India on this point. No hard and fast rule can be laid down but we do not consider that the possibility of conflicting decisions in the civil and criminal courts is a relevant consideration. The law envisages such an eventuality when it expressly refrains from making the decision of one court binding on the other, or even relevant, except for certain limited purposes, such as sentence or damages. The only relevant consideration here is the likelihood of embarrassment”.

In Para 18, on the question of staying a proceeding on the ground there is another proceeding:

“Another factor which weighs with us is that a civil suit often drags on for years and it is undesirable that a criminal prosecution should wait till everybody concerned has forgotten all about the crime. The public interests demand that criminal justice should be swift and sure; that the guilty should be punished while the events are still fresh in the public mind and that the innocent should be absolved as early as is consistent with a fair and impartial trial. Another reason is that it is undesirable to let things slide till memories have grown too dim to trust. This, however, is not a hard and fast rule. Special considerations obtaining in any particular case might make some other course more expedient and just. For example, the civil case or the other criminal proceeding may be so near its end as to make it inexpedient to stay it in order to give precedence to a prosecution ordered under Section 476. But in this case we are of the view that the civil suits should be stayed till the criminal proceedings have finished”.

In *Iqbal Singh Marwah v. Meenakshi Marwah and Anor.* AIR 2005 SC 2119, the five member bench of the Supreme Court held that “it is necessary to point out that the standard of proof required in the two proceedings are entirely different. Civil cases are decided on the basis of preponderance of evidence while in a criminal case the entire burden lies on the prosecution and proof beyond reasonable doubt has to be given. There is neither any statutory provision nor any legal principle that the findings recorded in one proceeding may be treated as final or binding in the other, as both the cases have to be decided on the basis of the evidence adduced therein”.

## CRIMINAL COURTS AND CIVIL COURTS

The Gujarat High Court in *Natvarlal A.Jani v. N.N Jain, Chairman and Managing Director, Prestige Foods Limited* [1999] 98 Comp Cas 720 (Guj), observed as follows:

- The civil liability or responsibility arising out of a civil nature under a statute is one thing and it is another thing that the penalty imposed by that very statute necessarily has to be treated under CrPC read with relevant provisions of the statute which makes that particular act an offence.
- The civil court, ordinarily is to be understood with reference to the Civil Procedure Code and whenever there is a reference to a principal court of original jurisdiction, it would be a District Court and that was originally known in the Act.
- Very rarely the High Court came into the picture as the court of first instance.
- Once it is an offence, obviously, no civil court can exercise its jurisdiction and the punishment has to be awarded by a competent court established under CrPC.
- It is not to say that the statute creating an offence may not provide for a forum duly empowered to deal with penal provisions.

## Saving of Inherent Powers of Court

Section 151 of the Civil Procedure Code says ‘Nothing in this Code shall be deemed to limit or otherwise affect the inherent power of the Court to make such orders as may be necessary for the ends of justice or to prevent abuse of the process of the Court.’

Though it does not confer any specific power to the Courts, it is one of the most used sections of the Code in litigation. Any situation that is not covered under the Code can be brought under this Section. The scope of Section 151 CPC has been explained by the Supreme Court in the case *K.K. Velusamy v. N. Palanisamy* (2011) 11 SCC 275 as follows:

- (a) Section 151 CPC is not a substantive provision which creates or confers any power or jurisdiction on courts. It merely recognises the discretionary power inherent in every court as a necessary corollary for rendering justice in accordance with law, to do what is “right” and undo what is “wrong”, that is, to do all things necessary to secure the ends of justice and prevent abuse of its process.
- (b) As the provisions of the Code are not exhaustive, Section 151 recognises and confirms that if the Code does not expressly or impliedly cover any particular procedural aspect, the inherent power can be used to deal with such situation or aspect, if the ends of justice warrant it. The breadth of such power is coextensive with the need to exercise such power on the facts and circumstances.
- (c) A court has no power to do that which is prohibited by law or the Code, by purported exercise of its inherent powers. If the Code contains provisions dealing with a particular topic or aspect, and such provisions either expressly or by necessary implication exhaust the scope of the power of the court or the jurisdiction that may be exercised in relation to that matter, the inherent power cannot be invoked in order to cut across the powers conferred by the Code or in a manner inconsistent with such provisions.

In other words the court cannot make use of the special provisions of Section 151 of the Code, where the remedy or procedure is provided in the Code.

- (d) The inherent powers of the court being complementary to the powers specifically conferred, a court is free to exercise them for the purposes mentioned in Section 151 of the Code when the matter is not covered by any specific provision in the Code and the exercise of those powers would not in any way be in conflict with what has been expressly provided in the Code or be against the intention of the legislature.
- (e) While exercising the inherent power, the court will be doubly cautious, as there is no legislative guidance to deal with the procedural situation and the exercise of power depends upon the discretion and wisdom of the court, and in the facts and circumstances of the case. The absence of an express provision in the Code and the recognition and saving of the inherent power of a court, should not however be treated as a *carte blanche* to grant any relief.
- (f) The power under Section 151 will have to be used with circumspection and care, only where it is absolutely necessary, when there is no provision in the Code governing the matter, when the bona fides of the applicant cannot be doubted, when such exercise is to meet the ends of justice and to prevent abuse of process of court.

## **PUBLIC PROSECUTORS AND COMPANY PROSECUTORS**

Criminal cases are prosecuted by the State representing the public and the society. Public prosecutors carry out the prosecution in such cases. The role of a prosecutor lies in placing before the court all the material and evidences, whether it helps the accused or otherwise.

Section 24(7) of CrPC states that a person shall be eligible to be appointed as a Public Prosecutor or an Additional Public Prosecutor only if he has been in practice as an advocate for not less than 7 years. Section 24(8) of CrPC states that the Central Government or the State Government may appoint, for the purposes of any case or class of cases, a person who has been in practice as an advocate for not less than 10 years as a Special Public Prosecutor.

In *S. Thamizharasan v. The State of Tamil Nadu*, 2010 - 2 MLJ (Cri) 715 rep. by Secretary to Government, (Home Courts), Mr. M.K. Jhah, IPS, Director of Prosecution and N. Chanbagaraman, IPS, Director of Prosecution, 2010 (1) CTC 229, the Madras High Court held that –

“the Office of the Public Prosecutor is a very responsible Office and he has an important role to play in the Criminal Justice Delivery System. The Public Prosecutors are to be independent, unbiased and impartial while conducting prosecution. The Public Prosecutor is not a Police Prosecutor in the sense that he is not a mouthpiece of the Police, for he is not an Advocate engaged by the State to conduct its prosecutions. Therefore, the Prosecutors cannot be allowed to be controlled either administratively or in any other mode by the Police Department”. It was further held that “as held repeatedly by the Hon’ble Supreme Court and various High Courts that there should be complete separation of Public Prosecutors, Additional Public Prosecutors, Special Public Prosecutors and Assistant Public Prosecutors from the control or supervision in any form by the Police, as otherwise, such control or supervision would only invade into the independence of the institution of Prosecutors, which would only bring harm to the Criminal Justice Delivery System”.

As held by the Supreme Court, (as eminent Justice *V R Krishna Iyer* wrote) in *Balwant Singh and Ors. v. State of Bihar*, AIR 1977 SC 2265 that “the Criminal Procedure Code is the only matter of the public prosecutor and he has to guide himself with reference to Criminal Procedure Code only”.

When a Registrar or any other person duly authorized /entitled, to file a complaint for any offence under the *erstwhile* Companies Act, 1956, files a complaint, the prosecution is conducted in the trial court by a special category of officers called Company Prosecutors. They were appointed under section 624A of the *erstwhile*



*Companies Act, 1956* by the Central Government. The company prosecutors have all the powers and privileges of public prosecutors appointed by State Government under section 24 of CrPC.

Under the newly inserted section 443 of the *Companies Act, 2013* it has been provided that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Central Government may appoint generally, or for any case, or in any case, or for any specified class of cases in any local area, one or more persons, as company prosecutors for the conduct of prosecutions arising out of this act and the persons so appointed as company prosecutors shall have all the powers and privileges conferred by the Code on Public Prosecutors appointed under section 24 of the Code.

## CRIMINAL COURTS AND THEIR POWERS

Courts of Magistrates are the basic courts for conducting trial of criminal offences. In Metropolitan Cities such as Mumbai, Kolkata and Chennai, respectively the capitals of the States of Maharashtra, West Bengal and Tamil Nadu, have special category of Magistrates called Presidency Magistrates / Chief Metropolitan Magistrates.

The following are the powers of Criminal Courts [Section 28 and 29 of CrPC]:

Name of the Court	Power
High Court	To award any sentence as authorized by a substantive law.
Sessions Judge / Additional Sessions Judge	To award any sentence authorized by a substantive law. Sentence of death should be subject to confirmation by High Court.
Assistant Sessions Judge	To award imprisonment up to 10 years and/or fine. For fine, no upper limit has been prescribed.
Chief Judicial / Chief Metropolitan Magistrate	To award imprisonment up to 7 years and / or fine. For fine, no upper limit has been prescribed.
Judicial Magistrates of Class I / Metropolitan Magistrates/ Sub- divisional Judicial Magistrates	To award imprisonment up to 3 years or fine up to INR 10,000/-, or both.

Deviating from CrPC, section 435 of the *Companies Act, 2013* states that offences that are punishable with imprisonment of two years or more shall be tried by special courts established or designated as stated under clause (a) of sub section 2 of section 435 and other offences shall be tried by special courts established or designated as stated under clause (b) of sub section 2 of section 435 viz. a Metropolitan Magistrate or a Judicial Magistrate of the First Class..

In the light of the limitations section 28 and section 29 on the powers of the respective criminal courts. One has to see if such courts upon which power to try offences under the *Companies Act, 2013* have been conferred would have powers to award the prescribed punishment.

## COURTS UNDER THE COMPANIES ACT, 2013

Section 2(29) of the *Companies Act, 2013* defines and declares what “court” means. For different purposes, different courts are the relevant courts.

Section 2(29)(i) states that Court means the High Court having jurisdiction in relation to the place at which the registered office of the company concerned is situate, except to the extent to which jurisdiction has been conferred on any district court or district courts subordinate to that High Court under sub-clause (ii).



Section 2(29)(ii) states Court means the district court, in cases where the Central Government has, by notification, empowered any district court to exercise all or any of the jurisdictions conferred upon the High Court, within the scope of its jurisdiction in respect of a company whose registered office is situate in the district.

Further, with specific reference to offences under the *Companies Act, 2013*, section 2(29) states as under:

- Section 2(29)(iii) states that Court means the Court of Session having jurisdiction to try any offence under this Act or under any previous company law;
- Section 2(29)(iv) states that Court means the Special Court established under section 435;
- Section 2(29) (v) states that Court means any Metropolitan Magistrate or a Judicial Magistrate of the First Class having jurisdiction to try any offence under this Act or under any previous company law;

Thus, for the purpose of trying offences under the *Companies Act, 2013* or as the case may be for offences arising under the *Companies Act, 1956*, there are only three courts - viz., the Court of Session; the Special Court if established or designated by Central Government under section 435 of the *Companies Act, 2013* and the Court of the Metropolitan Magistrate or a Judicial Magistrate of the First Class having jurisdiction to try any offence under the *Companies Act, 2013* or any previous company law.

Section 1(4) of the *Companies Act, 2013* declares that the provisions of the *Companies Act, 2013* applies to companies incorporated under any previous company law.

Section 2(20) says that “company” means a company incorporated under this Act or under any previous company law.

The expression “previous company law” has been clearly defined under section 2(67). Section 2(67) states “previous company law” means any of the laws specified below: –

- i. Acts relating to companies in force before the *Indian Companies Act, 1866*;
- ii. the Indian Companies Act 1866<sup>1</sup>
- iii. the Indian Companies Act, 1882;
- iv. the Indian Companies Act, 1913;
- v. the Registration of Transferred Companies Ordinance, 1942;
- vi. the Companies Act, 1956; and
- vii. any law corresponding to any of the aforesaid Acts or the Ordinances and in force—
  - a. in the merged territories or in a Part B State (other than the State of Jammu and Kashmir), or any part thereof, before the extension thereto of the Indian Companies Act, 1913; or
  - b. in the State of Jammu and Kashmir, or any part thereof, before the commencement of the Jammu and Kashmir (Extension of Laws) Act, 1956, in so far as banking, insurance and financial corporations are concerned, and before the commencement of the Central Laws (Extension to Jammu and Kashmir) Act, 1968, in so far as other corporations are concerned;
- viii. the Portuguese Commercial Code, in so far as it relates to *sociedades anonimas*<sup>1</sup>; and
- ix. the Registration of Companies (Sikkim) Act, 1961;

In view of section 2(29) of the *Companies Act, 2013*, inter alia, declaring that Court means (a) the Court of Session having jurisdiction to try any offence under this Act or under any previous company law; and (b)

<sup>1</sup> *Société Anonyme (S.A.)* is a French term for a public limited company (PLC) and has many equivalents all over the world. A *société anonyme* is the equivalent of a corporation in the United States (publicly-traded company or incorporated), a public limited company in the United Kingdom, or an *Aktiengesellschaft (AG)* in Germany. This type of business structure establishes a company as a legal person that can own and transfer property, enter contracts, and be held liable for crimes. One of its key benefits is that it limits the owners' personal liability for the company's actions.

the Court of the Metropolitan Magistrate or a Judicial Magistrate of the First Class having jurisdiction to try any offence under the *Companies Act, 2013* or any previous company law, it is necessary to see if the *Companies Act, 1956*, which is the immediate past previous company law contains provisions conferring jurisdiction upon any such courts. In fact, the *Companies Act, 1956* has not yet attained fully the position of a “Previous Company Law” in view of the fact that the whole of the *Companies Act, 2013* has not yet been made fully enforceable. Even if the whole of the *Companies Act, 2013* becomes fully operational and comes into force, in view of the language of Section 2(29) of the *Companies Act, 2013* it seems the *Companies Act, 1956* cannot be completely repealed.

Section 2(11) of the *erstwhile Companies Act, 1956* states that the expression “the court” means-

- a. with respect to any matter relating to a company (other than any offence against this act), the court having jurisdiction under this Act with respect to that matter relating to that company, as provided in section 10;
- b. with respect to any offence against this Act, the court of a Magistrate of the First Class, or, as the case may be, a Presidency Magistrate, having jurisdiction to try such offence.

Section 2(11)(b) is important in the context of offences under the *Companies Act, 1956*.

There is no reference to a Court of Session under the *Companies Act, 1956*.

The *Companies Act* seeks to establish a special court consisting of a single judge appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working. The Special Court has powers to try all the offences under this Act under the jurisdiction of which the registered office of the company is situated.

Section 435 of the *Companies Act, 2013*, as amended by the *Companies (Amendment) Act, 2017*, which came into force with effect from 7 May 2018 states as follows:

The Central Government may, for the purpose of providing speedy trial of offences under this Act, by notification, establish or designate as many Special Courts as may be necessary.

(2) A Special Court shall consist of –

- (a) a single judge holding office as Session Judge or Additional Session Judge, in case of offences punishable under this Act with imprisonment of two years or more; and
- (b) a Metropolitan Magistrate or a Judicial Magistrate of the First Class, in the case of other offences,

who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working

Section 436 of the *Companies Act, 2013* as amended by the *Companies (Amendment) Act, 2015* contains a very important provision with respect to trying offences and jurisdiction of courts.

Section 436(1) declares that notwithstanding anything contained in the Code of Criminal Procedure, 1973-

- a. all offences specified in section 435(1) shall be triable only by the Special Court established for the area in which the registered office of the company in relation to which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned; and
- b. where a person accused of, or suspected of the commission of, an offence under this Act is forwarded to a Magistrate under section 167(2) or section 167(2A) of the Code of Criminal Procedure, 1973, such Magistrate may authorise the detention of such person in such custody as he thinks fit for a period not exceeding 15 days in the whole where such Magistrate is a Judicial Magistrate and 7 days in the whole where such Magistrate is an Executive Magistrate.

A proviso under this sub-section states that if such Magistrate considers that the detention of such person upon or before the expiry of the period of detention is unnecessary, he shall order such person to be forwarded to the Special Court having jurisdiction. Pursuant to the amendment of the provisions conferring jurisdiction upon a Special Court, there seems to be some error that requires the Magistrate to forward such person to the Special Court even if the jurisdiction to try the offence rests with the Magistrate. Therefore, this provision should be construed accordingly. Section 436(1 Xc) says that the Special Court may exercise, in relation to the person forwarded to it under clause (b), the same power which a Magistrate having jurisdiction to try a case may exercise under section 167 of CrPC in relation to an accused person who has been forwarded to him under that section; and (d) a Special Court may, upon perusal of the police report of the facts constituting an offence under this Act or upon a complaint in that behalf, take cognizance of that offence without the accused being committed to it for trial.

Section 167 of the CrPC empowers the Magistrate, other than a Magistrate of the Second Class unless the Magistrate of the Second Class has been authorized by the High Court, to commit a person to custody of the police for a specified period if he is satisfied that there are grounds for doing so. Where the offence in question is punishable with death, imprisonment for life or imprisonment for a term not less than ten years, the total period for permitting such detention cannot exceed ninety days and in other cases, for a period not exceeding 60 days. Further, at a time, the maximum period of detention cannot exceed 15 days, and every time police requires the custody of the accused, the accused must be forwarded to the Magistrate for this purpose.

Section 436(2) of the *Companies Act, 2013* contains an important declaration that the Special Court, when trying an offence under this Act, may also try an offence other than an offence under this Act with which the accused may, under CrPC be charged at the same trial.

Section 436(3) contains another non-obstante clause. It says notwithstanding anything contained in CrPC, the Special Court may, if it thinks fit, try in a summary way any offence under the *Companies Act* which is punishable with imprisonment for a term not exceeding 3 years. A proviso under this sub-section stipulates clearly that in case of any conviction in a summary trial, no sentence of imprisonment for a term exceeding 1 year shall be passed. This is akin to statutory reduction of the maximum period of imprisonment that could be awarded while sentencing. Actually, commission of most of the offences under the *Companies Act, 2013* could be understood from documentary evidence and therefore, it may not be difficult to try offences summarily. There is, of course, an outer cap to the power of the Special Court to decide trial of an offence summarily. This sub-section has made it clear if the offence in question is punishable with imprisonment for period of exceeding three years, the question of deciding trial of an offence summarily does not arise.

The second proviso under section 436(3) of the *Companies Act, 2013* states that when at the commencement of, or in the course of, a summary trial, it appears to the Special Court that the nature of the case is such that the sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Special Court shall, after hearing the parties, record an order to that effect and thereafter, recall any witnesses who may have been examined and proceed to hear or rehear the case in accordance with the procedure for the regular trial.

The moot point under section 436 is that the offences under the *Companies Act* which are punishable with imprisonment of two years or more are triable only by the Special Court established under section 435 of the *Companies Act, 2013*. It is only in the case of offences punishable with imprisonment of a term less than two years, the proviso empowers a Judicial Magistrate or a Metropolitan Magistrate to try the offence. The Special Court need not be an altogether new Court established for this purpose. It could be an existing court designated as a Special Court by Notification issued under section 435 of the *Companies Act, 2013*.

