



This Article endeavours to deal with the meaning of Consent Orders, Compounding of Offences, procedure for compounding of offences under Companies Act, 1956 & FEMA and the passing of the Consent Orders by SEBI.

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Consent Orders & Compounding of Offences – An Escape Mechanism from Prosecution

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Introduction

Laws provide the regulatory framework intended to ensure that the activities, be it economical or social, are carried out in accordance with the provisions contained in the various Acts, Rules and Regulations. Any non-compliance affects the society at large and hence the violator not only faces penal action by the law enforcement agencies but also tarnishes his image and reputation. In order to check violations, penal provisions are part and parcel of any Statute and they are administered by the Court(s) and Tribunals etc. Every business entity whether it is in manufacturing sector or service sector in order to grow, expand, diversify or compete with its peers should have a competent corporate compliance department so that it complies with various legal provisions. Since the corporates are run by humans and as the saying goes, “To err is human”, sometimes certain mistakes are inadvertently committed. A company acts through its Board of Directors and the Directors individually and collectively hold the position of trust and have fiduciary duties towards the company and its stakeholders. In view of the importance attached to the position held by the Directors, they are liable for any violation or contravention of laws. If the Regulatory Authorities proceed against the erring companies for any violation of the legal provisions, the directors/officers who are in default have only two options. The first option is to defend the case in the appropriate court for the offences/violations committed and the other option is to admit the guilt and pay the penalty under the provisions relating to “compounding of offences” prescribed under the concerned Act. Thus, compounding of offences is an important provision.

Definition of “offence”—Offence has been defined in Section 3(38) of General Clauses Act, 1897 to mean “any act or omission made punishable by any law for the time being in force”. “Offence” generally implies infringement of public rights as distinguished from mere private rights punishable under criminal law. [*Depot Manager, AP State Road Transport Corporation v. Mohd Yousuf Miya* (1997) 2 SCC 699 at 704, 1997 SCC (L&S) 548].

Categories of offences

Offences have been divided into two categories viz., cognizable and non-cognizable, which have been defined in Clauses (c) & (l) respectively of Section 2 of Criminal Procedure Code, 1973.

“Cognizable offence” means an offence for which and ‘cognizable case’ means a case in which, a police officer may, in accordance with the First Schedule or under any other law for the time being in force, arrest without warrant.

“Non-cognizable offence” means an offence for which and ‘non-cognizable case’ means a case in which, a police officer has no authority to arrest without a warrant.

Meaning of compounding of offences

Compounding is a process whereby the accused admits his guilt and pays the compounding charges in lieu of undergoing prosecution. For the purpose of compounding, the offence complained of should be cognizable and compounding (meaning-compromise) can be done

with or without the permission of the Court described under Section 320 of the Criminal Procedure Code, 1973. The offences which are simple and not grave in nature can be compounded by the affected party and the concerned Regulatory Authority but offences which are bit more grave can be compounded under the supervision of the court.

PROVISIONS RELATING TO CONSENT ORDERS AND COMPOUNDING UNDER SECURITIES LAWS

Consent orders of SEBI

The Securities and Exchange Board of India (SEBI) was established through SEBI Act, 1992 in order to protect the interest of investors in securities and to promote orderly development of, and to regulate, the securities market and matters connected therewith. The process of issuing of Consent Orders was introduced by SEBI vide its Circular No. EFD/ED/Cir-1/2007 dated 20-4-2007. "Consent Order" is an order passed by an adjudicating officer or by SEBI wherein it settles the administrative or civil proceedings between the Regulator and a person or entity who is *prima facie* found to have violated any of the provisions of Securities laws. The consent order must be specific and should precisely state the issues or claims that are being settled and the matters/issues which are being reserved. A consent order may or may not include a determination that a violation has occurred. Consent Orders cannot be construed as waiver of statutory powers by SEBI. SEBI always has the right to proceed for appropriate action if it cannot achieve its objectives through a consent order. In case of matters of administrative or civil nature, SEBI can pass 'consent orders' pursuant to Section 15T(2) of SEBI Act.

Section 15T(2) of the SEBI Act reads as under : -

"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.

Therefore, if a consent order has been issued by an adjudicating officer or by SEBI then no appeal can be preferred to the Securities Appellate Tribunal (SAT) against the said Order. Consent Orders can be passed with or without admission of guilt or even on denial of guilt. Where an order is passed without admitting or denying the guilt, such person shall never represent subsequently that he was not guilty. In the event, such a representation is made, the enforcement process may be reopened.