So far as section 436 of the *Companies Act, 2013* is concerned, it is clear that any offence under this Act which is punishable with imprisonment not exceeding three years may be tried in a Special Court in a summary way. This power is absolutely subject to the discretion of the Special Court. However, there is a caveat in the proviso which says that the Special Court may try the offence in a summary way, even though it is an offence punishable

with imprisonment of not exceeding three years, only if it is of the tentative view that it may not be necessary to pass a sentence of imprisonment for a term exceeding one year. This requirement arises because, when an offence is tried in a summary way, the Special Court, upon conviction of the accused, cannot award of sentence of imprisonment of a term which is more than a period of one year. In case it proceeds to try the offence in question summarily, the Special Court must note that it cannot pass any sentence of imprisonment for a term exceeding one year.

In case, during the course of a summary trial, if it appears to the Special Court, that a sentence of imprisonment exceeding one year may have to be passed, section 436 enables the court to close this summary trial and proceed to hear or rehear the case as a regular trial. Thus, section 436 is only providing an option to try offences under the Act in a summary way, which are punishable with imprisonment with a term not exceeding 3 years, subject to the condition that, in case of conviction, the maximum sentence that could be passed in such a case cannot exceed 1 year. Further, the icing on the cake is that the Special Court has the power to try, in addition to offences under the *Companies Act*, other offences too, in which the accused may be charged under CrPC at the same trial.

The Special Court has powers to order detention of a person accused of having committed an offence under the Act for a period not exceeding 15 days, where the Magistrate is a Judicial Magistrate and for a period not exceeding 7 days if the Magistrate is an Executive Magistrate. By virtue of this provision, it becomes clear that the person accused of having committed an offence under this Act can be forwarded to a Magistrate under section 167(2) or section 167(2(A)) of CrPC and it appears that for committing the accused to trial in any case, the Special Court alone will have jurisdiction.

In order to appreciate the powers of the Special Court established under section 435, it is desirable to consider as an illustrative case, the offence falling under section 447 of the Act, which prescribes the punishment for fraud.

Under section 447, any person who is found to be guilty of fraud involving an amount of atleast ten lakh rupees or one percent of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both. Therefore, an offence under section 447 is typically a case where the offence is punishable with imprisonment for a term exceeding 3 years (if it is an offence involving public interest) and also with fine. Therefore, a person who is found to be guilty of fraud in such cases cannot be tried in a summary way.

For an offence arising under section 186 of the *Companies Act, 2013*, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than INR 25,000/- but which may extend to INR 1 lakh. This offence, being an offence punishable with a mandatory imprisonment for a period which may extend to two years, the jurisdiction to try such an offence lies with the Special Court only. Therefore, if the Special Court so thinks fit and arrives at a tentative conclusion that it is not a case which would require awarding a sentence of imprisonment of a term exceeding one year, it could proceed to conduct the trial summarily. Whether the Special Court so decides or not, it has to be tried by the Special Court only. Only the method of trial is different.

Being an offence involving granting of loan or guarantee or security or making investment in excess of the limits specified in section 186 or in contravention of section 186, documentary evidence will be sufficient to show-

- a. when did the contravention take place;
- b. what is the amount involved in the contravention;
- c. who were the persons who could be termed as Officer who is Default;
- d. what are the reasons for undertaking such a transaction in contravention of the provisions of section 186 of the Companies Act, 2013.

Audited financial statements, notices, agenda, notes on agenda and minutes and correspondence and cheques, demand drafts or bank remittances and other records will speak volumes of the offence. If it is purely a case of the company setting up a device for misappropriation or diversion of funds or if the funds are not recoverable or it is an irretrievable risk, the Court may not decide to try the offence in a summary trial. Otherwise, the object of the trial could be easily achieved by conducting the trial in a summary way.

Another interesting point that arises in a case involving an offence under section 186 of the *Companies Act, 2013* is that while an 'Officer who is in Default' is punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, the company is punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees. In this case, the nature of offence and the penal provision are such that there is no question of the company alone being liable nor the 'Officer in Default' alone being liable. However, so far as the company is concerned, it is an offence triable by a Metropolitan Magistrate or a Judicial Magistrate of the First Class having jurisdiction to try any offence under this Act.

However, there cannot be two parallel proceedings for the same matter, making the accused to face trial in two courts. The person appearing and representing the company which is liable may be the other accused who is liable as an 'Officer who is in Default'. Therefore, the entire trial, whether it is for the company or its 'Officers who is in Default', must be done only by the Special Court. Section 436(2) of the *Companies Act, 2013* does not come to the rescue directly because it only empowers the Special Court, while trying an offence under the Act to try offences other than an offence under the *Companies Act*.

### **Special Court should be deemed to be a Court of Session**

Section 437 of the *Companies Act, 2013* makes it clear that the High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX of the CrPC on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court. In other words, if the matter goes up to the High Court within whose jurisdiction the seat of that Special Court lies, the Special court should be deemed to be a Court of Session situate within the local limits of the jurisdiction of the High Court.

## **TRIAL PROCEDURE FOR SUMMON CASES**

### **Summons**

A summon is an authoritative call to the accused person to appear in court to answer to a charge of an offence.

As per P. Ramanatha Iyer's Law Lexicon, a "summon" is a process issued from the office of a court of justice requiring the persons to whom it is addressed to attend the court for the purpose therein stated. 'Summons' is the name of a writ, commanding the sheriff, or other authorized officer, to notify the party to appear in court to answer a complaint made against him and in writ specified, on a day therein mentioned.



### Summons Case and Warrant Case

As per section 2 (w) of CrPC, 'summons-case' means a case relating to an offence, and not being a warrant case. This implies that summons cases are cases relating to offences provided they are not warrant cases. As per section 2 (x) of CrPC, 'Warrant- case' means a case relating to an offence punishable with death, imprisonment for a term exceeding two years. In other words if the minimum punishment prescribed by any substantive law for an offence is an imprisonment for a term exceeding two years, the offence will be dealt with as a warrant case. The basis of the classification is the seriousness of the offence to which the case relates. A warrant case relates to a serious offence while a summons case relates to a comparatively less serious offence. It is for the same reason that the trial-procedure prescribed for a warrant case is very elaborate when compared to that prescribed for a summons case.

As per CrPC in a summons case a summons is to be issued to the accused in the first instance and in a warrant case a warrant of arrest is normally to be issued for the arrest of the accused. CrPC gives discretion to the Judicial Officer to depart from this general rule if the circumstances so demand in a particular case.

### Summons Cases under the Act

As most of the offences under the Act are punishable for a term of imprisonment that does not exceed two years, the cases involving such offences are summons cases only. Under the Act there are only a few cases that are punishable with imprisonment for a term exceeding two years, whether as a mandatory part of punishment or as an alternative or together with a fine.

### Summary Trial

In respect of certain petty cases including mostly summons cases and a few specific warrant cases, the Magistrate concerned has been given discretion to try these cases in a summary way. The procedure for summary trials is essentially one prescribed for the trial of a summons case but in an abridged form.

### Constitutional Duty

Article 22 of the Constitution of India requires that every person who is arrested and detained shall be produced before the nearest Magistrate within a period of twenty-four hours of such arrest excluding the time necessary for the journey from the place of arrest to the court of the Magistrate and no such person shall be detained in custody beyond the said period without the authority of a Magistrate.

### Investigation with / without order of Magistrate

As per section 156 of CrPC, a police officer may, without an order of the Magistrate, investigate any cognizable case. Section 156(2) of CrPC provides that the proceeding of a police officer in any such case shall not be called in question. Under section 202 of CrPC, a Magistrate has powers to direct investigation to be made by a police officer on receipt of a complaint of an offence of which he is authorized to take cognizance for the purpose of deciding whether or not there is a sufficient ground for proceeding. But under section 156 of CrPC, the police officer directly takes up the investigation in the case of a cognizable offence. If on the basis of a first information report and other material placed before the police, there is a suspicion that a cognizable offence has been committed, the police officer may arrest without warrant.

Under the Act, there is absolutely no scope for such investigation even in relation to offences which are cognizable offences such as the ones falling under section 447 or section 448 of the *Companies Act, 2013* because the cognizance of such offences can be taken only on the basis of a complaint made by Central Government or by an officer authorized by it. But if the complaint filed with a police officer includes an offence under, say, the IPC also, the police officer may act in accordance with the powers conferred upon him under CrPC.

### Service of Summons on corporate bodies and societies

As per section 63 of CrPC, service of a summon on a corporation may be effected by serving it on the secretary, local manager or other principal officer of the corporation, or by letter sent by registered post, addressed to the chief officer of the corporation, or by letter sent by registered post, addressed to the chief officer of the corporation in India, in which case the service shall be deemed to have been effected when the letter would arrive in ordinary course of post.

In case of companies formed and registered under the Act, section 51 of the Act provides the mode of service. As per the said provision, a document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at the registered office.

The registered office of a company can be verified at the office of the Registrar of Companies. Form No. 18 prescribed under the Companies (Central Government's) General Rules and Forms, 1956 will show not only the address of the registered office of the company but also the police station within the jurisdiction of which the said address falls. Companies have to file the said form with the Registrar of Companies and once the Registrar takes the form on record it is available for public inspection. If the company has not intimated the registered office or any change in registered office it is an offence under the Act. In such cases, service must be effected using other modes of service prescribed by law.

Even in case of *Mukand Kanaiyalal Patel v. Swarup Shree Yarn Private Limited* [2002] 109 Comp Cas 413 (Bom), a director of a company filed an intimation with the Registrar under section 146 of the Act regarding change in the Registered Office of the company and the Bombay High Court held that as the Registrar has not taken on record the change, any service on the changed office does not amount to service as contemplated by law. This gives us the clear impression that service of notice of complaint is a very, very crucial stage, which sets the ball in motion.

### Proof of service in such cases and when serving officer not present

When a summon issued by a Court is served outside its local jurisdiction, and in any case where the officer who has served a summon is not present at the hearing of the case, an affidavit, purporting to be made before a Magistrate, that such summon has been served, and a duplicate summon purporting to be endorsed (in the manner provided by section 62 or section 64 of CrPC) by the person to whom it was delivered or tendered or with whom it was left, shall be admissible as evidence, and the statements made therein shall be deemed to be correct unless and until the contrary is proved.

Service of summon could be made by Registered Post and in case of refusal to accept, an endorsement of the postal authorities that the person did not accept it should be taken as valid service.

### Dispensing with the personal attendance of Accused / Complainant

The presence of accused is deemed to be a pre-requisite for a fair trial. As such there is the need for the accused to be present in court at the time of every hearing. The main reason for such a stipulation is that the trial should not be conducted ex-parte as the prosecution is against the accused. As per the proviso under section 205 of CrPC, whenever the Magistrate issues a summon, he may, if he sees reason so to do, dispense with the personal attendance of the accused and permit him to appear by his pleader. In such cases the pleader of the accused can, in his stead, plead guilty to the "charge", or make an answer to the statement of allegations.

As per the proviso under section 256 of CrPC, where the complainant is represented by a pleader or by the officer conducting the prosecution or where the Magistrate is of the opinion that the personal attendance of the complainant is not necessary, the Magistrate may dispense with the attendance of the complainant and proceed with the case.



Under section 439(3) of the Act, it is provided that if the complainant is the Registrar or a person authorized by Central Government for filing complaints, the personal attendance of the complainant before the court trying the offence, shall not be necessary unless the court requires his personal attendance at the trial.

For most of the offences under the Companies Act, 2013 as stated in section 439 of the Act, the complainant is usually the Registrar of Companies. The Registrar usually files an application to dispense with his personal appearance in which he states that he is a public servant and he is filing this complaint in his official capacity and the complaint is mostly based on the records in his office and therefore his personal attendance should be dispensed with as per section 256 of CrPC read with section 439(3) of the Companies Act, 2013.

In *Bhaskar Industries Ltd. v. Bhiwani Denim and Apparels Ltd. and Ors.*, AIR 2001 SC 3625, the Supreme Court held that -

“it is within the powers of a magistrate and in his judicial discretion to dispense with the personal appearance of an accused either throughout or at any particular stage of such proceedings in a summons case, if the magistrate finds that insistence of his personal presence would itself inflict enormous suffering or tribulations to him, and the comparative; advantage would be less. Such discretion need be exercised only in rare instances where due to the far distance at which the accused resides or carries on business or on account of any physical or other good reasons the magistrate feels that dispensing with the personal attendance of the accused would only be in the interests of justice. However, the magistrate who grants such benefit to the accused must take the precautions enumerated above, as a matter of course. We may reiterate that when an accused makes an application to a magistrate through his duly authorized counsel praying for affording the benefit of his personal presence being dispensed with the magistrate can consider all aspects and pass appropriate orders thereon before proceeding further”.

### **Notice to the Accused**

As per section 251 of CrPC, when in a summons case, the accused appears or is brought before the Magistrate, the particulars of the offence of which he is accused shall be stated to him, and he shall be asked whether he pleads guilty, or has any defence to make, but it shall not be necessary to frame a formal charge. While the section dispenses with a formal charge in a summons case, it does not dispense with the statement of the particulars of the offence for which the accused is to be dealt with. The purpose of questioning the accused under the section is to apprise him of the charge against him. The accused should know the offence or facts constituting the offence with the commission of which he is accused and that he is about to be put on the trial. The record must show the particulars, which were explained or stated to the accused by the Magistrate.

### **Effect of minor defects**

Where there is any error, omission or irregularity in the complaint, summons, warrant, proclamation, order, judgment or other proceedings in a trial or in commencing a prosecution, it will not affect any finding, sentence or order *passed by a court of competent jurisdiction. The above protection has been enshrined in section 465 of CrPC. As held by many High Courts, if there is any defect in compliance of the requirements of section 251 of CrPC, such as a mere omission to state the particulars of an offence to an accused, such defect cannot be construed to be fatal to the case and it is not an illegality to vitiate the trial, provided no prejudice can be shown to have been caused to the accused. Such defect may be a mere omission or irregularity curable under section 465 of CrPC. However, it should be mentioned that the above protection will not rescue a prosecution which is void ab initio.*

### **Furnishing a copy of the complaint to the accused**

In a case instituted upon a complaint made in writing, such as the one for any offence against the Act, every summons or warrant issued under section 204(1) of CrPC should accompany a copy of the complaint so that

when the accused enters appearance in answer to such summons, he would have a fair idea of the allegations made against him on the basis of which the summons was issued.

## **FRAMING OF CHARGE**

As provided under section 251 of CrPC, in a trial of a summons case it is not necessary to frame a formal charge according to the provisions contained in sections 211 to 213 of CrPC. The provisions relating to joinder of charges and joint trial of persons are applicable in respect of trials of summons cases. Similarly, if a summons case is to be tried jointly with a warrant case, the procedure for trial of warrant cases must be followed and a charge will have to be framed for the summons case.

### **Can different offences be clubbed in a single trial?**

Section 220 (1) of CrPC provides for single trial for more than one offence. If, in one series of acts so connected together as to form the same transaction, more offences than one are committed by the same person, he may be charged with, and tried at one trial, for every offence. The above section could be used when different offences committed by a single person or same persons and the trial could be a combined and held as a single trial.

The Calcutta High Court in *Madan Gopal Dey and Anor. v. State and Anor.* [1969] 39 Comp Cas 119 (Cal) held that if several offences are committed in the course of the same transaction, section 235 of Criminal Procedure Code, 1898 (the code) would authorise their joinder for the purpose of a single trial. Whether the offences under section 162(1), section 168, section 220(3) and section 210(5) of the Act could be said to be so connected together as to form the same transaction. The term “same transaction” has nowhere been defined. The term suggests a continuity of action and purpose and it has been held that the real and substantive test for determining whether several offences are so connected together as to form one transaction depends upon whether they are related together in point of purpose or as cause and effect or as principal and subsidiary acts so as to constitute one continuous action.

If a continuous thread runs through the acts complained of, charges arising out of those acts would be liable to be joined together under this section. Continuity of action, therefore, seems to be a very important test in the matter.

The substance of the charges framed against the petitioners is that they had failed to hold the annual general meeting and that they had failed to place the balance sheet and profit and loss account at the meeting and they had further failed to file with the Registrar the annual return and copies of the balance-sheet and profit and loss account within the specified periods following the annual general meeting. A limited company holding public funds is liable to account for those funds to the shareholders and also to the Registrar of Joint Stock Companies to whom the company is also liable to submit an annual return embodying certain specified particulars regarding its management and other affairs.

The requirements of the law in these regards fall into a pattern and the action that is to be taken to satisfy those requirements carries a sense of continuity in the matter of the administration of the company. The failure to act up to the legal requirements in these regards and the defaults in the matters mean a failure to pursue that continuity of action. A continuity of action when the charge is default or failure to take action is not inconceivable. If an action is required to carry a thread of continuity, the failure to take the action would constitute an omission which, connected together, will have a continuous thread of common purpose running through them.

The defaults and omissions in the present cases constitute a series of acts which are so connected as to form the same transaction and as such whatever offences might have been committed in the course of that transaction are liable to be joined together under section 235 of the code for the purpose of a single trial. Section 239 of the Code permits the joinder at the same trial of persons accused of the same offence committed in the course of the same transaction. The directors as well as the company were thus liable to be jointly tried and the

learned Magistrate cannot be said to have fallen into an error of law in jointly trying the petitioners in the cases at the same trial.

### Admission of Guilt

Under section 252 of CrPC, if the accused pleads guilty, the Magistrate should record the plea of the accused to the extent possible in the words used by the accused and the Magistrate may, in his discretion, convict the accused. This requirement of section 252 is a very important one and it is not a mere formality. The right of appeal of the accused depends upon the fact whether he pleaded guilty or not. The legislature requires the exact words used by the accused to be recorded so that there is no mistake or misapprehension.

If a number of persons have been arraigned as accused, each one should be made to understand the matters accused of. The plea of each of them should be recorded separately after each one has been made aware of the accusation. If the accused are told of the accusation jointly and if they jointly make an admission of guilt, such admission is bad in law, if the Magistrate records the same.

If the facts mentioned in the “charge” do not constitute an offence, the accused cannot be convicted on the mere plea of guilty. The Magistrate has the discretion to accept or not to accept the plea of guilty. Before accepting the plea of guilty, the Magistrate should satisfy that the accused has understood the charge and pleaded guilty after realizing the consequences of admission of the offence. As per section 255(2) of CrPC, if the Magistrate accepts the plea of guilty and convicts the accused person he shall pass sentence on him according to law unless he proceeds in accordance with the provisions of section 325 or section 360 of CrPC. The Magistrate may release the accused under the *Probation of Offenders Act, 1958* as well.

As per section 325 of CrPC when a Magistrate having jurisdiction over the offence under trial finds the accused guilty of that offence but considers that he is not competent to pass a punishment appropriate for the offence, he is supposed to submit the entire proceedings to the Chief Judicial Magistrate. Similarly, as per section 360 of CrPC, the Magistrate is empowered to release a convicted accused on probation of good conduct. In these cases passing of a sentence by the Magistrate after completion of the trial as stated in section 255 does not arise.

### Plea of guilty without appearing before the Magistrate

In petty cases it is possible for the accused to admit the guilt without personal appearance. On receiving a summons issued under section 206 of CrPC, if the accused desires to plead guilty to the charge without appearing before the Magistrate, as per section 253 of CrPC, the accused can intimate his plea to the Magistrate through a letter and remit the amount of fine specified in the summons. The Magistrate may, in his discretion, convict and sentence him to pay the fine. The amount remitted by the accused should be adjusted towards that fine. Where a pleader, if so authorized by the accused, plead guilty on behalf of the accused, the Magistrate should record the exact words of the pleader as far as may be possible and thereafter the Magistrate may convict and sentence the accused.