Consent Order may encompass issuing directions, suspension or cancellation of certificate of registration, imposition of monetary penalty. The benefit of issuing Consent Orders is that the Regulator can achieve the objective of appropriate sanction,

remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

A Consent order can be passed by SEBI at any stage of proceeding i.e. even when the concerned matter is pending with SAT or Court. When a matter is already in SAT/Court, consent process will be undertaken under the supervision of SAT/Court. The draft consent terms will be filed before the SAT/Court with a prayer to consider the terms of the consent and subject to such further terms as the SAT/Court may find appropriate in the facts and circumstances of the case. However, in the event of a serious and intentional violation, the process cannot be completed till the fact finding process is completed through investigation or otherwise.

Conditions for passing of the Consent Orders

Before considering the matter of issue of Consent Orders, SEBI obtains certain waivers from the concerned party(ies). The Party that has requested for a Consent Order shall have to waive the following rights : -

- (a) All hearings pursuant to the statutory provisions under which the proceeding is to be or has been instituted;
- (b) Filing of any reply relating to proposed findings of fact and conclusions of law;
- (c) All proceedings pending before the Board or any Officer;
- (d) All post-hearing procedures; and
- (e) Filing of Appeal or Review before SAT or any Court.

Further, by submitting to an offer of settlement, the Party shall have to waive:-

- (a) such provisions of the Regulations or other requirement of law as may be construed to prevent any officer of SEBI from participating in the preparation of, or advising the Competent Authority as to, any order, opinion, finding of fact, conclusion of law to be entered pursuant to the offer; and
- (b) any right to claim bias or prejudgment by SEBI based on the consideration of or discussions concerning settlement of all or any part of the internal proceeding.

Failure to obey consent orders, including violation of SEBI orders, would invite appropriate action besides revival of the pending action. Any proceeding which had been kept in abeyance pending the issue of consent order process will begin from such stage at which it was suspended.

Provision for compounding of offences under SEBI Act.

Section 24A of SEBI Act, 1992 states that notwithstanding anything contained in the Code of Criminal Procedure, 1973, 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 Securities Appellate Tribunal (SAT) or a Court before which such proceedings are pending.

Thus, Courts have well recognised the inherent powers vested with them to settle a case for violation of securities laws before them on an application made by the parties. Compounding of offence can take place at any stage after filing of a criminal complaint by SEBI. Where a criminal complaint has not yet been filed, but it is only envisaged, then the process of consent order will be followed rather than the compounding of offences. In compounding, an accused pays compounding charges in lieu of undergoing consequences of prosecution. The quantum of compounding charges depend upon the facts and circumstances of the case, gravity of alleged violation, interest of investors and the securities market and the deterrent effect. In cases pending before SAT/Courts, the party is also liable to pay the legal expenses incurred by SEBI.

How an offence is compounded under SEBI Act

Suppose a person is apprehending action for violation of SEBI (Prohibition of Insider Trading) Regulations 1992 and he is intimidated by SEBI that proceedings may or will be initiated/instituted against him or the proceedings have already been initiated, then he may at any time, propose in writing for settlement. In this case, the accused has to submit his proposal to the court where prosecution is pending. After taking necessary orders from the court, SEBI's internal committee will examine the compounding proposal and file its reply to the court after taking approval from the Competent Authority of SEBI. Thus, the accused, instead of contesting the same and going on through the lengthy legal trial can prefer to file an application before the Court under the provisions of Compounding of Offences and pay the necessary compounding charges.

Factors to be taken into consideration for the purpose of passing Consent Order/Compounding of offences under SEBI Act

Usually, the following factors would be considered before passing a Consent Order/Compounding of offence:-

- (a) Whether the violation was intentional
- (b) Party's conduct in the investigation and disclosure of full facts
- (c) Gravity of charge i.e. charge like fraud, market manipulation or violation of insider trading norms
- (d) History of non-compliance
- (e) Track record of the violator.
- (f) Violation is technical and/or of minor nature
- (g) consideration of the amount of investor's harm or party's gain, etc. The factors mentioned above are only indicative and while issuing Consent Order/Compounding of Offence, any other factor necessary in relation to facts and circumstances of the case may also be taken into account.

SEBI's Consent Orders – A Boon or Bane

It is worth noting here that passing of consent orders by SEBI to take action against stock market related violations has become a

routine affair, if we look at the number of Consent Orders posted at the SEBI website. The number of Consent Orders have increased manifold as more and more market players are approaching SEBI to resolve their disputes pertaining to non-compliance, violations and even frauds and other irregularities like market manipulation committed by them in the securities market. In majority of cases, the Regulator has imposed penalty ranging from Rs. 1 lakh to over Rs. 1 crore, depending upon the seriousness of the case. Certain entities have also been debarred from dealing in the market for period ranging from one to three years.