### Denial of Offence

When once there is a denial of the offence under section 251 of the Act, the Magistrate is required to proceed to hear the prosecution and to take the prosecution evidence under section 254 of the Act.

### Hearing the prosecution

As per section 254 of CrPC, it is the duty of Magistrate to hear the prosecution and take all evidence in support of the prosecution and also to hear the accused and take all evidence in his defense under the following circumstances:

- If the Magistrate does not convict the accused when he pleads guilty under section 252 or section 253.

- If the accused does not plead guilty.

## SUMMONING OF WITNESSES OF PROSECUTION

As per section 254 of CrPC, the Magistrate may, if he thinks fit, on the application of the prosecution, issue summons to any witness directing him to attend or produce any document or thing. A Magistrate is not bound to issue process to compel the attendance of any witness either on the application of the complainant or the accused. A Magistrate cannot refuse to examine a witness. As per section 254(3) of CrPC, the Magistrate may, before summoning any witness in pursuance of an application as aforesaid, direct that the reasonable expense of the witness incurred in attending for the purposes of the trial be deposited in court.

Under section 254 of CrPC, similar provision exists for summoning the witnesses of the accused also.

## Recording of Evidence

Section 273 of CrPC requires evidence to be taken in the presence of the accused. This is not an ordinary rule of procedure. It is an important part of the trial procedure in the criminal justice system. In case, the presence of the accused has been dispensed with, evidence can be taken in the presence of his pleader.

In *Bhaskar Industries Ltd. v. Bhiwani Denim and Apparels Ltd. and Ors.*, AIR 2001 SC 3625, the Supreme Court held that -

“the normal rule is that the evidence shall be taken in the presence of the accused. However, even in the absence of the accused such evidence can be taken but then his counsel must be presence in the court, provided he has been granted exemption from attending the court. The concern of the criminal court should primarily be the administration of criminal justice. For that purpose the proceedings of the court in the case should register progress. Presence of the accused in the court is not for marking his attendance just for the sake of seeking him in the court. It is to enable the court to proceed with the trial. If the progress of the trial can be achieved even in the absence of the accused the court can certainly take into account the magnitude of the sufferings which a particular accused person may have to bear with in order to make himself present in the court in that particular case “.

As per section 274 of CrPC, in all summons cases, the Magistrate shall, as the examination of each witness proceeds, make a memorandum of the substance of his evidence in the language of the court. However, if he is unable to make such memorandum himself, he shall, after recording the reason of his inability, cause *such memorandum to be made in writing or from his dictation in open court. Such memorandum shall be signed by the Magistrate and shall form part of the record.*

As per section 279 of CrPC, if the accused is present and if he is unable to understand the language in which any evidence is given, the Magistrate should ensure that the evidence is interpreted in the open court in the language understood by the accused. As per section 280 of CrPC, it is the duty of the Magistrate to record the remarks respecting the demeanor of the witness.

The same provisions are applicable in respect of recording of evidence of the accused.

## Arguments of prosecution

As per section 314 of CrPC, the prosecutor should submit his arguments after the conclusion of the prosecution evidence and before any other further step is taken in the proceedings.

## Personal examination of the accused

As per section 313 of CrPC, there will be an examination of the accused so that the accused is enabled to explain personally any circumstances appearing in evidence against him. The court may examine the accused by questioning him at any stage without previously warning the accused and the court shall put such questions

to the accused generally on the case after examination of the witnesses for the prosecution and before the accused is called on for his defence.

However, where the court has dispensed with the personal attendance of the accused, the court has got the discretion to dispense with the above-mentioned examination of the accused. Listening to the plea of the accused under section 252 or section 253 of CrPC is at the preliminary stage and that is totally different from the court examining the accused under section 313 of CrPC. Personal examination of the accused is mandatory after examination of the witnesses for the prosecution and before the accused is called on for his defence except when the personal attendance of the accused has been dispensed with.

### **Hearing of the accused**

After the personal examination of the accused, if any, under section 313(l)(b) of CrPC, the Magistrate shall hear the accused and take all such evidence as he produces in his defence as per section 254(2) of CrPC. The accused should be heard on every circumstance appearing in evidence against him. The accused must be examined under this section to ascertain whether he offers to produce the defence or not after the entire prosecution evidence was adduced. Failure to hear the accused amounts to a fundamental error in a criminal trial and it is an error that cannot be cured by section 465 of CrPC.

### **Arguments of / for the accused**

As provided under section 314 of CrPC, after the closure of the defence evidence, the accused may submit his arguments.

### **Power of the court to summon witnesses / examine**

At any stage of trial, the court has power to summon any person as a witness and examine any person who is in attendance though the court might not have summoned him. The court has also the power at any stage of trial, to recall and reexamine a person already examined. The above powers of the trial court are subject to the discretion of the court and the court may use such powers if thought fit. The court has also power to summon and examine or recall and re-examine if the court thinks that the evidence of any person to be summoned or examined or recalled or re-examined so would be very essential for the just decision of the case.

### **Issue of summons to produce document or thing**

Where any court or a police officer considers that the production of a document or thing is necessary or desirable, for the purpose of any proceeding under CrPC, the court may issue a summon or the police officer may issue a written order to any person who is believed to be in possession of such document or thing requiring him to produce such document or thing. It should be noted that it is not desirable to issue a summon or an order directing an accused to produce a document or a thing. An accused cannot be compelled to produce something, which will be incriminating him. This limitation can be traced to Article 20 of the Constitution of India as laid down by Supreme Court in various cases.

In a petition before the Andhra Pradesh High Court in *Nutech Agros Limited and Ors. v. Ch.Mohan Rao and Anor.* [2002] 109 Comp Cas 487 (AP). for quashing the order of the Special Judge for Economic Offence at Hyderabad for summoning certain documents from Central Bank of India and for directing the Manager of the Bank to appear before the court, the facts of the case were as follows:

- A shareholder holding 46,600 shares filed a complaint against the company and its directors alleging an offence under section 205 and 207 of the Act.
- The allegation was that the company had declared a dividend for the year 1994-95 and 1995-96 but he did not receive the dividends.
- Non-payment of dividend is punishable under section 207 of the Act.

The court held that if the company establishes exactly the fact that the unclaimed or unpaid dividend amount had in fact been transferred to a special account as required under section 205 of the Act, the company discharges its responsibility and is no more liable for any punishment. Further, the court also held that the burden of establishing that the company took all the requisite steps (to comply with section 205 of the Act) is on the company.

The Andhra Pradesh High Court quashed the summons on the ground that even if the documents were summoned and if it was established that the company did not open a special account in bank for the unpaid dividend amount, the guilt would not get automatically established as there was nothing in the law which stipulated that the special account as required under section 205 of the Act should be opened only in Central Bank of India, Adoni Branch. It is always open to the petitioners to establish that such a special account was opened in some other branch or some other bank.

### **Acquittal or Conviction**

Trial procedure terminates with the pronouncement of judgement which may be acquittal or conviction. If the Magistrate, upon taking the evidence for the prosecution and for the defence, and such further evidence, if any, as he may on his own motion, cause to be produced, finds the accused not guilty, he shall record an order of acquittal as per section 255(1) of CrPC.

When the prosecutor has sought the assistance of the court for securing the attendance of the witnesses, the court cannot refuse to take steps for securing attendance of such witnesses and pass an order of acquittal on the ground that the case fails for want of evidence. But if the prosecution did not take proper steps to produce the witnesses or ask the court to give them time to do the same, or to issue fresh summons, the court was not bound to fix another date. Under such circumstances, the Magistrate can record an order of acquittal under section 255 of CrPC, if there is no evidence to hold the accused guilty.

Provisions regarding the delivery, and pronouncement of the judgments, its language and content, various directions regarding the sentence and other postconviction order that might be passed, compensation and costs to the aggrieved party etc, are all contained in sections 353 to 365 of CrPC.

### **Conviction without being “charged”**

Though there may be no charge framed in a summons case, the details of the offence will be available in the complaint or summons. As per section 255 (3) of CrPC, a Magistrate may convict an accused of any offence, if he is convinced that from the facts admitted or proved, the accused appears to have committed the said offence. As such a person accused of a particular offence triable as a summons case, can be convicted of a totally different and unconnected offence. But the Magistrate should form an opinion that the accused would not be prejudiced thereby.

### **Effect of non-appearance or death of complainant**

As per section 256(1) of CrPC, if the summon has been issued on a complaint, and on the day appointed for the appearance of accused, or any day subsequent thereto on which the hearing may be adjourned, the complainant does not appear, the Magistrate may take any one of the following steps:

- i. He may acquit the accused.
- ii. He may adjourn the case to any other day.
- iii. He may dispense with the personal attendance of the complainant and proceed with the case.

Section 256(2) of CrPC states that the above provisions contained in section 256(1) of CrPC shall, so far as may be, apply also to cases where the non-appearance of the complainant is due to his death.



### Non-appearance of any person on behalf of a complainant, which is a company

The Kerala High Court in *Falcon Tyres Limited v. Mohan Rajan* [1997] 88 Comp Cas 547 (Ker) held that the Magistrate has jurisdiction under section 256(1) of CrPC to acquit the accused due to the absence of the complainant which is a juristic person and which will have to be represented only by natural person. The court rejected the contention that the complainant is a juristic person and such complainant cannot be physically present in court and hence there is no possibility of the complainant being absent.

The Supreme Court in *Associated Cement Company Limited v. Keshvanand* [1998] 91 Comp Cas 361 (SC) held that the Magistrate has powers to acquit the accused if the complainant fails to appear and the said power would include the absence of the corporeal person representing the incorporeal complainant and hence the provision is applicable even to cases where the complainant is a company. Section 247 of Code of Criminal Procedure, 1898 (now section 256 of CrPC) affords some deterrence against dilatory tactics on the part of a complainant who set the law in motion through his complaint. An accused who is per force to attend the court on all posting days can be put to much harassment by a complainant if he does not turn up in the court on occasions when his presence is necessary. The section, therefore, affords a protection to an accused against such tactics of the complainant. But that does not mean that if the complainant is absent, court has a duty to acquit the accused in invitum.

### Withdrawal of complaint

Section 257 of CrPC lays down the circumstances under which a complaint may be withdrawn with the consent of the court in a summons case. It permits a complainant, at any time before a final order is passed in any case, to withdraw, with the permission of the Magistrate, his complaint against the accused, or if there be more than one accused, against all or any of them provided he satisfies the Magistrate that there are sufficient grounds for permitting him to withdraw his complaint and the Magistrate may permit him to withdraw the same, and shall thereupon acquit the accused against whom complaint is so withdrawn.

On a bare reading of this section, therefore, it can be manifested that a complainant *has no legal or vested right to withdraw a complaint as and when he wishes. Withdrawal of the complaint under section 257 of CrPC is permissible only if the Magistrate is satisfied that there are sufficient grounds for permitting such withdrawal. This clearly implies that the Magistrate must apply his judicial mind to the reasons, which compel the complainant to withdraw the complaint, before granting permission.*

### Powers of Trial Courts to Drop Proceedings

The Supreme Court in *K.M.Mathew v. State of Kerala*, AIR 1992 SC 2206, 2208 held that -

“it is open to the accused to plead before the Magistrate that the process against him ought not to have been issued. The Magistrate may drop the proceedings if he is satisfied on reconsideration of the complaint that there is no offence for which the accused could be tried. It is his judicial discretion. No specific provision is required for the Magistrate to drop the proceedings rescind the process. The order issuing the process is an interim order and not a judgment. It can be varied or recalled. The fact that the process has already been issued is no bar to drop the proceedings if the complaint on the very face of it does not disclose any offence against the accused”.

### Power to stop proceedings in certain cases

Section 258 is concerned with summons cases instituted otherwise than upon a complaint. In such cases, a Magistrate may, after obtaining the previous sanction of the Chief Judicial Magistrate, stop the proceedings at any stage without pronouncing any judgment. Where proceedings have been stopped after recording evidence of the principal witnesses, the Magistrate has to pronounce a judgment of acquittal, and in any other case, release the accused, and such release shall have the effect of discharge. Under the Act all the cases will be instituted only upon a complaint made by competent persons.



### **Power of Court to convert Summons Cases into Warrant Cases**

As per section 259 of CrPC during the course of trial of a summons case relating to an offence punishable with imprisonment for a term exceeding six months, if the Magistrate opines that in the interests of justice, the offence should be tried in accordance with the procedure for the trial of warrant cases, the Magistrate may do so and proceed accordingly. In case the Magistrate forms an opinion that the case before him ought to be tried as a warrant case, he would commence the proceedings afresh.

### **Compensation for Accusation without Reasonable Cause**

Section 250(8) of CrPC provides that the provisions of the said section apply to summons cases also. As per section 250 of CrPC, the Magistrate may order payment of compensation to the accused if he is satisfied that there was no reasonable ground for institution of the proceeding.

### **Prosecution of Officers of Public Sector Undertakings**

Section 197 of CrPC provides that the sanction of the appropriate government is required in order to take cognizance of any offence which is allegedly committed by a person who, at the time of commission of the offence, was employed by the Central Government or a State Government.

The Supreme Court in *Mohd. Hadi Raja and Ors. v. State of Bihar and Anr.* [1998] 93 Comp Cas 362 (SC) observed that the common question of law that arises in all these matters is whether sanction under section 197 of CrPC is required for prosecuting officers of public sector undertakings or Government companies. The Supreme Court held that in order to invite the requirement for sanction as contemplated under section 197 of CrPC, the accused should be such a public servant who cannot be removed from his office except by or with the sanction of the Government and the offence must have been committed while such public servant had been acting or purporting to act in the discharge of his official duties.

The Supreme Court also referred to its own decision in *S.S. Dhanoa v. Municipal Corporation of Delhi* [1981] 3 SCC 438; AIR 1981 SC 1395 that-

“it has been contended that sanction contemplated under Section 197 of CrPC must be restricted only in respect of a judge or a Magistrate or a public servant who is directly employed by the Government and not by any instrumentality or agency of the Government.”

Public sector undertakings, being juristic persons with a distinct legal entity stand on a different footing than the Government departments. It will not be just and proper to bring such persons within the ambit of section 197 by liberally construing the provisions of section 197. Such exercise of liberal construction will not be confined to the permissible limit of interpretation of a statute by a court of law but will amount to legislation by the court.

Therefore, the Supreme Court held that the protection by way of sanction under section 197 of CrPC is not applicable to officers of Government companies or public undertakings even when such public undertakings are “State” within the meaning of Article 12 of the Constitution on account of deep and pervasive control of the Government.

However, the Andhra Pradesh High Court in *Andhra Pradesh State Essential Commodities Corporation Limited v. Registrar of Companies* [2002] 38 SCL 1016 (AP). quashed the criminal prosecution for an offence under section 220 of the Act against the directors of a public sector undertaking on the ground that the necessary sanction for prosecuting the directors under section 197 of the CrPC has not been obtained.

### **Framing of a charge v. discharge of accused**

The Supreme Court in *R.S.Nayak v. A.R. Antulay*, AIR 1986 SC 2045 pointed out that sections 227, 239 and 245 of CrPC contain somewhat different provisions in regard to discharge of the accused.

Under section 227 of CrPC, the trial judge is required to discharge the accused if he considers that there is no ground for proceeding against the accused. The obligation to discharge the accused under section 239 of CrPC arises when the Magistrate considers the charge against the accused to be groundless. The power to discharge is exercisable under section 245(1) of CrPC when the Magistrate considers, for reasons to be recorded, that no case against the accused has been made out which, if unrebutted, would warrant his conviction.

The Supreme Court has held that -

“it is a fact that Sections 227 and 239 of CrPC provide for discharge being ordered before the recording of evidence. The stage for discharge under Section 245 of CrPC, on the other hand, is reached only after the evidence referred to in Section 244 of CrPC has been taken. “

In spite of the difference in the language of the three sections, the legal position is that if the trial court is satisfied that a prima facie case is made out, charge has to be framed.

The apex court quoted its decision in another case of *State of Bihar v. Ramesh Singh* [1978] 2 SCR 257 wherein it was observed as follows:

“If the evidence which the prosecution proposes to adduce to prove the guilt of the accused even if fully accepted before it is challenged in cross-examination or rebutted by the defence evidence, if any, cannot show that the accused committed the offence, then there will be no sufficient ground for proceeding with the trial. An exhaustive list of circumstances to indicate as to what will lead to one conclusion or the other is neither possible nor advisable. At the conclusion of the trial, if the scales of a pan as to the guilt or innocence of the accused are even, then, on the theory of benefit of doubt, the case is to end in his acquittal. But, if on the other hand it is so at the initial stage of making an order under Section 227 of CrPC or Section 228 of CrPC, then charge must be framed under Section 228 of CrPC and not under Section 227 of CrPC to discharge the accused”.

As most of the offences under the Act will be tried only as summons case, the question of discharge does not arise. The accused may apply for dropping of the case against him, if the Magistrate is satisfied that no case has been made out, he may drop the proceedings.

### Petition for Discharge

The Madras High Court in case of *K. Seethalakshmi v. Registrar of Companies and Anor.* [1999] 21 SCL 1 (Mad); [2001] 103 Comp Cas 532 (Mad) rejected the plea of the petitioner that the Registrar of Companies has not issued any notice to her. The managing director had died when the proceedings were pending. The petitioner, who was also a director and the wife of the deceased managing director was impleaded as an accused in the proceedings. As the petitioner was impleaded as an accused, she filed an application under section 204 of CrPC, praying for her discharge. She claimed she could not be impleaded as an accused because of the below grounds:

- i. Notice had not been served upon her but her deceased husband,
- ii. When there were other directors, the Registrar had picked out the petitioner to proceed against: The High Court refusing to discharge the petitioner by dismissing the petition, held that:
  - a. The husband of the petitioner who was the managing director, died during the pendency of proceedings. At the relevant period, the petitioner was a director of the company. Therefore, for non-compliance with the provisions of Sections 159 and 220, the director was also liable to be proceeded against under law and punishable under law. It was the duty of the petitioner as the surviving director, to comply with the provisions of the Companies Act.
  - b. The Registrar had impleaded the petitioner, as an accused on the death of her husband, not

merely because she was the wife of the deceased managing director but because she was a director of the said company and liable to comply with the mandatory requirements of the Act.

### INVESTIGATION BY POLICE

As already stated most of the offences against the Act are non-cognizable offences and the Magistrate will not refer the case to Police.

The Karnataka High Court in *Anantha R. Hegde v. Capt. T.S. Gopalakrishna* [1998] 91 Comp Cas 312 (Kar). held that as far as this position of law is concerned, there is absolutely no quarrel and it is also true that the offences alleged against the petitioners are only non-cognizable offences and the Magistrate has rightly not referred it to the police.

### Issue of Warrant for Recovery of fines

As per section 421 of CrPC, where an offender has been sentenced to pay a fine, the Court has the authority to issue a warrant for the levy of the amount by attachment and of any movable properly belonging to the offender and further can issue a warrant to the Collector of the District authorizing him to realize the amount as arrears of land revenue or movable or immovable property or both of the defaulter.

It is possible to invoke the inherent powers of the High Court under section 482 of CrPC for recalling a warrant also.

The Orissa High Court in *Hrushikesh Panda v. State of Orissa and Ors.* [1997] 89 Comp Cas 613 (Ori), setting aside a non-bailable warrant of arrest as well as a distress warrant issued against the petitioner in order to realise a fine levied on the company of which he was the Managing Director, held that the fine has been imposed on the company and it is the liability of the company to pay the same. The High Court further held that the liability of the company is distinct from the liability of its managing director. Once it is concluded that the company has its own liability, the realization of fine has to be made from the company. The mode for realisation is provided under section 421 of CrPC.

The High Court further held that legal dues of a company could be realized only by attaching the assets of the company and not by putting the managing director or any of the directors in prison. It is to be kept in mind that the company is the offender or the defaulter. The issuances of a non-bailable warrant or distress warrant against the managing director or director to realize the same is not permissible.

Dismissing a petition under section 482 of CrPC seeking to recall warrants issued against the petitioner for alleged cheating of the public by accepting and failing to repay deposits, the Hon'ble Madras High Court in *S. Shreenivasa Rao alias S.S. Rao v. Inspector of Police* [2002] 109 Comp Cas 406 (Mad) held as follows:

“Where the petitioner was arraigned as a party to criminal conspiracy and cheating, it was immaterial whether the petitioner was a director of that Company or its group companies in as much as such criminal conspiracy could be hatched even by any person who need not necessarily be a director of the Company or its group of companies as there were materials available to show that the funds of the Company and its group companies were diverted to another Company of which the petitioner was admittedly a director. Therefore, it would not be proper for the court to lift the corporate veil and to analyse the contentions of the petitioner in a petition under Section 482. “

However, the Hon'ble High Court gave liberty to the petitioner to move the court of additional Chief Metropolitan Magistrate to recall the warrant invoking section 70(2) of CrPC.

### CAN A PERSON BE PROSECUTED AGAIN FOR THE SAME OFFENCE

Section 300 of CrPC contains adequate provisions to protect a person from being prosecuted for the same offence again. Section 300 of CrPC cannot be definitely interpreted to mean that if a person steals a property

and gets convicted of the offence of theft, he should not be prosecuted for the same offence if it arises out of another theft. Section 300 of CrPC is unique in the sense that it requires either a conviction or acquittal as a pre-requisite for the protection to be available. In simple words, the marginal note that "Person once convicted or acquitted not to be tried for same offence" conveys everything about the intention of the legislature.

Analysing the law laid down in section 300 of CrPC, the Kerala High Court in *Bharat Plywood and Timber Products Private Limited and Onr. v. Registrar of Companies and Anor.* [2002] 108 Comp Cas 601 (Ker) held as follows:

"Section 300 of the CrPC provides that so long as an order of acquittal or conviction handed down by a court of competent jurisdiction stands in respect of a person charged with committing an offence, that person cannot again be tried on the same facts for the offence for which he was earlier tried or for any other offence arising there from. Section 300 of CrPC becomes applicable when a court of competent jurisdiction had already tried the accused and that he is either acquitted or convicted. It is also necessary to note that for the first part of sub-section (1) of Section 300 to apply, the prior prosecution and subsequent prosecution should be for the same offence."

The High Court held that the principle embodied in Section 300 of CrPC is as follows:

*"A person cannot be tried again for the offence for which he had already been tried or on the same facts for any other offence for which a different charge from the one made against him might have been made under Section 221 (1) of CrPC or for which he might have been convicted under sub-section (2) of that section."*

The Kerala High Court in the said case considered a criminal revision petition filed by a company and its director. The facts were as follows:

- There was a complaint filed in the court of the Chief Judicial Magistrate, Ernakulam. This complaint was for a contravention under rule 4A of the Companies (Acceptance of Deposits) Rules, 1975. The allegation in the petition of complaint was that the petitioners had not complied with the conditions requiring advertisement for inviting deposits from the public.
- Another complaint was filed before the Judicial Magistrate of First Class, Kannur alleging that the Company had failed to maintain the liquidity of the assets as required by rule 3A of the Companies (Acceptance of Deposits) Rules, 1975. In the said case the accused was held guilty and they were convicted and sentenced.
- Yet another complaint was that the company has accepted deposits in excess of the limits specified under the Act read with the said Rules.
- It is the contention of the petitioners before the High Court in the criminal revision petition that the third complaint must be quashed on the ground that section 300 of CrPC bars prosecution for the same offence.

The High Court held that in order to ascertain whether there will be a bar as per section 300 of CrPC, it has to be seen whether the subsequent trial of the offence can be said to be upon the same facts. In order to check whether subsequent trial of the offence is upon the same facts, it should be proved that the evidence in the first case supported the conviction for the offence charged in the second case also. The first complaint was regarding accepting deposits without the necessary advertisement and the second complaint was regarding the failure to maintain the necessary liquid deposits. That would indicate that for establishing the commission of the offence in present case for which the revision petition has been filed, it is necessary to prove that repayment of deposits was not made within 30 days from the date of receipt of the deposits. This is a fact which was not necessary alleged and proved in the prior two prosecutions and hence it cannot be said that the prior prosecution and the present case are on the basis of the same facts. Hence, section 300 of CrPC did not bar the present prosecution.

## TRIAL PROCEDURE BEFORE A SESSIONS COURT

Chapter XVIII of CrPC contains the entire procedure in this regard. As the Judge of a Special court is going to be of the rank of the Sessions Judge or the Additional Sessions Judge, the Special Court has to follow this procedure except as regards matters that are contained under the *Companies Act, 2013* (the substantive law relating to offences triable by the Special Court established or designated under section 435 of the *Companies Act, 2013*), as if it were a trial before a Court of Sessions.

- Sections 225, 226 and 227 relate to the stage prior to the framing of charge. Section 228 provides for the framing of charge against the accused person.
- If after the charge is framed the accused pleads guilty, section 229 provides that the Judge shall record the plea and may, in his discretion, convict him thereon. However, if he does not enter a plea of guilty, sections 230 and 231 and provide for leading of prosecution evidence.
- If, on the completion of the prosecution evidence and examination of the accused, the Judge considers that there is no evidence that the accused committed the offence with which he is charged, the Judge shall record an order of acquittal.
- If the Judge does not record an acquittal under section 232, the accused would have to be called upon to enter on his defense as required by section 233. After the evidence-in-defense is completed and the arguments heard as required by section 234, section 235 requires the Judge to give a judgment for the case.
- If the accused is convicted, section 235(2) requires that the Judge shall, unless he proceeds in accordance with the provisions of section 360 of CrPC, hear the accused on the question of sentence and then pass sentence on him according to the law.
- Section 360 pertains to setting off the convicted person on probation for good conduct.
- Section 353 of CrPC requires the Judgment to be pronounced in the open court. Even if the accused is in custody, he should be brought to the court when the judgment is pronounced.
- Section 354 specifically requires the Court to state in the Judgment the offences for which the accused has been convicted and sentenced or of which he has been acquitted. As per section 354 of CrPC, the Judgment -
  - a. shall be written in the language of the Court;
  - b. shall contain the point or points for determination, the decision thereon and the reasons for the decision;
  - c. shall specify the offence (if any) of which, and the section of the Indian Penal Code (45 of 1860) or other law under which, the accused is convicted and the punishment to which he is sentenced; and
  - d. if it be a judgment of acquittal, shall state the offence of which the accused is acquitted and direct that he be set at liberty.
- Section 354(2) states that when the conviction is under the Indian Penal Code (45 of 1860) and it is doubtful under which of two sections, or under which of two parts of the same section, of that Code the offence falls, the Court shall distinctly express the same, and pass judgment in the alternative section. It may be noted that Special Court has powers, while trying offences under the Companies Act, 2013, to try other offences too. Ultimately the Court proceeds pass the Judgment, if it has some difficulty in mentioning the exact provision, this resolution contained in this subsection would come handy.
- Section 354(3) of CrPC stipulates that when the conviction is for an offence punishable with death or,

in alternative, with the imprisonment for life or imprisonment for term of years, the judgment shall state the reasons for the sentence awarded, and, in the case of sentence of death, the special reasons for such sentence.

- Section 354(4) states that when the conviction is for an offence punishable with imprisonment for a term of one year or more, but the Court imposes a sentence of imprisonment for a term of less than three months, it shall record its reasons for awarding such sentence, unless the sentence is imprisonment till the rising of the Court or unless the case was tried summarily under the provisions of CrPC. It may be noted that under Section 436 of the Companies Act, 2013 the Special Court which has tried an offence punishable with imprisonment for a term less than 3 years summarily cannot award a sentence of imprisonment for a term more than one year. Section 354(4) enjoins a duty upon the Court to mention the Judgment the reasons for awarding a sentence of imprisonment for a term of less than three months if the conviction is for an offence punishable with imprisonment for a term of one year or more. There are two exceptions to this rule. Firstly, if the Court awards a sentence of imprisonment till rising, it is not necessary to record the reasons for as mandated by this section. Secondly, it need not do so if the offence in question had been tried summarily.
- Section 354(5) of CrPC states that when any person is sentenced to death, the sentence shall direct that he be hanged by the neck till he is dead.
- Section 354(6) states that every order under section 117 or section 138(2) and every final order made under section 125, section 145 or section 147 shall contain the point or points for determination, the decision thereon and the reasons for the decision.
- Section 355 of CrPC is concerned with the manner in which a Metropolitan Magistrate will make the Judgment. Judgment should state the below points in all the cases in which an appeal lies from the final order either under section 373 or under section 374(3):
  - e. the serial number of the case;
  - f. the date of the commission of the offence;
  - g. the name of the complainant (if any);
  - h. the name of the accused person, and his parentage and residence; (e) the offence complained of or proved;
  - i. the plea of the accused and his examination (if any); (g) the final order;
  - j. the date of such order;
- Section 356 of CrPC prescribes the requirement regarding making an order for notifying address of previously convicted offender.
- Section 357 of CrPC is about the power of the Court to order payment of compensation. Such order could require a part of the fine to be awarded with regard to-
  - a. defraying the expenses incurred in the prosecution;
  - b. payment to any person for compensation of any loss or injury caused by the offence, when compensation is, in opinion of the Court, recoverable by such person in a Civil Court;
  - c. when any person is convicted of any offence for having caused the death of another person or of having abetted the commission of such an offence, in paying compensation to the persons who, under the Fatal Accidents Act, 1855 (13 of 1855), entitled to recover damages from the person sentenced for the loss resulting to them from such death;
  - d. when any person is convicted of any offence which includes theft, criminal misappropriation,



criminal breach of trust, or cheating, or of having dishonestly received or retained, or of having voluntarily assisted in disposing of, stolen property knowing or having reason to believe the same to be stolen in compensating any bona fide purchaser of such property for the loss of the same if such property is restored to the possession of the person entitled thereto.

- Section 357(2) of CrPC makes it clear that if the fine is imposed in a case, which is subject to appeal, no such payment shall be made before the period allowed for presenting the appeal has elapsed, or if an appeal was presented, then before the decision of the appeal.
- Section 357(3) states that when a Court imposes a sentence of which fine does not form a part, the Court may, while passing the judgment, order the accused person to pay, by way of compensation such amount as may be specified in the order to the person who has suffered any loss or injury by reason of the act for which the accused person has been so sentenced.
- Section 357(4) of CrPC contains an important declaration that the type of order referred to in this Section may also be made by an Appellate Court or by the High Court or Court of Session while exercising its powers of revision.
- Section 359 provides for an order in regard to the payment of costs in non- cognizable cases

Thus, trial comes to end with an order of acquittal or where the order is an order of conviction, it ends with an order of sentence that mentions the punishment awarded to the convicted person and it goes without saying that the sentence has to be as authorized by the applicable law. Section 235(2) of CrPC contains an important rule which if not followed would be fatal to the validity of the sentence passed. It says before passing the sentence order, the accused has a statutory right to be heard unless the court proposes to set him out on probation on the ground of good conduct in accordance with section 360 of CrPC. In the case of conviction, it is only after the sentence is awarded that the judgment becomes complete and can be appealed again under section 374 of the Code.

## PROBLEMS OF TRIAL SYSTEM

### Strict Adherence of Trial Procedure is Essential

Emphasizing on the need for scrupulous following of the procedure laid down for trial of criminal offences, the Kerala High Court in *V.Sugandhalal v. St.Mary's Finance Limited* [2001] 107 Comp Cas 451 (Ker) held that when a person is sentenced to undergo imprisonment, there is deprivation of his personal liberty.

Justice V.R.Krishna Iyer in *State of Punjab v. Shamlal Murari*, AIR 1976 SC 1177 said that -

“we must always remember that procedural law is not to be a tyrant but a servant, not an obstruction but an aid to justice. It has been wisely observed that procedural prescriptions are the handmaid and not the mistress, a lubricant, not a resistant in the administration of justice. Where the non-compliance, though procedural, will thwart fair hearing or prejudice doing of justice to parties, the rule is mandatory. But, grammar apart, if the breach can be corrected without injury to a just disposal of the case, we should not enthrone a regulatory requirement into a dominant desideratum. After all, courts are to do justice, not to wreck this end product on technicalities “.

The Bombay High Court Indian in *Hotels Co. Limited v. Bhaskar Moreshwar Karve and Anor.* [1994] 81 Comp Cas 132 (Bom) referring to litigations arising out of wrongful withholding of properties by ex-employees of companies, held as follows:

“It has become almost routine in this class of litigation that the criminal prosecution instituted by the company is sought to be stayed on the ground that the accused has raised issues which are within the exclusive jurisdiction of the civil court where the accused can confidently assure himself that the first round of litigation will not be over for at least two decades if the requisite dilatory tactics are resorted to The remedy prescribed by Section 630 of the Act is required to be speedy and it is required to be effective. Consequently it must necessarily yield the



desired result is how the section has been interpreted. What is, in fact, happening in the proceedings is exactly the reverse and it is, therefore, necessary to ensure that the law is given effect to and not put into cold storage.”

### DETAILED WRITTEN ORDERS UNNECESSARY AT EVERY STAGE OF TRIAL

The Supreme Court in *Kanti Bhadra Shah v. State of West Bengal*, [2000] 1 SCC 722 said that it is unnecessary to write detailed orders, at all stages of the criminal justice such as issuing process, remanding the accused to custody, framing charge etc. The apex court further held that at the stage of framing charge there need to be only a prima facie case and there is no need for giving reasons for his decision to frame charges.

Even in the cases instituted otherwise than on a police report, the Magistrate is required to write an order showing the reasons. Even in a trial before a Sessions Court, the Judge is required to record reasons only if he decides to discharge the accused. But, if he decides to frame charge, he could do so without adducing any reasons.

### WRONGFUL CONVICTION - A CASE STUDY

The case before the Madras High Court in *P. Venkatakrishna Reddy v. Registrar of Companies* [1996] 85 Comp Cas 572 (Mad) was a revision petition by the Managing Director of a Company against the order of conviction and sentence recorded first by the Chief Metropolitan Magistrate and thereafter in appeal confirmed by the Principal Sessions Judge in respect of a complaint preferred by the Additional Registrar of Companies for an offence under section 209A of the Act.

- The inspecting officer came to the registered office of the company in the period between 1 August 1985 and 3 August 1985;
- Section 209A (2) of the Act has cast the mandatory duty on the inspecting officers to require all the books of account and papers of the company to be produced by the company or its employees specifying the time within which they should produce and the place for the production and inspection of the same;
- The accused did not produce the account books of the company in the said period. Therefore, it is alleged that they have contravened the provisions of section 209A(5) and section 209A(8) of the Act;
- On completion of the inspection, Radhakrishnan, a director of the company, gave a letter, exhibit P-1, requesting time till 10 September 1985, to produce the books of account, which was followed by another letter, exhibit P-2, asking further time till 20 September 1985;
- But books were not produced till 14 October 1986. This was the charge revealed by the evidence of P.W.-1, Mr.B.C.Davey, Asst.Registrar of Companies, Madras-6;
- The trial court found the revision petitioner guilty of the offence tried against him and accordingly convicted and sentenced him;
- The trial court found that the accused Nos.2 to 9 were not guilty and acquitted all of them;
- On appeal the learned Principal Sessions Judge confirmed the finding of the trial court. The contention in the revision petition was as follows:
- The launching of the prosecution against the accused is clearly an error of law committed to the utter disregard of the mandate built in under the provisions of the company law itself.
- Therefore, the finding of conviction and sentence recorded by the both courts against the revision petitioner are liable to be set aside by the interference of this court.
- Where books of account and papers were not produced before them for inspection, it was imperative on the part of the inspecting officers, to require the company or its employees to produce such books of account or the papers of the company within such time as they may think fit and fixing the place to

comply with the same by specifying the above said aspects impliedly in writing to the company or its employees. (This aspect is called the summoning of books by the Registrar or the Inspecting Officer as per section 209A of the erstwhile Companies Act, 1956)

- The Registrar or the person appointed for such inspection may specify the time, date and place where the company or its staff should comply with their requirements. This condition appears to be a sine qua non before launching criminal prosecution under section 209A(8) of the erstwhile Companies Act, 1956.
- Perhaps P.Ws -1 and 2 on being fully conscious of sub-section (2) and its mandatory obligations cast upon them issued exhibits P-5 notice to the revision petitioner and other on 17 February 1986.
- The last two paragraphs of exhibit P-5 which read as follows:

“You are, therefore, being the managing director of the above mentioned company, requested to show cause within 10 days from the date of issue of this notice, as to why penal action, as provided under Section 209A(5) of the erstwhile Companies Act, 1956, should not be taken against you for noncompliance with the provisions of Section 209A(1) of the erstwhile Companies Act, 1956 and the proviso thereto, you are requested to submit your reply in triplicate.

Please take notice that if no reply is received or cause shown within the above stipulated time, it will be presumed that you have nothing to say in the matter and prosecution will be launched against you without any further reference in the matter “.

- It has to be noticed that the revision petitioner had addressed a letter to the Additional Registrar of Companies on 27 February 1986, under exhibit D-3 wherein he has stated that one S. Radhakrishnan, director, has since been entrusted with the day to day running of the company from February, 1985, onwards, that since the said Radhakrishnan died on 17 November 1985, the required documents of the company could not be produced when inspection was made from 1 August 1985 to 3 August 1985, and that, therefore, to procure the said documents and papers from the custody of the said Radhakrishnan and to produce before the authority, he wanted 30 days' time.
- This was followed by another notice sent to the revision petitioner by P.W.-I on 15 April 1986, and then exhibit D-5 had been addressed to P.W.-I on behalf of the company. The perusal of exhibits D-3, D-4 and D-5 has clearly established not only the cause and reasoning for the non- production of the books of account and papers during the inspection, but also within the time specified and required under exhibit P-5 and exhibit D-4.

The High Court expressed no hesitation to hold as follows:

- Ample and convincing cause has been shown by the revision petitioner on behalf of the company to the authorities concerned for not producing the books of account or the papers of the company as required.
- There was no response at all from the authorities to the explanation and cause shown to the notice given by them.
- Significantly till 17 February 1986, for a period of more than six months they were silent and did not proceed against the accused.
- The delay is to be taken as relevant in context of the opportunity provided under section 209A(2) made available to the accused herein to tender his explanation or cause for their non-compliance, if any.
- Without doing so, launching prosecution in spite of their explanation would clearly be not only against the spirit of the mandatory obligations provided in the section itself but also against the principles of natural justice.
- Both the trial court as well as the lower appellate court clearly and totally overlooked the above said legal aspects and did not even attempt to consider these aspects while rendering the judgment on a

criminal charge being framed and tried against a person and thereby to sustain a conviction against him.