Another issue with the consent orders of SEBI is that they come after a long time after the commission of offence, especially in the case of stock market manipulations. Moreover, the consent orders are quite often too short and do not contain detailed information about the investigation of the case. The reason for accepting the consent terms is also not spelt out clearly in the order. The Regulator should furnish more details in the consent orders so that the system becomes transparent and reliable for the investors at large.

It would not be out of place to say that the consent orders have become an escape mechanism from prosecution for erring entities as they can easily get relief by getting the Consent Orders passed. Since SEBI is not required to prove that an offence has been committed and at the same time the other party also need not necessarily admit the guilt formally, SEBI's Consent Order has become a boon to the corporates, market intermediaries to easily settle the dispute with the Regulator. Simultaneously, the system is a bane for the investors who are duped of their hard earned money by the market manipulators.

As per the news item published in the Economic Times dated 23rd October, 2009, the Auditing Firm, Price Waterhouse Coopers (PWC) has decided to seek Consent Order from SEBI in the case related to the Rs. 10,000 crore accounting fraud at Satyam Computer Services Ltd., for which it has received notice from SEBI besides other Regulators. Here also, PWC has said that it has decided to go in for consent proceedings without in any way acknowledging the fact that there was any wrong doing on their part (PWC) in relation to the audit of Satyam's books of accounts.

Thus, the mechanism of issuing consent orders is a boon for the market players but will definitely harm the interests of the investors if this trend continues unabated.

Compounding of offences under the Securities Contracts (Regulation) Act, 1956 and Depositories Act, 1996

SEBI is empowered to issue Consent Orders as well as consider request for composition of offences in respect of violation of the provisions of the Securities Contracts (Regulation) Act (SCRA) and Depositories Act. This is in consonance with the provisions of Section 15T of the SEBI Act and Section 23A of the Depositories Act which permit issue of consent orders. Section 24A of the SEBI Act, Section 23N of the SCRA and Section 22A of the Depositories

Act permit composition of offences. The procedure for issuing consent orders and for composition of offences under these Acts is the same as that of other violations under the SEBI Act and the Rules framed thereunder.

WAYS TO DEAL WITH COMPOUNDING OF OFFENCES UNDER THE COMPANIES ACT, 1956

Nomination of competent and reliable officers

Under most of the Acts, including the Companies Act, 1956 there are specific provisions that it shall be a defence for the Managing Director and other Directors that a competent and reliable person was entrusted with the duty of ensuring compliance with the particular provisions/section(s) of the Act. For e.g. according to the proviso to Section 210(5) of the Companies Act, 1956, in case of any proceedings against a person in respect of an offence under Section 210 (preparation of Annual Accounts), it is a defence if the concerned Director can prove that a competent and reliable person(s) was charged with the duty of seeing that the provisions of section 210 are fully complied with and such person was in a position to discharge that duty.

Suppose, XYZ Limited charges Mr. A, its Financial Controller, with the duty of seeing that the provisions of Section 210 of the Act are duly complied with but unfortunately due to some lapse on part of Mr. A some non-compliance occurs then only Mr. A shall be liable for such non-compliance and other directors and officers of the Company shall not be held responsible for such default. In such a case if Mr. A opts for compounding of offence then the penalty for compounding shall be levied only on Mr. A and not on the Directors of the Company. Thus by charging competent and reliable persons for ensuring compliance with the provisions of the Companies Act, 1956, a company can save its Non-executive Directors from lot of botheration.

Another example is Section 5 of the Companies Act, 1956 which defines the term "Officer in default". Section 5 specifically provides under clause (f) that the Board of Directors can entrust the duty of compliance to any officer of the company who is willing to accept that responsibility. In the event of any default only that particular person shall be treated as "Officer in default" and shall be liable for penalty/fine and other officers, directors shall not be regarded as defaulting officers. In case no specific individual was charged with the responsibility of compliance then all those persons who were dealing with the matter would be treated as officers in default and thus shall be liable for prosecution and penalty. Section 5(f) of the Companies Act, 1956 requires that necessary forms viz., Form 1AB and Form 1AC are filed with the Registrar of Companies and only after that it is conclusive evidence that these persons have given their consent to act as "Officers in default". Therefore it is utmost necessary that the legal & secretarial departments should identify the Acts which permit charging of competent & reliable persons with the

duty of ensuring compliance of various provisions of those Acts and thereafter requisite returns are also filed with the concerned regulatory authorities.