- The conviction and sentence recorded by both the courts against the revision petitioner are hereby set aside and the accused is set at liberty.
- The fine amount paid, if any, shall be refunded to the revision petitioner immediately.

### ERRONEOUS INTERPRETATIONS AND CONSEQUENT EFFECTS - A CASE STUDY

The decision of the Delhi High Court in *Satish Dayal v. Mackinnon Mackenzie and Co. Limited cited supra*, illustrates how the judicial officers at different stages interpret the procedural requirements built in under the CrPC and how such wrong notions and unwanted elaboration of requirements of law could bring up litigations and prolong the trial process.

The important stages in the said case were as follows:

- The petitioner was summoned by the Additional Chief Metropolitan Magistrate to face trial.
- Notice under section 251 of CrPC was duly served on him on 12 April 1983.
- The case was adjourned to 12 August 1983, for the respondent-complainant to present the evidence.
- An application was moved on behalf of the respondent on 5 August 1983, for permission to withdraw the complaint on the ground that due to inadvertence / oversight, the court had not examined the complainant under section 200 of CrPC which was mandatory in the case of a private complaint before issuing process against the accused, i.e. the petitioner.
- Indeed a fresh complaint was filed along with the said application.

The learned Additional Chief Metropolitan Magistrate allowed the complainant to withdraw the complaint with permission to file a fresh complaint. He dismissed the complaint as withdrawn:

- The learned Magistrate entertained the fresh complaint on the same day and after examining the complainant, he directed the issue of the process against the petitioner, vide order dated 8 August 1983.
- The petitioner appeared in the court in obedience to the summons issued and made an application under section 300 of CrPC contending that in view of the mandatory language of section 257 of CrPC, the withdrawal of the previous complaint was tantamount to his acquittal and as such a fresh complaint on the same acts/cause of action was barred by the provisions of section 300 of CrPC.
- He contended that the learned magistrate could permit withdrawing complaint after providing sufficient reasons for the same but in this case, no reason whatsoever existed which could have justified permission by the court to withdraw the original complaint.
- Further, no notice of the said application was ever given to him which was imperative, especially when the court made a further order that the respondent-complainant could file a fresh complaint which was not only prejudicial to him but also beyond the jurisdiction of the learned Magistrate.
- The learned Additional Chief Metropolitan Magistrate, dismissed the application of the petitioner under section 300 of CrPC.
- The petitioner filed a revision petition against the said order in the Court of Sessions.
- The Additional Sessions Judge vide impugned order dated 24 January 1985, dismissed the revision petition as well.

The grounds raised before the High Court were as follows:

- Both the courts below slipped into a grave error as the order dated 5 August 1983, did not purport to be one under section 257 of CrPC.
- As the question was already at the trial stage, the Magistrate could only act under the provisions embodied in Chapter XX of CrPC that prescribes the procedure for trial of the summon cases by the Magistrates.
- The Magistrate had no jurisdiction to permit the complainant to file a fresh complaint on the same subject-matter / with regard to the same cause of action as there is neither any provision in CrPC (like those of Order XXIII of the Code of Civil Procedure) that empower a Magistrate to grant permission to file a fresh complaint nor the criminal court has any inherent power.
- The learned Magistrate did not even care to issue notice of the application made by the complainant for withdrawal before disposing of the same. Thus, he did not afford any opportunity to the petitioner to be heard on the point and such a procedure too is abhorrent to criminal jurisprudence and the concept of rule of law to which we are wedded.
- Withdrawal of the complaint under section 257 of CrPC is permissible only if the Magistrate is satisfied that there are sufficient grounds for permitting such withdrawal. This clearly implies that the Magistrate must apply his judicial mind to the reasons, which impel the complainant to withdraw the complaint before granting the permission.

The High Court observed that the proceedings were vitiated by the flaw of non- examination of the complainant prevailed with the learned Magistrate when he allowed the withdrawal. He characterized his original order dated 7 December 1982, under section 200 of CrPC, which was issued without examination of the complainant as totally invalid.

The question arose was whether non-compliance with the said provision would vitiate the subsequent proceedings / trial of the accused or whether it would be merely an irregularity curable under section 465 of CrPC.

Sections 460 to 464 of CrPC deals with particular kinds of irregularities and their effect on proceedings. Section 465 of CrPC, however, is residuary. Obviously, this section is based on the principle that mere technicalities in respect of the matters, which are not of vital or important significance in a criminal trial, should not be allowed to frustrate the ends of justice.

Where a Magistrate dismisses a complaint without examining the complainant or his witnesses as required by section 200 of CrPC, the complainant may have a legitimate grievance that he was not given an opportunity to substantiate his allegations at least *ex facie*. Likewise, if an accused is summoned without examining the complainant, he may challenge the summoning order on the ground that there was no verification of the complaint, unless, the

Complainant happens to be a public servant and as such no prima facie case for summoning was made out. Of course, he must question the legality of the order even at the threshold.

However, once the trial commences and culminates in the conviction or acquittal of the accused, it is not understandable how he can claim to have been prejudiced, as it may happen only in the exceptional cases, by non-examination of the complainant before issuing the process.

The Delhi High Court quoted the following conclusion arrived at by a learned single judge of Madras High Court *In Re T. Subramania Achari*, AIR 1955 Mad 129:

“The net result of this analysis is that what has to be considered in each case is whether the illegality or irregularity complained of affected the competency of the court or whether it had occasioned or must be taken to have occasioned in a failure of justice. To quote Dr. Nandlal [the Code of Criminal Procedure,

Volume II, Kishen Lai & Co., Lahore (1936)] the test is: Does the error go to the whole root of trial? Does it vitiate the proceedings? Has the court assumed an authority, which it did not possess? Has it broken the vital rules of procedure?

If the error is of such a nature, then the proceedings are vitiated in their very inception but the mere fact that a certain provision of CrPC is imperative does not itself indicate that a breach of the provision vitiates the whole proceedings: *Bechu Chaube v. Emperor*, AIR 1923 All 81. “

After the above observations the Delhi High Court held as follows:

“Looking at the matter from this angle, there was no sufficient ground for granting permission to withdraw the complaint. A Magistrate can always grant permission to the complainant to withdraw the complaint, by passing an order of acquittal as per Section 257. In such a case even if no notice of the application made for withdrawal was given to the accused, the latter cannot complain of having been prejudiced because he is benefited by an order of acquittal. However, that cannot be said of a case where a complainant is permitted not only to withdraw the complaint in the absence of the accused but is also granted permission to file afresh complaint. Such an order will be evidently prejudicial to the accused, as he has to face a fresh trial for no fault of his. Further, such an order will naturally enable the complainant to remove any defect or flaw, which might have existed in the original complaint, or the allegations contained therein.”

The crucial point, however, is that for the applicability of the rule of *autrefois acquit* (The Law Lexicon, P. Ramanatha Aiyar, says that it is a plea by a criminal, that he was heretofore acquitted of the same offence; for one shall not be brought into danger of his life or liberty for the same offence more than once) embodied in section 300 of CrPC, the following three essential conditions have to be satisfied:

- There must have been a trial of the accused for the offence charged against him. The trial must have been by a court of competent jurisdiction.
- There must have been a judgment or order of acquittal.

The Delhi High Court referred to the decision of the Supreme Court in *Mohammad Safi v. State of West Bengal*, AIR 1966 SC 69 where the accused had taken the plea of *autrefois acquit* and the Supreme Court observed as follows:

“Where a person has done something which is made punishable by law, he is liable to face a trial and this liability cannot come to an end merely because the court before which he was placed for trial forms an opinion that it has no jurisdiction to try him or that it has no jurisdiction to take cognizance of the offence alleged against him. Where, therefore, a court says, though erroneously, that it was not competent to take cognizance of the offence, it has no power to acquit that person of the offence. An order of acquittal made by it is in fact a nullity. It would be only repetition to say that for proceedings to amount to a trial, they must be held before a court which is in fact competent to hold them and which is not of opinion that it has no jurisdiction to hold them. A fortiori it would also follow that the ultimate order made by it by whatever name it is characterized cannot, in law, operate as an acquittal.”

Taking note of the above observations, the Delhi High Court held that there can be no shadow of doubt that the order made by the learned Additional Chief Metropolitan Magistrate on 5 August 1983, in the previous complaint was not warranted by law and as such it cannot be said to be an order of acquittal as contemplated in section 257 of CrPC so as to operate as a bar to a subsequent prosecution. Even if the said order is held to be bad in law and none of the previous complaint will have to be restored and decided afresh. Needless to say, the High Court, in exercise of its revision / inherent power, can examine the legality and propriety of even that order. So, looking at the matter from this angle too, the petitioner has to go through the trial. He cannot approbate and reprobate at the same time.

## OFFENCES RELATING TO PERJURY

### Section 340

Section 340 of CrPC contains the procedure to be followed for prosecuting offences referred to under 195 of the CrPC. Section 340 should be read in conjunction with section 195 of CrPC. When an offence under section 195 of the Code of Criminal Procedure, 1973 [CrPC] has been committed, the person aggrieved must make an application to the Court before which the main proceedings is taking place requesting the Court to make a complaint in writing to the appropriate judicial magistrate so as to prosecute the persons who appear to have committed the offence.

Section 340(1) of CrPC states that when upon an application made to it in this behalf or otherwise any Court is of opinion that it is expedient in the interest of justice that an inquiry should be made into any offence referred to in section 195(l)(b), which appears to have been committed in or in relation to a proceeding in that Court or as the case may be, in respect of a document produced or given in evidence in a proceeding in that Court, such Court may, after such preliminary inquiry, if any, as

it thinks necessary-

- a. record a finding to that effect;
- b. make a complaint thereof in writing;
- c. send it to a Magistrate of the first class having jurisdiction;
- d. take sufficient security for the appearance for the accused before such Magistrate, or if the alleged offence is non-bailable and the Court thinks it necessary so to do send the accused in custody to such Magistrate; and
- e. bind over any person to appear and give evidence before such Magistrate.

Section 340(2) of CrPC states that the power conferred on a Court by sub-section (1) in respect of an offence may, in any case where that Court has neither made a complaint under sub-section (1) in respect of that offence nor rejected an application for the making of such complaint, be exercised by the Court to which such former Court is subordinate within the meaning of section 195(4).

Section 340(3) states that the complaint made under this section shall be signed, (a) where the Court making the complaint is a High Court, by such officer of the Court as the Court may appoint; (b) in any other case, by the presiding officer of the Court or by such officer of the Court as the Court may authorise in writing in this behalf.

Section 340(4) of CrPC makes it very clear that for the purposes of section 340, the word “Court” has the same meaning as in section 195.

### Section 195

Section 195(1) of CrPC states that no Court shall take cognizance of the following offences except on the complaint in writing of that Court or by such officer of the Court as that Court may authorise in writing in this behalf, or of some other Court to which that Court is subordinate:

#### Clause (a)

- i. any offence punishable under sections 172 to 188 (both inclusive) of the Indian Penal Code (45 of 1860), or
- ii. any abetment of, attempt to commit, such offence, or
- iii. any criminal conspiracy to commit, such offence, except on the complaint in writing of the public servant concerned or of some other public servant to whom he is administratively subordinate;



**Clause (b)**

- i. any offence punishable under any of the following section of the Indian Penal Code (45 of 1860), namely, sections 193 to 196 (both inclusive), 199,200,205 305 to 211 (both inclusive) and 228, when such offence is alleged to have been committed in, or in relation to, any proceeding in any Court, or
- ii. any offence described in section 463, or punishable under section 471, section 475 or section 476, of the said Code, when such offence is alleged to have been committed in respect of a document produced or given in evidence in a proceeding in any Court, or
- iii. any criminal conspiracy to commit, or attempt to commit, or the abetment of, any offence specified in sub-clause (i) or sub-clause (ii).

Section 195(2) states where a complaint has been made by a public servant under clause (a) of subsection (1) any authority to which he is administratively subordinate may order the withdrawal of the complaint and send a copy of such order to the court; and upon its receipt by the court, no further proceedings shall be taken on the complaint. A proviso under this sub-section states that no such withdrawal shall be ordered if the trial in the Court of first instance has been concluded.

Section 195(3 of Section 195 of CrPC adds that in clause (b) of sub-section (1), the term “Court” means a Civil, Revenue or Criminal Court, and includes a tribunal constituted by or under a Central, provincial or State Act if declared by that Act to be a Court for the purposes of this section.

Section 195(4) of CrPC states that for the purposes of clause (b) of sub-section (1), a Court shall be deemed to be subordinate to the Court to which appeals ordinarily lie from appealable decrees or sentences of such former Court, or in the case of a civil Court from whose decrees no appeal ordinarily lies, to the principal Court having ordinary original civil jurisdiction within whose local jurisdiction such Civil Court is situate.

A proviso under section 195(4) of CrPC adds that -

- a. where appeals lie to more than one Court, the Appellate Court of inferior jurisdiction shall be the Court to which such Court shall be deemed to be subordinate;
- b. where appeals lie to a civil and also to a Revenue Court, such Court shall be deemed to be subordinate to the civil or Revenue Court according to the nature of the case or proceeding in connection with which the offence is alleged to have been committed.

In *Iqbal Singh Marwah v. Meenakshi Marwah and Anor.* AIR 2005 SC 2119, it was observed by the Supreme Court that “judicial notice can be taken of the fact that the Courts are normally reluctant to direct filing of a criminal complaint and such a course is rarely adopted”

When a party makes an application under section 340 of CrPC to the Court before which the main proceeding is taking place in relation to which an offence referred to section 195(l)(b) of CrPC has allegedly been committed, the Court has a duty to see whether it is expedient in the interest of justice to make a complaint after making an *enquiry into the alleged commission of such offence. For this purpose the Court must hold a preliminary enquiry and record a finding as to whether any such offence has been committed. Thereafter if the court is of opinion that it is expedient to make a complaint in writing, it may do so and send it to magistrate having jurisdiction. Therefore, prior to making such preliminary enquiry, no such complaint can be sent to the magistrate concerned. Even after making the enquiry, only if the court thinks it is expedient to do so in the interest justice, it may make a complaint in writing.*

Therefore, it is clear that even after forming an opinion that an offence referred to under section 195(l)(b) appears to have been committed by a party to the main proceeding, the Court need not rush to making the complaint. It has the absolute discretion to make or not to make any such complaint. The language contained in section 340 of CrPC leaves no manner of doubt on this score. The factor that guides the Court in dealing with an application under that section seems to be whether it is necessary to do so in the interest of justice.



For this purpose, the Court may have to first of all ascertain whether the document in respect of which the offence complained has been allegedly committed is the one which has been produced or given to the Court in evidence in a proceeding before it. The document in respect of which the alleged offence has taken place must have been tendered to the Court by a party to a suit or other legal proceeding for the purpose of evidence. If it is not a document submitted to the Court as evidence, section 340 of CrPC does not apply at all. Similarly, if the document is not the one which was created and produced during the course of the proceedings before the Court, as would be the case where the document was one which was created long before the institution of the suit or other legal proceeding, section 340 of CrPC would not apply at all.

Even after being satisfied that the document in question is produced or given to Court in evidence, the Court may look at the weight of the evidence contained in the said document by considering all other evidence in front of it. If the document is not containing any substantial evidence or if it is of such nature that by disregarding the same, the adjudication of the dispute before it is possible, the Court may reject the application under section 340 of CrPC.

The following are the important aspects / points relating to such offences:

- Firstly, the Court may see if the document in question which is the subject matter of the application under section 340 of CrPC is created and produced during the course of the suit or other legal proceedings. If it is not, the application is liable to be considered unnecessary because no such application is mandatory for the purpose of prosecuting the offence. In such a case, the application does not come under the ambit of section 340 of CrPC at all.
- Secondly, if the Court is satisfied that the application in question falls within the ambit of section 340 of CrPC, it may hold a preliminary enquiry to see whether the document in question constitutes any evidence at all. The Court may look at the document to see whether the document has been produced to lead evidence in relation to the matter in issue before the Court. In case, the Court of the opinion that the document in question does not at all constitute 'evidence', no further enquiry is needed.
- In case of the Court thinks that the document has been created and given to the Court to constitute evidence and in relation to the same, an offence referred to under section 195 of CrPC appears to have been committed, it may proceed further in accordance with law.
- It is only when a document constitutes an evidence of any fact which is in issue in the suit or proceedings in question and if that document has been created and given during the course of the proceeding in question, then only section 340 of CrPC will come into play. Even in such cases, only if the court thinks it expedient in the interest of justice, it can make a complaint in writing for criminal prosecution. Thus, the court has absolute discretion to make or not to make any such complaint in writing, if it is of the opinion that in the interest of the justice it is not expedient to do so.
- In any case, the Court may have to complete the enquiry in the proceeding before it so as to arrive at an opinion whether it is expedient to make the complaint in the interests of justice.
- Where a party to a suit or proceeding files any application under section 340 of the CrPC requesting the Court to make a complaint in writing in relation to an offence falling under section 190 of CrPC and if the Court or as the case may be the other judicial authority refuses to accede to the request, the applicant cannot proceed with the matter any further except preferring an appeal against such decision in a manner known to law. However, nothing prevents the Court declining to make a complaint as prayed for to draw adverse inference against such party as it may think fit.
- Where the application is dismissed on the ground that the document in relation to which an offence under section 190 of CrPC had been committed does not constitute an evidence at all or the document had not been created at all during the course of the proceeding, the applicant can proceed to make a criminal complaint in a manner known to law as the case does not warrant the Court to make the

complaint for the reasons aforesaid. The simple conclusion is that in such cases the intervention of the Court is not at all necessary for prosecuting the offence by filing criminal complaint against the persons alleged to have committed.

- Thus, in no case the applicant is left remediless nor does person accused of having committed an offence is protected in any way without being punished in accordance with law.
- Court for the purpose of section 340 of CrPC would include tribunals and other judicial authorities also if the proceedings before such judicial forums are legal proceedings.

A close reading of section 340 of CrPC would show that the words “which appears to have been committed in or in relation to a proceeding in that Court or, as the case may be, in respect of a document produced or given in evidence in a proceeding in that Court” do not indicate anything that the documents should have been fabricated after institution of the complaint for the purpose of defrauding the court. It is possible that a fabricated document is presented to the court or tribunal for proving a fact which could amount to presenting a false or untrue evidence to the court with an intention to play fraud on the court itself and in such cases there is no other go except to pay the price thereof.

However, it may be noted that in *Iqbal Singh Marwah v. Meenakshi Marwah and Anor.* AIR 2005 SC 2119, a five member bench of the Supreme Court held that -

“an enlarged interpretation to Section 195(I)(b)(ii), whereby the bar created by the said provision would also operate where after commission of an act of forgery the document is subsequently produced in Court, is capable of great misuse. As pointed out in *Sachida Nand Singh*, after preparing a forged document or committing an act of forgery, a person may manage to get a proceeding instituted in any civil, criminal or revenue court, either by himself or through someone set up by him and simply file the document in the said proceeding. He would thus be protected from prosecution, either at the instance of a private party or the police until the Court, where the document has been filed, itself chooses to file a complaint. The litigation may be a prolonged one due to which the actual trial of such a person may be delayed indefinitely. Such an interpretation would be highly detrimental to the interest of society at large “.

In *Sachida Nand Singh v. State of Bihar*, AIR 1998 SC 1121, pronounced by Justice K T Thomas, the Supreme Court held that -

“the scope of the preliminary enquiry envisaged in Section 340(1) of the Code is to ascertain whether any offence affecting administration of justice has been committed in respect of a document produced in Court or given in evidence in a proceeding in that Court. In other words, the offence should have been committed during the time when the document was in *custodia legis*”. It was further held that “it would be a strained thinking that any offence involving forgery of a document if committed far outside the precincts of the Court and long before its production in the Court, could also be treated as one affecting administration of justice merely because that document later reached the Court records “.

In that case, the Supreme Court categorically concluded that “the bar contained in Section 195(IXX) of the Code is not applicable to a case where forgery of the document was committed before the document was produced in a Court”.

## APPEALS UNDER CRPC

Section 372 of CrPC clearly states that there is no question of preferring any appeal against any order unless the statute specifically provides. Section 373 of CrPC will apply with respect to appeals from orders requiring security or refusal to accept or rejecting security for keeping peace or good behaviour. Section 374 enables appeals by a person who has been convicted of an offence. Sections 375 and 376 contain the restrictions relating to appeals.

Section 374 of CrPC says as follows:

- Any person convicted on a trial held by a High Court in its extraordinary original criminal jurisdiction may appeal to the Supreme Court. [s 374(1)]
- Any person convicted on a trial held by a Sessions Judge or an Additional Sessions Judge or on a trial held by any other Court in which a sentence of imprisonment for more than seven years has been passed against him or against any other person convicted at the same trial; may appeal to the High Court. [s 374(2)]

Save as otherwise provided in sub-section (2), any person, convicted on a trial held by a Metropolitan Magistrate or Assistant Sessions Judge or Magistrate of the first class or of the second class, or sentenced under section 325, or in respect of whom an order has been made or a sentence has been passed under section 360 by any Magistrate, may appeal to the Court of Session, [section 374(3)]

Section 375 of CrPC states that there shall be no appeal when the conviction in a case is pursuant to the accused pleading guilty if the order of conviction was issued by a High Court. If the conviction in such cases is passed by a Court of Session, Metropolitan Magistrate or Courts of Judicial Magistrates, the appeal may lie only with respect to the extent or legality of the sentence.

Further, section 376 of CrPC states that there shall be no appeal against any order of sentence of a High Court if the punishment awarded is a sentence of imprisonment for a term not exceeding 6 months or of a fine exceeding INR 1000/-. In the case of an offence in which a sentence of imprisonment for a term not exceeding 3 months or of fine not exceeding INR 200/-, or of both, no appeal can be preferred.

A proviso under section 376 of CrPC says that appeal would however lie in the following situations:

- i. that the person convicted has been ordered to furnish security to keep the peace; or
- ii. that a direction for imprisonment in default of payment of fine is included in the sentence; or
- iii. that more than one sentence of fine is passed in the case, if the total amount of fine imposed does not exceed the amount hereinbefore specified in respect of the case.

There are several offences under the *Companies Act, 2013* that are punishable with imprisonment which may extend to 6 months. Further, there are offences in which punishment by way of fine cannot be less than the prescribed minimum amount.

For instance, let us consider the penal clause contained in section 117(2) of the *Companies Act, 2013*. Section 117 requires resolutions and agreements to be filed with Registrar of Companies. Sub-section (2) says that in case of default in filing resolutions and agreements as required under sub-section (1), the company shall be punishable with fine which shall not be less than INR 5 lakhs but which may extend to INR 25 lakhs and every officer of the company who is in default, including liquidator of the company, if any, shall be punishable with a fine which shall not be less than INR 1 lakh but which may extend to INR 5 lakhs.

If a person is convicted of an offence under any of the laws specified in Part I of the Schedule V to the *Companies Act, 2013* and if he had been sentenced to imprisonment for any period, or to a fine exceeding INR 1,000/-, he stands disqualified from being appointed as a managerial person and such a person cannot be a managing director or manager or whole-time director of any company.

Though there may not be any case under the *Companies Act, 2013* in which the sentence awards a fine of INR 200/- only, it is important to see if there is anything that could be done if the sentence awards a fine of INR 1000/-. If the order of conviction awarding such a fine is by a High Court, no appeal lies against such sentence is the important point to be noted under section 376 of CrPC. There may not be a criminal case arising under the *Companies Act, 2013* that involves the High Court convicting the accused. When section 2(29) read with section 435 of the *Companies Act, 2013* declares the court that has jurisdiction to try offences under the Act, the question of any other court trying the offence does not arise.

However, nothing prevents the High Court from being seized of the case or any matter or question relating to a case arising from the provisions such as sections 395, 397, 398, 402 of CrPC.

### REFERENCE, CALLING FOR RECORDS, REVISION POWERS

The High Courts have powers throughout the State in which they are created and in addition it applies to such other States as may be conferred upon it. The High Court exercises jurisdiction in respect of criminal matters also. Section 482 of CrPC provides that a High Court may use its inherent powers for the purpose of giving effect to any order under CrPC or to prevent abuse of process of any court or otherwise to secure the ends of justice. Section 483 of CrPC provides that every High Court shall exercise its superintendence over the Court of Judicial Magistrates subordinate to it so as to ensure that there is an expeditious and proper disposal of cases by such Magistrates.

Section 395(1) of CrPC contains a provision for making a reference to the High Court for determination of validity of an Act or Ordinance or Regulation or of any provisions thereto. When a question as to the validity of any Act or Ordinance or Regulation or of any provisions thereto arises in a court before which a case is pending disposal and if that court is of the opinion that the Act or Ordinance or Regulation or of any provisions thereto is invalid though neither the High Court under whose jurisdiction that court concerned falls nor the Supreme Court has made any declaration to that effect that such Act or Ordinance or Regulation or of any provisions thereto is invalid, the court should state its opinion and refer the same to the High Court.

Section 395(2) of CrPC provides that if section 395(1) does not apply but a question of law arises and the court before which any case is pending disposal thinks it fit, it may refer the same to the decision of the High Court.

Section 397(1) of CrPC contains an important provision which says that the High court or the Sessions Judge may call for and examine the record of any proceeding before any inferior Criminal Court situate within its or his local jurisdiction for the purpose of satisfying itself or himself as to the correctness, legality or propriety if any finding, sentence or order, recorded or passed, and as to the regularity of any proceedings of such inferior Court, and may, when calling for such record of such inferior Court, direct even suspension of order or suspension of execution of sentence or if the accused is in confinement, release on bail or bond pending such examination. This is nothing but a revision jurisdiction. As stated in an explanation under section 397(1) of CrPC, the Judicial Magistrate or the Executive Magistrate, whether exercising original or appellate jurisdiction shall be deemed to be inferior to the Sessions Judge not only for the purpose of power to examine records as aforesaid but also for the purpose of section 398 of CrPC. Section 397(2) of CrPC provides that such power to call of records and examine the records cannot be exercised in relation to any interlocutory orders passed in appeal, enquiry, trial or other proceeding.

In *Bhaskar Industries Ltd. v. Bhiwani Denim and Apparels Ltd. and Ors.*, AIR 2001 SC 3625, on the interdict contained in section 397(2) of CrPC that the powers of revision shall not be exercised in relation to any interlocutory order, it was held that -

“whether an order is interlocutory or not, cannot be decided by merely looking at the order or merely because the order was passed at the interlocutory stage. The safe test laid down by this Court through a series of decisions is this: If the contention of the petitioner who moves the superior court in revision, as against the order under challenge is upheld, would the criminal proceedings as a whole culminate? If it would, then the order is not interlocutory in spite of the fact that it was passed during any interlocutory stage “.

Section 397(3) of CrPC makes it clear that if a person has made an application under section 397 to the High Court or the Sessions Judge, no further application can be made by that person to any other Court. In other words, if a person is aggrieved on grounds of correctness, legality or propriety of any finding, sentence or order, recorded or passed or as to the regularity of any proceedings of such inferior Court, and makes an application under section 397(1) to the Sessions Judge or to the High Court, the same person cannot make another application under this section to the High Court or the Sessions Judge. A second application for revision is not

maintainable. In case, he makes an application to the Sessions Judge for calling for and examining records of an inferior Court to the Sessions Judge, he would have an appeal opportunity before the High Court which he would not have if he directly makes such application to the High Court.

Section 398 of CrPC contains power that flows from exercising of powers under section 397 of CrPC. Section 398 empowers a High Court (as well as a Sessions Judge) to direct the Chief Judicial Magistrate by himself or by any of the Magistrates subordinate to him and the Chief Judicial Magistrate may himself make, or direct any subordinate Magistrate to make further enquiry in any complaint which has been dismissed under section 203 or section 204(4) or into any case of any person accused of any offence who has been discharged. Of course, a proviso under this section states that the person concerned must be given an opportunity of being heard.

Section 401 of CrPC contains an important provision conferring powers of revision upon the High Court. It flows from an application made under section 397 of CrPC calling for and examining records of an inferior court. It may also arise even otherwise if High Court comes to know about any proceeding that requires intervention. Section 401 of CrPC states that the High Court may exercise, any of the powers of a Court of Appeal by sections 386, 389, 390 and 391 or those powers conferred upon on a Court of Session by section 307. The power of the High Court is discretionary. In other words, the High Court has as much powers to entertain and do the revision as it could reject the revision application. It further states that when the Judges composing the Court of revision are equally divided in opinion, the case shall be disposed of in the manner provided in section 392 of CrPC.

Section 401(2) of CrPC provides that no order under this section can be made to the prejudice (detriment) of the accused or the person concerned unless he has been given an opportunity of being heard.

Section 401(3) of CrPC states that the power of High Court in section 402 does not extend of converting a finding of acquittal into one of conviction. In most of the offences arising under the *Companies Act*, such questions would not arise as delays, deficiencies, deviations and delays causing contravention of provisions of the *Companies Act* would be provable without the need of presence of the guilty frame of mind and that is why offences are triable in a summary way. Section 436(3) of the *Companies Act, 2013* states that notwithstanding anything contained in CrPC, the Special Court may, if it thinks fit, try in a summary way any offence under the Act which is punishable with imprisonment for a term not exceeding three years. A proviso under this sub-section states that in case of a conviction in a summary trial, no sentence of imprisonment for a term exceeding one year can be passed.

Section 401(4) of CrPC says that where an appeal under CrPC lies against any order or finding and no such appeal has been preferred, no proceedings for revision under section 402 should be entertained at the instance of the party who could have appealed. It may be noted that sections 372 to 393 contain provisions relating to appeals and all matters incidental thereto.

Section 401(5) of CrPC states that where under CrPC an appeal lies but an application for revision has been made to the High Court by any person and the High Court is satisfied that such application was made under the erroneous belief that no appeal lies thereto and that it is necessary in the interests of justice so to do, the High Court may treat the application for revision as a petition of appeal and deal with the same accordingly.

There may be transfer of a criminal case, when one or more persons convicted at the same trial, make or makes an application under section 402 of CrPC.

## **APPEAL IN CASE OF ACQUITTAL**

Section 378(1) states that save as otherwise provided in sub-section (2) and subject to the provisions of sub-sections (3) and (5) -

- a. the District Magistrate may, in any case, direct the Public Prosecutor to present an appeal to the Court of Session from an order of acquittal passed by a Magistrate in respect of a cognizable and non-bailable offence;



- b. the State Government may, in any case, direct the Public Prosecutor to present an appeal to the High Court from an original or appellate order of an acquittal passed by any Court other than a High Court not being an order under clause (a) or an order of acquittal passed by the Court of Session in revision.

Section 378(2) of CrPC states that if such an order of acquittal is passed in any case in which the offence has been investigated by the Delhi Special Police Establishment constituted under the *Delhi Special Police Establishment Act, 1946 (25 of 1946)* or by any other agency empowered to make investigation into an offence under any Central Act other than this Code, the Central Government may, subject to the provisions of sub-section (3), also direct the Public Prosecutor to present an appeal-

- a. to the Court of Session, from an order of acquittal passed by a Magistrate in respect of a cognizable and non-bailable offence;
- b. to the High Court from an original or appellate order of an acquittal passed by any Court other than a High Court not being an order under clause (a) or an order of acquittal passed by the Court of Session in revision.

Section 378(3) states that no appeal under sub-section (1) or sub-section (2) shall be entertained except with the leave of the High Court. In other words the High Court has powers to admit the appeal or refuse to admit the same. Without obtaining the leave of the High Court, the appeals under sub-sections (1) and (2) of section 378 are not possible.

Section 378(4) of CrPC states that if such an order of acquittal is passed in any case instituted upon complaint and the High Court, on an application made to it by the complainant in this behalf, grants special leave to appeal from the order of acquittal, the complainant may present such an appeal to the High Court.

Section 378(5) of CrPC states that no application under sub-section (4) for the grant of special leave to appeal from an order of acquittal shall be entertained by the High Court after the expiry of six months, where the complainant is a public servant, and sixty days in every other case, computed from the date of that order of acquittal. Registrar of Companies must certainly be regarded as a public servant and can avail the benefit of 6 months for preferring an appeal.

In technical offences arising from delays, deficiencies, deviations and defaults of provisions under the *Companies Act, 2013*, acquittal will be rare and if acquittal happens, it would mean there has been something radically wrong with the prosecution. Granting relief in terms of powers conferred upon a Court under section 463 of the *Companies Act, 2013* or as the case may be, section 633 of the *Companies Act 1956* is different from acquittal. Dismissing a complaint on the ground that complaint has been filed beyond the period of limitation specified in CrPC is altogether different from acquittal. Acquittal or conviction will happen only after a trial when the proceedings against the accused reach its logical conclusion resulting in acquittal or conviction of the accused.

Section 378(6) of CrPC states that if, in any case, the application under sub-section (4) for the grant of special leave to appeal from an order of acquittal is refused, then no appeal from that order of acquittal shall lie under sub-section (1) or under sub-section (2). In fact, window for appeal is limited and as stipulated in section 372 of CrPC, no appeal shall lie unless otherwise provided.

Section 444 of the *Companies Act, 2013* provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Central Government may, in any case arising under this Act, direct any company prosecutor or authorise any other person either by name or by virtue of his office, to present an appeal from an order of acquittal passed by any court, other than a High Court, and an appeal presented by such prosecutor or other person shall be deemed to have been validly presented to the appellate court.

Similar provision was there under the *Companies Act, 1956* too. As per section 624B of the *Companies Act, 1956*, the Central Government may direct any company prosecutor or authorise any other person either by name or by virtue of his office to present an appeal from an order of acquittal passed by any court other than

a High Court. An appeal presented by such prosecutor or other person will be deemed to have been validly presented to the appellate court.

## **POWERS OF THE APPELLATE COURT**

Section 386 of the CrPC declares the powers of an Appellate Court. It will come into play only in a case where the appeal has not been dismissed summarily under section 384 though the power to dismiss an appeal summarily is by itself a power of the Appellate Court.

With respect to the powers of the Appellate Court, section 386 of CrPC states that the Appellate Court may dismiss the appeal if it considers that there is no sufficient ground for interfering with the order under appeal. Before doing so, the Appellate Court must peruse the records, hear the appellant or his pleader, if he appears, and also the Public Prosecutor, if he appears, and in case of an appeal under Section 377 or Section 378, the Appellate Court must hear the accused too.

If the Appellate Court has not dismissed the appeal as aforesaid, it may -

- a. in an appeal from an order of acquittal, reverse such order and direct that further inquiry be made, or that the accused be re-tried or committed for trial, as the case may be, or find him guilty and pass sentence on him according to the law.
- b. in an appeal from a conviction, reverse the finding and the sentence and acquit or discharge the accused, or order him to be re-tried by a Court of competent jurisdiction subordinate to such Appellate Court or committed for trial, or alter the finding, maintaining the sentence, or with or without altering the finding, alter the nature or the extent, or the nature and extent, of the sentence, but not so as to enhance the same;
- c. in an appeal for enhancement of sentence, reverse the finding and sentence and acquit or discharge the accused or order him to be re-tried by a Court competent to try the offence, or alter the finding maintaining the sentence, or with or without altering the finding, alter the nature or the extent, or the nature and extent, of the sentence, so as to enhance or reduce the same;
- d. in an appeal from any other order, alter or reverse such order;
- e. make any amendment or any consequential or incidental order that may be justified or proper;

Provided that the sentence shall not be enhanced unless the accused has been given an opportunity of showing cause against such enhancement.

Provided further that the Appellate Court shall not inflict greater punishment than the court passing the order or sentence under appeal for the offence, which in its opinion the accused has committed.

Section 386(b) of CrPC is important. It gives ample powers to the Appellate Court in relation to an appeal arising from an order of conviction and the Appellate Court may even acquit the person convicted of an offence by the trial court.

Section 389 of CrPC contains another important provision.

Section 386(1) of CrPC states that pending any appeal by a convicted person, the Appellate Court may, for reasons to be recorded by it in writing, order that the execution of the sentence or order appealed against be suspended and, also, if he is in confinement, that he be released on bail, or on his own bond.

The words “execution of sentence or order appealed against may be suspended” are very important and in order that the sentence or order is capable of being suspended, it should be an executable order.

A proviso under sub-section (1) states that the Appellate Court shall, before releasing on bail or on his own bond a convicted person who is convicted of an offence punishable with death or imprisonment for life or



imprisonment for a term of not less than ten years, shall give opportunity to the Public Prosecutor for showing cause in writing against such release. In the case of offences covered under section 447 involving the element of fraud or similar fraudulent elements, a person may be sentenced to imprisonment for a term of 10 years too. In case of offences covered under section 443 of the *Companies Act, 2013*, as stated in section 443 company prosecutors have all the powers and privileges conferred by the Code on Public Prosecutors appointed under Section 24 of the Code and accordingly opportunity must be given to the company prosecutors as stated in this proviso. A further proviso states that in cases where a convicted person is released on bail it shall be open to the Public Prosecutor to file an application for the cancellation of the bail.

Section 386(2) states that the power conferred by this section on an Appellate Court may also be exercised by the High Court in case of an appeal by convicted person to a Court subordinate thereto.

Section 386(3) of CrPC states that if the convicted person satisfies the Court by which he is convicted that he intends to present an appeal, the Court shall, (i) where such person, being on bail, is sentenced to imprisonment for a term not exceeding three years, or (ii) where the offence for which such person has been convicted is bailable, and he is on bail, order that the convicted person be released on bail unless there are special reasons for refusing the bail. The Court shall give sufficient time to present the appeal and obtain the orders of the Appellate Court under sub-section (1), and the sentence of imprisonment shall be deemed to be suspended as long as he is released on bail.

Section 386(4) of CrPC declares that when the appellant is ultimately sentenced to imprisonment for a term or to imprisonment for life, the time during which he is so released shall be excluded in computing the term for which he is sentenced.

In *Rama Narang v. Ramesh Narcmg and Ors.* [1995] 83 Comp Cas 194 (SC), the Supreme Court, while reviewing the validity of the Judgment of the Bombay High Court which had declared that the Delhi High court had no power to make a particular interim order, considered the question whether powers of an appellate court (in this case it was the Delhi High Court) under section 389 of CrPC could extend to suspending the order of conviction or would it apply only to suspending the order of sentence of the trial court which is the executable part of the order. The question that arose before the Bombay High Court in a collateral civil proceeding and before the Supreme Court in an appeal against the decision of the division bench of the Bombay High Court was whether the interim order passed by Delhi High Court in an appeal stating that “the operation of the impugned order shall remain stayed” stops a disqualification incurred by the appellant as a result of the impugned order in which he was convicted for certain offences. Section 267 of the *Companies Act, 1956* introduces disqualification to a person from being appointed or re-appointed as a managing director or whole-time director of any company upon conviction if the conviction pertains to an offence involving moral turpitude. For instance a person who is conviction of an offence involving corruption can be said to be convicted of an offence involving moral turpitude. Once a person is convicted, he loses his fitness to be the managing director or whole-time director of any company. If he was holding such a position prior to the order of conviction, in view of section 267, he cannot continue to be the managing director or whole-time director after incurring such disqualification. It is important to note that the passing of the order of conviction instantaneously attaches to such a person the disqualification. Section 385 of the *Companies Act, 1956* contains a similar provision attaching disqualification to a person who is the manager or who is being appointed as the manager of a company. However, section 385(2) of the *Companies Act, 1956* states that the Central Government may, by notification in the Official Gazette, remove the disqualification incurred by any person in virtue of clause (a), (b) or (c) of sub-section (1), either generally or in relation to any company or companies specified in the notification.