Compounding of offences

Section 624 of the Act states that notwithstanding anything contained in the Code of Criminal Procedure 1898 (read "1973") every offence against this Act shall be deemed to be non-cognizable within the meaning of the said code. However, Section 58AAA which was introduced in the Act by the Companies (Amendment) Act, 2000 provides that an offence connected with the acceptance/repayment of deposits (Section 58A & 58AA) shall be a cognizable offence.

Section 621A of the Companies Act, 1956 deals with compounding of offences. When an offence is committed under the Act, it attracts either fine or imprisonment or both. Compounding is nothing but a settlement by paying the penalty in lieu of facing the prosecution for the offence committed. When compounding is done, the prosecution is converted into fine i.e. condonation of prosecution by imposing penalty. According to Section 621A(6) of the Act the offences that are punishable with imprisonment only or with imprisonment and also with fine can't be compounded. Hence all offences are NOT compoundable. In other words, only the following kinds of offences can be compounded:-

- (a) Offences punishable with fine only.
- (b) Offences punishable with fine or imprisonment or with both.

It has been held in *Hoffland Finance Ltd., In re* (1999) (CLB-New Delhi) that all offences, other than those which are punishable with imprisonment only or with imprisonment and also fine, can be compounded even when the prosecution is pending in a criminal court.

Accordingly, the persons who have been entrusted with the duty of compliance with the provisions of the Act must exercise utmost care while dealing with the provisions of the Companies Act, the non-compliance or violation of which cannot be compounded. The offences under some of the sections of the Companies Act that are non-compoundable include 58A, 68A(1), 73(2B), 80A(3)(a) & (b), 116, 117C(5), 209A(8), 269(11), 293A(5) etc.

Procedure for compounding of an offence under Section 621A

Every application for compounding of an offence shall be electronically filed with ROC in Form 61 who shall forward the same, together with his comments thereon to the Regional Director, if the offence is punishable with a fine upto Rs. 50,000 and in case of exceeding this limit to the Company Law Board. No fee is payable to ROC along with the aforesaid application in Form 61.

The application has to be made by the delinquent company and/or its officers in default who has/have committed or who

are alleged to have committed the offence. The application shall clearly specify the nature of offence, Sections of the Act violated, the date or the period during which the offence was committed or continued, the names and addresses of officers of the company who have committed the offence and the prayer for compounding. The applicant shall also furnish the details as to how the default has been made good indicating the date on which the default has been made good, wherever applicable. Persons like Trustees, liquidators, contributories cannot apply for compounding. Separate applications shall be made for separate offence(s) – charging sections under the Companies Act, 1956.

The application will thereafter be posted for hearing and while compounding the offence, the Regional Director/CLB may direct any officer of the company to file a return or other document(s) in question within such time, as may be specified in the order and non-compliance of the order shall be a punishable offence. The RD/CLB shall follow the principles of natural justice before disposing of the application for compounding. They will give an opportunity of being heard to the applicant company, to the officer in default, ROC or any other complainant. After hearing the parties the amount required to be paid for compounding of the offence shall be decided. The sum prescribed shall not, in any case, exceed the maximum amount of the fine which may be imposed for the offence so compounded. While levying the amount for compounding of offence, the sum already paid by way of additional fee for delayed filing of Forms>Returns with ROC pursuant to sub-section (2) of Section 611 of the Companies Act, 1956 shall be deducted. The sum for compounding of an offence shall be paid in accordance with the Order of RD/CLB, as the case may be.

The following points also need to be kept in mind while getting an offence compounded :-

- (1) After composition of an offence, an intimation shall be given by the company to the ROC in Form 21 within 7 days from the date on which the offence is so compounded.
- (2) In case an offence has been compounded after the institution of any prosecution, then such composition should be brought to the notice of the Court by ROC in writing, in which such prosecution is pending. After receipt of notice of composition of the offence the Court shall discharge the company and its officers.
- (3) In case of a company, the composition fee shall be paid from the company's funds. In case, if the compounding fees is to be paid by the Directors/officers in default, it shall be paid from their personal funds.
- (4) If a particular offence is compounded, no prosecution shall be instituted thereafter in relation to such an offence.
- (5) If a similar offence is committed within a period of 3 years

from the date of its first compounding, the same cannot be compounded.