Further, there are other provisions of the *Companies Act, 1956* that would also get triggered. Section 274 of the *erstwhile Companies Act, 1956* also contains provisions declaring, inter alia, the disqualifications which will prevent a person from being fit to occupy the position of a director of any company. Section 274(1)(d) states that he has been convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of

the sentence. Even under section 274 of the *erstwhile Companies Act, 1956*, there is a provision enabling the Central Government to remove a disqualification arising under clause (d). While disqualification under section 267 arises from conviction itself, the disqualification under section 274 arises only when if the person convicted and sentenced to imprisonment for a term not less than 6 months. In short, in the case of manager or directors, there is a provision for Central Government to remove the disqualification arising from conviction; but in the case of managing or whole-time directors, there is no such provision. There is also automatic vacation of *that position as section 267 states that such a person cannot continue to be in such office after the incurring of the disqualification*.

Another interesting observation of the Supreme Court in *Rama Narang v. Ramesh Narang and Ors.* [1995] 83 Comp Cas 194 (SC) case was that the appellant (before Delhi High Court, the interim order of which was the subject matter of the appeal, it arose from a civil proceedings in which the impugned interim order was a subject matter in the matter of Narang International Hotels Private Limited) did not come to the court with clean hands.

The Supreme Court held as follows:

“Obviously the order referred to in Section 389(1) must be an order capable of execution. An order of conviction by itself is not capable of execution under the Code. It is the order of sentence or an order awarding compensation or imposing fine or release on probation which are capable of execution and which, if not suspended, would be required to be executed by the authorities “.

“In certain situations the order of conviction can be executable, in the sense, it may incur a disqualification as in the instant case. In such a case the power under Section 389(1) of the Code could be invoked. In such situations the attention of the Appellate Court must be specifically invited to the consequence that is likely to fall to enable it to apply its mind to the issue since under Section 389(1) it is under an obligation to support its order for reasons to be recorded by it in writing’. If the attention of the Court is not invited to this specific consequence which is likely to fall upon conviction how can it be expected to .assign reasons relevant thereto? No one can be allowed to play hide and seek with the Court; he cannot suppress the precise purpose for which he seeks suspension of the conviction and obtain a general order of stay and then contend that the disqualification ceased to operate”.

The following were the observations made by the Supreme Court in the above case:

*“We are afraid the appellant did not approach the Delhi High Court with clean hands if the intention of obtaining the stay was to avoid the disqualification under Section 267 of the Companies Act. That is why we have said that a litigant cannot play hide and seek with the court and must approach the court candidly and with clean hands. It would have been so if the intention of the appellant in obtaining the interim stay was to avoid the disqualification he was likely to incur by the thrust of Section 267 of the Companies Act. If that was his intention he was clearly trying to hoodwink the court by suppressing it instead of coming clean. If he had frankly and fairly stated in his application that he was seeking interim stay of the conviction order to avoid the disqualification which he was likely to incur by virtue of the language of Section 267 of the Companies Act, the Delhi High Court would have applied its mind to that question and would have, for reasons to be stated in writing, passed an appropriate order with or without conditions. We are, therefore, satisfied that the scope of the interim order passed by the Delhi High Court does not extend to staying the operation of Section 267 of the Companies Act”.*

An appeal may be summarily dismissed under section 384 of CrPC. In case, the appeal is essential to stop any disqualification, it must also be brought to the knowledge of the Appellate Court. There is no doubt that a person who loses his eligibility to be a managing director or whole-time director or manager would be suffering an irreparable loss unless Central Government approves his appointment despite of disqualification suffered by him.

## INHERENT POWER OF HIGH COURT

Section 482 of Cr.P.C. is one of the most important sections of the Code. It says that nothing in this Code shall be deemed to limit or affect the inherent powers of the High Court to make such orders as may be necessary to give effect to any order under this Code, or to prevent abuse of the process of any Court or otherwise to secure the ends of justice.

The powers of the High Court u/s 482 Cr.P.C are partly administrative and partly judicial. Inherent powers u/s 482 of Cr.P.C. include powers to quash FIR, investigation or any criminal proceedings pending before the High Court or any Courts subordinate to it and are of wide magnitude and ramification. Court can always take note of any miscarriage of justice and prevent the same by exercising its powers under section 482 of Cr.P.C. These powers are neither limited nor curtailed by any other provisions of the Code. However, such inherent powers are to be exercised sparingly and with caution.

The Supreme Court in *Madhu Limaye v. State of Maharashtra*, 1978 AIR 47, has held that the following principles would govern the exercise of inherent jurisdiction of the High Court:

1. Power is not to be resorted to, if there is a specific provision in the Code for redress of grievances of aggrieved party.
2. It should be exercised very sparingly to prevent abuse of process of any Court or otherwise to secure ends of justice.
3. It should not be exercised as against the express bar of the law engrafted in any other provision of the code.

It is well settled that the inherent powers under section 482 can be exercised only when no other remedy is available to the litigant and not where a specific remedy is provided by the statute. If an effective alternative remedy is available, the High Court will not exercise its powers under this section, especially when the applicant may not have availed of that remedy.

## POWERS OF THE SUPREME COURT

As per Article 132 of the Constitution, an appeal shall lie to the Supreme Court from any judgment, decree or final order of a High Court whether in a civil or criminal or any other proceeding, if the High Court certifies under Article 134A that the case involves a substantial question of law as to the interpretation of some provision of the constitution involved in the case.

As per Article 134 of the Constitution an appeal shall lie before the Supreme Court in a criminal proceeding, from any judgment, final order or sentence, if the High Court on appeal has reversed the order of acquittal of an accused and sentenced him to death or has withdrawn for trial before for any case from any court subordinate to its authority and in such trial, if the High Court had convicted the accused and sentenced him to death or when the High Court certifies under Article 134A that it is a fit case to appeal before the Supreme Court.

The Supreme Court may, under Article 136 of the Constitution, grant in its discretion, a special leave to appeal from any judgment, decree, determination, sentence or order in any case or matter passed or made by any court or tribunal in India.

Under section 406 of CrPC, the Supreme Court is empowered to transfer, in the interests of justice, cases and appeals from one High Court to another High Court or from one criminal court subordinate to one High Court to another criminal court subordinate to another High Court.

## DON'T THWART PROSECUTION

Justice delayed is Justice denied. Persons who occupy a very respectable position in Corporate India try their

best to scuttle the prosecution at any cost. The Madhya Pradesh High Court in case of *Dhirubhai H. Ambani v. Sonia Sethi and Anor.* [2001] 106 Comp Cas 486 (MP) held that Dhirubhai H. Ambani should not have any objection to the service of summons to Reliance Petroleum Limited through him, for the reason that it is not in dispute that he is the executive chairman of the Reliance Petroleum Limited. On the other hand, the court expected that Dhirubhai H. Ambani who was one of the leading captains of the industries in India, should honour the summons of the court. By obeying the legal process of the court the prestige of Dhirubhai H. Ambani was not likely to go down. On the other hand, his stock was bound to go up as a law-abiding citizen.

### REVAMP THE SYSTEM AND DELIVER JUSTICE FAST

In these days of judicial reforms and high-speed technology, it is natural to look forward to various reforms that would cut layers, cost and time to which Corporate India is definitely looking forward. It is true that a criminal trial may result in depriving a person from his life and liberty and it should be handled very cautiously.

However, it is a fact that there is a scope for revamping. The Supreme Court in *U.P. Pollution Control Board v. Mohan Meakins and Ors.* [2000] 101 Comp Cas 278 (SC) quoted its own decision that it gave in the case of Kanti Bhadra Shah, which projects clearly the present problems and calls for efforts to speed up the process.

“If there is no legal requirement that the trial court should write an order showing the reasons for framing a charge, why should the already burdened trial courts be further burdened with such an extra work. The time has reached to adopt all possible measures to expedite the court procedures and to chalk out measures to avert all roadblocks causing avoidable delays. If a Magistrate has to write detailed orders at different stages, merely because counsel would address arguments at all stages, the snail paced progress of proceedings in trial courts would further be slowed down. It is quite unnecessary to write detailed orders at other stages such as issuing process, remanding the accused to custody, framing of charges, passing over to next stages in the trial”.

### IMPORTANT PRINCIPLES

From various decision of the Supreme Court, it could be understood that the following are certain broad but basic principles which are important in criminal justice system.

- “The purpose of the criminal trial is to dispense fair and impartial justice uninfluenced by extraneous consideration”. [*Abdul Nazar Madani v. State of Tamilnadu and Anr.*, AIR 2000 SC 2293]
- “Free and fair trial is sine qua non of Article 21 of the Constitution. It is trite law that justice should not only be done but it should be seen to have been done. If the criminal trial is not free and fair and not free from bias, judicial fairness and the criminal justice system would be at stake shaking the confidence of the public in the system and woe would be the rule of law”. [*K. Anbazhagan v. The Superintendent of Police and Ors.* (2004) 3 SCC 767]
- “Section 303 of Code of Criminal Procedure says that any person accused of an offence before a criminal court or against whom proceedings are instituted under the Code, may of right be defended by a pleader of his choice. Even under the British Rule when Code of Criminal Procedure 1898, was enacted, Section 340(1) thereof gave a similar right to an accused. It is elementary that if a lawyer whom the accused has engaged for his defence is put under a threat of criminal prosecution, he can hardly discharge his professional duty of defending his client in a fearless manner. [*Jayendra Saraswathy Swamigal, Tamil Nadu v. State of Tamil Nadu and Ors.* AIR 2006 SC 6]

### PENAL PROVISIONS AND PERSONS LIABLE

As per the scheme of the *Companies Act, 2013*, for different offences, different categories of people are liable. While generally company and every “Officer who is in Default” are liable, there are offences for which directors, manager, officers other than KMPs, accountants, other persons including auditors, company secretaries, cost accountants, share transfer agents, merchant bankers, liquidators are also liable.

In *Kalpesh Dagli v. State of Gujarat* [2012] 173 Comp Cas 292 (Guj), the Gujarat High Court quoted with approval the decision of Rajasthan High Court in the case of *Ravindra Narayan* [1994] 81 Comp Cas 925 as well as the decision of the Andhra Pradesh High Court in the case of *Smt. G. Vijayalakshmi* [2000] 100 Comp Cas 726 and considering section 5 of the *Companies Act* it is held that -

“the directors are officer in default only where the company does not have Managing Director, Whole-Time Director or manager. It is also required to be noted that even considering the decision of the Rajasthan High Court in the case of *Ravindra Narayan* [1994] 81 Comp Cas 925 the Department of Company Affairs have also issued Circular No. 6/1994 [F. No. 3/41/93-CL-V] dated June 24, 1994 and it is observed that where penal provisions provide for punishment of “officers in default” prosecution be filed against the Managing Director(s); Whole-Time Director(s) and manager, apart from the secretary, if any, and the company and only in those cases where there is no such managerial personnel, i.e., Managing Director/

Whole-Time Director/manager, prosecution be filed against all ordinary directors, apart from the secretary, if any, and the company. Considering the aforesaid, to continue the criminal proceedings against original accused No. 6, who was at the relevant time only ordinary director, would not be maintainable and the same would be abuse of process of law.”

In *Kingfisher Airlines Limited v. Income Tax Department, Assistant Commissioner of Income Tax* [2014] 185 CompCas 374 (Kar), it was held that “there is no bar for treating more than one person as the Principal Officer for initiation of criminal proceedings”.

In *MM Shah v. Deputy Director of Enforcement, Bombay*, [2011] 166 CompCas 17 (Bom), the Bombay High Court held that the liability depends on the role one plays in the affairs of a company and not on designation or status.

When one considers the above decision in the contradistinction to the definition of the expression “officer who is in default”, it can be understood that for most of the offences under the *Companies Act, 2013*, designation certainly matters and any person of a particular designation may be directly and squarely liable irrespective of the role played by him in the affairs of the company. The penal liability arise on account of the deeming fiction contained in the statute and notwithstanding the same, a person, irrespective of the designation or status may also become liable in view of the role played by him. Though it was held in a different context in *Yogendra Singh v. Ranbir Sharma and Anor.* [2011] 165 CompCas 69 (All), by the Allahabad High Court that if a person is a Managing Director of the company, the mere fact that he is the Managing Director makes him liable.

In *S N Jain v. Registrar of Companies*, [2008] 145 CompCas 453 (Del), the Delhi High Court held that when a petitioner had been arrayed as an accused on the ground that he was the Managing Director of the company and not as a nonexecutive director, the complainant cannot turn around and attempt to have the accused prosecuted in a different capacity.

In *Pepsico India Holdings Private Limited v. Food Inspector and Anor.* [2011] 161 CompCas 197 (SC), the Supreme Court held that -

“it is now well established that in a complaint against a Company and its Directors, the Complainant has to indicate in the complaint itself as to whether the Directors concerned were either in charge of or responsible to the Company for its day-to-day management, or whether they were responsible to the Company for the conduct of its business. A mere bald statement that a person was a Director of the Company against which certain allegations had been made is not sufficient to make such Director liable in the absence of any specific allegations regarding his role in the management of the Company.”

In *State of NCT of Delhi v. Rajiv Khurana*, [2010] 158 CompCas 151 (SC), after going through several decisions, the Supreme Court held that –

“the complainant is required to state in the complaint how a Director who is sought to be made an accused,



was in charge of the business of the company or responsible for the conduct of company's business. Every Director need not be and is not in charge of the business of the company. If that is the position with regard to a Director, it is needless to emphasize that in the case of non-Director officers, there is all the more necessary to state what were his duties and responsibilities in the conduct of business of the company and how and in what manner he is responsible or liable".

Applying the ratio in the above decision, in relation to a complaint against any offence committed by a company, it is necessary to show how an accused is an officer in default and how he or his role fits within the description of the term "Officer in Default". It is important to clearly mention in the complaint, the identity of the accused, in what capacity he is liable, and if he is liable as an officer of the company who is in default. The complaint must specifically state under what category the accused has been treated as an officer in default.

### **Director Entrusted with Responsibility**

In *Daewoo Motors India Limited v. Wg Cdr (Retd.) J H D Talwani*, [2012] 175 CompCas 530 (Del), it was held that no useful purpose would be served in continuing with the prosecution as the high court found that the applicant before it was also only a Nominee Director and she had resigned four years prior to the date of initiation of the winding up proceedings and she has had no access to the records of the company and admittedly not having signed even a single document on behalf of the company.

### **Company must be an Accused**

In *Aneeta Hada v. Godfather Travels and Tours Private Limited*, AIR 2012 SC 2795, it was held that a complaint against an authorized signatory of a company cannot be maintained without the company being arraigned as an accused. Though this case was a criminal appeal for an offence under section 67 of the *Information Technology Act, 2000*, the proposition set out in that decision could be safely applied in prosecutions against offences under the *Companies Act, 2013*. It was a case where a director of a company was prosecuted under section 292 of the Indian Penal Code, 1860 and section 67 of the *Information Technology Act, 2000* without impleading the company as an accused.

In this decision the Supreme Court had quoted with approval the decision of Supreme Court dated 28 October 1970 in *State of Madras v. C. V. Parekh and Anor.* AIR 1971 SC 447, where it was held that the company must be first arrayed as an accused.

Therefore, in relation to those offences for which the penal clause states that the company as well as its officers in default are liable for punishment, it is necessary to note that the Act presupposes that the offence is committed primarily by the company (acts omission and commission on the part of its directors being identified as that of the company itself) and officers in default are also vicariously liable for the same as per the penal clause. Thus, unless the company is made liable and arraigned as an accused, its officers in default cannot be punished.

Lord Asquith, in *East End Dwellings Company Ltd. v. Finsbury Borough Council* 1952 AC 109, had expressed his opinion as follows:

*"If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequences and incidents, which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it.... The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs."*

### **CONTINUING OFFENCES**

Before dwelling deep into the meaning of the expression "Continuing Offences", it would be necessary to understand section 472 of Code of Criminal Procedure which states that in the case of a continuing offence,

a fresh period of limitation shall begin to run at every moment of the time during which the offence continues. Section 472 is essentially the most relevant section of CrPC when it comes to continuing offences.

From the purview of penal clauses contained in the *Companies Act, 2013*, it would be seen that almost every penal clause speaks about a fine for every day during which the default continues. Merely because the penal clauses so provide, does that mean the offence is continuing? Would such a penal clause suggest that the offence in question is a continuing offence? Would therefore, the benefit of section 472 of CrPC be available to persons filing criminal complainants?

It is necessary to understand how the expression “Continuing Offences” has to be construed in order to answer those questions. This expression has been the subject matter of hundreds of cases, not only in relation to offences under the *Companies Act*, but also in relation to several other statutes. Therefore, a review of those decisions would help in understanding the subject in depth.

In *P. Ramanatha Iyer’s Law Lexicon*, it is stated that the expression “continuing offence” has been defined under section 56(2) of *Bengal Act II of 1891*. “Continuing offence”, as explained in the said lexicon is a transaction or a series of acts constituting an offence set on foot by a single impulse, and operated by an un- intermittent force, no matter how long a time it may occupy. The expressions “continuing offence” and “continuing contravention” must mean the same thing since in each case the offence consists of contravention of certain rules.

The difficulty in defining the concept of a continuing offence in a strait jacket was best illustrated by Supreme Court in *State of Bihar v. Deokaran Nenshi*, AIR 1973 SC 908 in which case the expression “continuing offence” was defined as follows:

“Continuing offence is one which is susceptible of continuance and is distinguishable from the one which is committed once and for all. It is one of those offences which arise out of a failure to obey or comply with a rule or its requirement and which involves penalty, the liability for which continues until the rule or its requirement is obeyed or complied with. On every occasion that such disobedience or non-compliance occurs and recurs there is the offence committed. In the case of a “continuing offence”, there is, thus the ingredient of continuance of the offence which is absent in the case of an offence which takes place when an act or omission is committed once and for all”.

The Supreme Court in *CWT v. Suresh Seth* [1981] 129ITR 328, held that “the court should not be eager to hold an act or omission as a continuing wrong or default unless there are words in the statute concerned which make out that such was the intention of the Legislature.”

The principle enunciated by Supreme Court in *CWT v. Suresh Seth’s* case cited supra, was quoted with approval by the Madras High Court in *Asst. Registrar of Companies R. Narayanaswamy and Ors.* [1985] 57 Comp Cas 787 (Mad). In the said case, the Supreme Court held that -

“the words, “for every month during which the default continued” indicate only the multiplier to be adopted in determining the quantum of penalty and do not have the effect of making the default in question a continuing one. The failure to repay excess deposits on or before April 1, 1975, is a single default, which gets completed on the expiry of the aforesaid period and (therefore the offence alleged) cannot be said to be a continuing one.”

The Supreme Court in *Bagirath Kanoria v. State of M.P.* AIR 1984 SC 1688, while considering the provisions of section 14(2A) of the Employees’ Provident Fund and Miscellaneous Provisions Act, 1952, observed that “the question whether a particular offence was a ‘continuing offence’ must necessarily depend upon the following factors:

- the language of the statute which created that offence;
- the nature of the offence; and
- the purpose which was intended to be achieved by constituting the particular act as an offence.



In *Maya Rani Punj v. CIT* [1986] 157 ITR 330 (SC), while considering the provisions of section 271(1)(a) of the *Income Tax Act, 1961*, it was held that if a duty continued from day to day, the non-performance of that duty from day to day was a continuing wrong.

The Delhi High Court in *Kuldip Singh v. State* [1990] 68 Comp Cas 625 (Del), held that it is not necessary to use the words 'repetitive', 'subsequent' or 'recurring' while determining the question if the offence is a continuing offence. The concept of continuing offence does not wipe out the original guilt. Rather, it keeps the contravention alive day by day. This concept of continuing offence is somewhat akin to continuing cause of action as used in the civil law (see section 22 of the *Limitation Act, 1963*, which says that in case of a continuing breach of contract or in the case of a continuing tort, a fresh period of limitation begins to run at every moment of the time during which the breach or the tort, as the case may be, continues).

The Karnataka High Court in *Chandra Spinning & Weaving Mills (P) Limited v. Registrar of Companies* [1990] 4 CLA 232 : [1990] 69 Comp Cas 117 (Kar), observed that –

“the doctrine of “continuing offence “ should be applied only in limited circumstances, since the doctrine effectively extends the statute of limitations beyond its stated term. A particular contravention or offence should not be deemed to be a continuous one unless the explicit language of the substantive criminal statute compels such a conclusion.”

The Karnataka High Court further held that

“a continuing cause of action in civil law is a cause of action, which arises from the repetition of acts or omissions of the same kind as that for which the action was brought. Similarly, it is the very essence of a continuing wrong that it is an act, which creates a continuing source of injury and renders the doer of the act responsible and liable for the continuance of the injury or wrong. If the wrongful act or omission causes an injury, which is complete, there is no continuing wrong even though the damage resulting from the wrong may continue.”

In *Gokak Patel Volkart Ltd. v. Dundayya Gurushiddaiah Hiremath and Ors.* [1991] 71 CompCas 403 (SC), answering a question as to what constitutes a “continuing offence”, the Supreme Court in its decision dated 14 February 1991 states that according to the Blacks' Law Dictionary, Fifth Edition (Special Deluxe), 'Continuing' means “enduring; not terminated by a single act or fact; subsisting for a definite period or intended to cover or apply to successive similar obligations or occurrences.” Continuing offence means “type of crime which is committed over a span of time.” As to period of statute of limitation in a continuing offence, the last act of the offence controls for commencement of the period. A continuing offence, such that only the last act thereof within the period of the statute of limitations need be alleged in the indictment or information, is one which may consist of separate acts or a course of conduct but which arises from that singleness of thought, purpose or action which may be deemed a single impulse. So also a 'Continuous Crime'<sup>1</sup> means one consisting of a continuous series of acts, which endures after the period of consummation, as, the offence of carrying concealed weapons. In the case of instantaneous crimes, the statute of limitation begins to run with the consummation, while in the case of continuous crimes it only begins with the cessation of the criminal conduct or act.

By way of elucidation, in the above decision, the Supreme Court had observed that the corresponding concept of continuity of a civil wrong is to be found in the Law of Torts. Trespass to land in the English law of Torts (trespass quare clause fregit) consists in the act of –

1. entering upon land in the possession of the plaintiff, or
2. remaining upon such land, or
3. placing or projecting any object upon it-in each case without lawful Justification.

In relation to the offence under section 630 of the *Companies Act, 1956* (which is similar to section 452 of the *Companies Act, 2013*) arising from wrongful withholding of property of company, the Supreme Court held that it is a continuing offence and it continues until the wrongfully withheld property is delivered to the company.

An analysis of the above meaning and decisions show that the following are the basic factors for constituting a continuing offence:

- The effect of commission of an offence should continue to prevail for any number of days after the date on which it is first committed.
- The effect should be understood from the point of view of intention of the legislation.
- The statute should have made the compliance requirement a compulsory one.
- The language used in the statute should be given due weight.
- The penal clause should provide for a penalty, which is liable to be levied during the period of continuance of the offence.

In *Jiyuan LI v. Registrar of Companies* and in *Tianjin Tianshi India Private Limited v. Registrar of Companies* [2012] 171 CompCas 280 (Delhi), the Delhi High Court held that unless the offence was repeated or committed on a daily basis after the initial default, it cannot be said to be a continuing offence.

In *Udai Shankar Awasthi v. State of U.P. and Anor.* (2013) 2 SCC 435, in a decision dated 09 January 2013, the Supreme Court held that -

“in the case of a continuing offence, the ingredients of the offence continue, i.e., endure even after the period of consummation, whereas in an instantaneous offence the offence takes place once and for all i.e. when the same actually takes place. In such cases, there is no continuing offence, even though the damage resulting from the injury may itself continue. “

### **Continuing Offences under the Companies Act, 2013**

In a petition under section 482 of the CrPC, the Rajasthan High Court in *Herdilia Unimers Limited v. Smt. Renu Jain* [1998] 92 Comp Cas 841 (Raj), held that “looking to the provisions of Section 113(2), it is clear that the statutory recognition has been given to the defaults committed under sub-section (1) of Section 113 of the act as continuing ones. The words “default continues” make a declaration of law that it is a continuing offence by the Company and, therefore, it cannot be said that the complaint is barred by limitation.”

The Calcutta High Court in *Registrar of Companies v. Bharat Produce Co. Ltd. and Ors.* [1980] 50 CompCas 250 (Cal) case cited supra held that before an act can be regarded as an offence there must be a specified statutory prohibition against the commission of the act and such a prohibition is entirely lacking in section 269(2) of the *Companies Act, 1956*. Section 269 of the Act creates no offence. As section 269(2) of the Act does not create any offence, the question whether it creates a continuing offence or the bar of limitation under section 468, CrPC, applies does not arise. The application accordingly fails and the rule is discharged.

While considering the provisions of r 11 of the Companies (Acceptance of Deposits) Rules, 1975, with reference to an offence under r 10 of the said Rules, the Karnataka High Court in *Shree Dharma Sugar Industries (P) Limited and Ors. v. Registrar of Companies* [1989] 66 Comp Cas 337 (Kar) observed that -

“Rule 11 prescribes that contravention of any of the provisions of the Rules shall be punishable with fine which may extend to INR500, and where the offence is a continuing one, with a further fine of INR50 for every day during which the default continues. The court further held that once there has been a default in filing the return as required under Rule 10 on or before June 30, the offence under Rule 10 is complete, and it cannot be said that the offence continues to be committed till the return is filed.”

The Andhra Pradesh High Court in *Hyderabad Vanaspathi Limited and Ors. v. Registrar of Companies and Anr.* [1986] 59 Comp Cas 654 (AP), held that -

“until the return of deposits as contemplated under Rule 10 of Companies (Acceptance of Deposits) Rules, 1975, is filed the default continues and the company cannot file a complete return for the next year until the

return for the year defaulted is furnished. So, the contravention under Rule 10 of the Deposits Rules is a continuing one. Rule 11 provides that where the contravention is a continuing one, it is made punishable with a further fine, which may extend to fifty rupees for every day during which the contravention continues.

As per Section 472 – law further than the previous authorities, though i do not think it really does so.

“If a man having no knowledge whatever on the subject takes upon himself to represent a certain state of facts to exist he does so at his peril, and if it be done either with a view to secure some benefit to himself or to deceive a third person he is in law guilty of a fraud, for he takes upon himself to warrant his own belief of the truth of that which he so asserts. Although the person making the representation may have no knowledge of its falsehood the representation may still have been fraudulently made.”

The foundation of this proposition manifestly is, that a person making any statement which he intends another to act upon, must be taken to warrant his belief in its truth. Any person making such a statement must always be aware that the person to whom it is made will understand, if not that he who makes it knows, yet at least that he believes it to be true. And if he has no such belief he is as guiltier of fraud as if he had made any other representation which he knew to be false, or did not believe to be true. It was further observed that -

“Firstly, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it is true or false. Although, I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.”

### **DIVERTING PROPERTIES OF THE COMPANY**

In *J.K. Paliwal and Shri B.K. Paliwal v. Paliwal Steel Ltd. and Ors.*, [2008] 141 CompCas 624 (CLB), the Principal Bench of the Company Law Board had found that a property of the company had been sold without any authorization by the Board of Directors or shareholders to sell and the provisions of section 293(IXa) have not been complied with and in addition the consideration was also inadequate. Further, it was observed that the transaction was sham and the sale consideration was deposited in the bank and was withdrawn on the same day. On these facts, in the above case, the Company Law Board held that the respondents have breached their fiduciary duties as directors. The Company Law Board held that on the role of Directors, the law is well settled. In some respects, Directors resemble trustees. Equity prohibits a trustee from making any profit by his management, directly or indirectly. It is objectionable to use such power simply or solely for the benefit of directors or merely for an extraneous purpose like maintenance or acquisition of control over the affairs of the company. Directors are required to act on behalf of a company in a fiduciary capacity and their acts and deeds have to be exercised for the benefit of the company. The fiduciary capacity within which Directors have to act enjoins upon them a duty to act on behalf of a company with utmost good faith, utmost care and skill and due diligence and in the interest of the company they represent. They have duty to make foil and honest disclosure to the shareholders regarding all important matters relating to the company.

### **DIVERTING FUNDS OF THE COMPANY**

The recent decision of Supreme Court of New South Wales in *Fodare Pty Ltd v. Shearn* [2011] NSWSC 479 is an eye-opener. It was a company in which Shearn was the sole director during the relevant period and by sale of a property of the Company, Shearn cleared all registered mortgages and diverted funds to the tune of A\$ 383,000 to her bank account and diverted another A\$ 251,000 to pay up and discharge a mortgage

over a property of her daughter. The company was wound up. Liquidator commenced proceedings seeking a declaration that Shearn was in breach of fiduciary duties and her daughter was charged on the ground that she falls within the ambit of a constructive trustee as she was aware that she is receiving funds out of proceeds arising from sale of company's property. The Supreme Court held that Shearn was liable to the Company for equitable compensation of both the amounts and statutory compensation together with interest and costs. Further, the Supreme Court held that her daughter was also liable to the company for equitable compensation of A\$ 251,000 plus interest. The Court found that the daughter might be aware that her mother who was a former bankrupt did not have money and the property that was sold belonged to the company. The Court said the liability of the mother and the daughter for equitable compensation of A\$ 251,000 plus interest would run concurrently such that both of them will be jointly and severally liable.

In *Say-Dee v. Farah Constructions Pty Ltd* [2005] NSWCA 309, wherein a joint venture partner had surreptitiously used information acquired in the course of pursuing the joint venture in order to acquire property adjacent to the joint venture site for its own advantage. This conduct was in breach of fiduciary duty. In calculating the profits which the party in breach had made, the Court made an allowance in its favour for its entrepreneurial skill and efforts in taking advantage of and turning to profit the business opportunity it had appropriated to itself. This allowance was deemed appropriate despite the surreptitious way in which the errant fiduciary had behaved.

## INSOLVENT TRADING

There is no doubt that corporate powers of the Board of Directors continue to exist until a company is ordered to be wound up. Section 277(3) of the *Companies Act, 2013* (corresponds to section 445(3) of the *Companies Act, 1956*) states that the winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the company, except when the business of the company is continued. However, even before a winding up commences, which in any case as stated in section 441 of the *Companies Act, 1956* (corresponding to section 357 of the *Companies Act, 2013*), is the date of presentation of a petition for the winding up of a company, the Board of Directors of the company must ensure that if there is no reasonable prospect of paying its debts, the company should not contract for further debts and obtain goods and services on credit. Such trading will constitute insolvent trading and it may expose its directors to consequences trading (carrying on the business of a company with an intention to defraud).

Though the provisions of Chapter XX of the *Companies Act, 2013* relating to winding up of companies commencing from section 270 to section 365 have been brought into force, it is worth noting that in the case of a voluntary winding up, section 308 of the *Companies Act, 2013* states that a voluntary winding up shall be deemed to commence on the date of passing of the resolution for voluntary winding up under section 304. Section 309 of the *Companies Act, 2013* declares that the corporate state and corporate powers of the company shall continue until it is dissolved. In any winding up other than a voluntary winding up, section 357(2) of the *Companies Act, 2013* relating to the winding up of a company by the Tribunal shall be deemed to commence at the time of the presentation of the petition for the winding up itself.

In *Re: William C. Leitch Bros.* [1932] 2 Ch. 71, it was held that if a company continues to carry on business and to incur debts at a time when to the knowledge of the director, there is no reasonable prospect of the creditor ever receiving payment of those debts, it is in general a proper inference that the company is carrying on business with intent to defraud.

## OFFENCES FOR WHICH NO SEPARATE PENAL CLAUSE EXISTS -SECTION 450

Offences under various sections of the Act for which no separate penal clause has been provided are punishable under section 450 of the act. Section 450 states that if a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made thereunder, or any condition, limitation or restriction subject to which any approval, sanction, consent, confirmation, recognition, direction or exemption in

relation to any matter has been accorded, given or granted, and for which no penalty or punishment is provided elsewhere in Offences under Corporate Laws regulations also enlarge the scope of “Connected Person” by including all the persons, entities connected with the company at that time or six months prior to the alleged act of insider trading.

### LESSON ROUND UP

- Tribunal and the Appellate Tribunal are not bound by the procedure laid down in the Code of Civil Procedure, 1908, the Tribunal and the Appellate Tribunal have power to regulate their own procedure.
- All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code.
- The Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.
- Code of Criminal Procedure, 1973 [CrPC] is a procedural law applies to every offence punishable under the IPC or any other special or local law.
- A civil proceeding is distinguished from a criminal proceeding by the fact that if the criminal proceeding is taken to a logical conclusion and if the accused is found guilty, there may be imposition of a sentence of fine or imprisonment or both including a capital punishment, if the statute so provides. In civil proceeding there may be an award of compensation and damages.
- A Special Court shall consist of a single judge holding office as Session Judge or Additional Session Judge, in case of offences punishable under this Act with imprisonment of two years or more; and a Metropolitan Magistrate or a Judicial Magistrate of the First Class, in the case of other offences.
- a “summon” is a process issued from the office of a court of justice requiring the persons to whom it is addressed to attend the court for the purpose therein stated.
- if the minimum punishment prescribed by any substantive law for an offence is an imprisonment for a term exceeding two years, the offence will be dealt with as a warrant case.

### TEST YOURSELF

*(These are meant for recapitulation only, Answer to these questions are not to be submitted for evaluation)*

1. Briefly discuss the powers of National Company Law Tribunal specified under section 424 of the Companies Act, 2013.
2. Differentiate Criminal Proceeding vis-a-vis Civil Proceeding.
3. Discuss the powers of the Criminal Courts.
4. Discuss the Summons Case and Warrant Case.
5. Discuss the Powers of the Appellate Court.



**PROFESSIONAL PROGRAMME**

**RESOLUTION OF CORPORATE DISPUTES,  
NON-COMPLIANCES & REMEDIES**

**PP-RCDN&R**

**WARNING**

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

“27. Suspension and cancellation of examination results or registration.

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as student, or debar him from re-registration as a student, or take such action as may be deemed fit.



## PROFESSIONAL PROGRAMME

### RESOLUTION OF CORPORATE DISPUTES, NON-COMPLIANCES & REMEDIES – TEST PAPER

*(This Test Paper is for recapitulate and practice for the student. Student need not submit responses/Answers to this Test Paper)*

Time allowed: 3 hours

Maximum Mark: 100

Total number of questions: 6

(All references to the sections relate to Companies Act 2013, unless stated otherwise)

1. (a) Shareholders democracy play a key role in good governance of the company. Comment. **(5 Marks)**  
 (b) Describe the measure through which the differentiation can be made between intentional and unintentional fraud. **(5 Marks)**  
 (c) Describe the grounds on which the NCLT can order for the freezing of assets of the company. **(5 Marks)**  
 (d) The Compounding Order under section 441 of the Companies Act, 2013 is generally not appealable. Comment. **(5 Marks)**  
 (e) A person advising to the Board of the company in his professional capacity is considered as an “officer in default”, Comment. **(5 Marks)**
2. (i) State the persons who can file an application for Oppression and Mismanagement in a company. State the eligibility criteria for making application. **(5 Marks)**  
 (ii) What are the remedies available to an investor in case the company has refused to register the transfer of shares? **(5 Marks)**  
 (iii) Under Class Action Suit, who are liable for damages or compensation or demand for any damage caused to a shareholder? **(5 Marks)**

**OR**

- 2A. (i) Explain the term ‘Criminal Breach of Trust’ under the Indian Penal Code, 1860. What are its essential ingredients? **(5 Marks)**  
 (ii) There is a demarcation line between Alteration of Memorandum/ Article of the company under the normal course and under the order of the National Company Law Tribunal (NCLT) pursuant to section 242(5) of the Companies Act, 2013. Comment. **(5 Marks)**  
 (iii) Explain the reasons upon which the investigation of the ownership of the company may be ordered by the Central Government. **(5 Marks)**
3. (i) What are the preparatory steps for a Company Secretary in case of investigation of the company by the Central Government? **(5 Marks)**  
 (ii) Briefly explain the mechanism of the Adjudication of Penalties in case of initial and subsequent defaults. **(5 Marks)**  
 (iii) Explain the term ‘fraud’ defined under the Companies Act, 2013. State the consequence in case of the fraud involving an amount of Rupees 10 lakh or more involving public interest. **(5 Marks)**

**OR**

- 3A. (i) When there is a provision for compounding under section 441 of the Companies Act, 2013, how does section 454 of the Companies Act, 2013 come in to play? Examine. **(6 Marks)**

(ii) What may be the consequences to the company and its officer in case of the following?

- a) Political contribution made in contravention of section 182 of the Companies Act, 2013
- b) Failure to file financial statement with the registrar

**(2 Marks each)**

(iii) Describe the activities for which a person can be detained under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974. **(5 Marks)**

4. (i) Explain the offences which are triable by Special Court constituted under the Prevention of Money Laundering Act, 2002 **(5 Marks)**

(ii) What is the requisite qualification for the empanelment as mediator and conciliator under the Companies Act, 2013? **(5 Marks)**

(iii) Enumerate the procedure for appeal under Securities Appellate Tribunal (Procedures) Rules, 2000. **(5 Marks)**

5. (i) What do you mean by Crisis Management and explain the various types of crisis relating to organizational misdeeds. **(5 Marks)**

(ii) Differentiate between General Liability Insurance and Professional Liability Insurance. **(5 Marks)**

(iii) What are the points, the director of a company should be aware about his D&O Policy. **(5 Marks)**

6. (i). Distinguish between:

- a) Criminal proceeding vis-a-vis civil proceeding.
- b) Summons case and Warrant Case
- c) Public Prosecutor and Company Prosecutor

**(3 Marks each)**

(ii) Can a person be prosecuted again for the same offence for which he has already been convicted? Give your answer with decided case laws. **(6 Marks)**