Provisions relating to compounding under Companies Bill, 2009

Clause 402 of the Companies Bill, 2009 provides that the power to compound the offences shall vest with the Court having jurisdiction to try the offence. Thus, after passing of the Bill, all the fresh applications for compounding of offences would have to be submitted to the appropriate Court having jurisdiction over the matter instead of Company Law Board.

Petition for relief under Section 633 of the Companies Act

A question that obviously comes to our mind is what should be done in case it is not possible to get the offence compounded, due to one reason or the other? In such a situation the only option that can be thought of is to take shelter under the provisions of section 633 of the Act. Sub-section (1) of section 633 provides that if in any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against any officer of any company the court hearing the case finds that although he is liable for such negligence, default, breach of duty, misfeasance or breach of trust but since he has acted honestly and reasonably and having regard to the circumstances of the case he ought to be fairly excused then the Court may relieve him either wholly or partly. Thus it becomes necessary for the concerned officer to prove to the court that although the default took place due to some negligence on his part but he acted honestly and reasonably and there was no malafide intention on his part or he has not gained any advantage or benefit in any manner due to such default or non-compliance. It may be noted here that in case of criminal proceedings under Section 633 (1), such Court can't grant relief from civil liability. The object behind section 633 is to provide relief against any undue hardship in deserving cases.

In *Om Prakash Khaitan v. Keshariya Investment Ltd.*, a petition was filed for relief by a Solicitor-Director of a Company which had committed breaches and defaults in relation to its obligations under the Essential Commodities Act, the Companies Act, the Sales Tax Act, Employees Provident Fund Act and Employees State Insurance Act. The Court while granting relief held that it was necessary to make a distinction between directors who are on the Board purely by virtue of their professional skills and acumen and those who were in effective control of the Company's management and affairs. The Court also held that since the object of Section 633 was to provide against undue hardship in deserving cases, it was proper to relieve persons who, though technically liable in law, ought to be excused rather than subjected to legal proceedings; unless they are directly involved in the acts or omissions complained off or have otherwise not acted honestly or reasonably or have financial involvement in the Company.

Section 633(2) further provides that in case the proceedings have not yet commenced but the concerned officer apprehends that proceedings for negligence, default, breach of duty, misfeasance or breach of trust may be initiated against him then he may move an application for relief to the concerned High Court which has jurisdiction over the matter. Thus the application under Section 633(2) is for the purpose of obtaining anticipatory relief.

COMPOUNDING OF OFFENCES UNDER FEMA

The Foreign Exchange Management Act, 1999 (FEMA) which has replaced the Foreign Exchange Regulation Act, 1973 (FERA), with effect from 1st June, 2000 also contains provisions for compounding of offences. The basic difference between FERA and FEMA from the point of view of offences committed under the said Acts is that offences under FERA attracted criminal proceedings whereas the offences under FEMA are considered to be of civil nature only. Moreover under FEMA, maximum penalty is thrice the sum involved (as against the penalty of 5 times under erstwhile FERA). In case it is not possible to quantify the contravention amount the penalty prescribed is Rs. 2 lacs and further penalty of Rs. 5,000/- per day if the default is of a continuing nature.

The provisions of Section 15 of FEMA empower the Compounding Authority to compound any contravention/offence as defined under Section 13 of the Act on an application made by the person who has committed such contravention, either before or after the institution of the Adjudication Proceedings. The Government has in consultation with RBI reviewed the procedure for compounding of contraventions under FEMA and the same is detailed in the circular of RBI – A.P.(DIR Series) Circular No. 31 dated 1st February 2005. The objective behind review of the compounding procedure was to provide comfort to the citizens and the corporate community by minimising the transaction costs but at the same time the procedure ensures that the wilfull, malafide and fraudulent transactions are dealt with seriously. The authority for compounding contraventions is vested with RBI except section 3(a) which deals with “Hawala” transactions. The compounding cases pertaining to Section 3(a) of FEMA are dealt with by the Directorate of Enforcement.

The application for compounding together with fee of Rs. 5,000 has to be submitted to RBI in the format appended to the Foreign Exchange (Compounding Proceedings) Rules, 2000. The compounding of contraventions enable the contravener to settle an offence through imposition of a monetary penalty without going in for litigation. RBI has to conclude the proceedings within 180 days from the receipt of application for compounding and the sum worked out after compounding has to be paid within 15 days from the order of compounding. Once a contravention has

been compounded no proceeding can be further initiated against the contravener. If a second offence is committed after the expiry of three years, it is treated as a fresh contravention and not a repetition of the earlier one. In other words if the second contravention takes place within three years of the earlier contravention the same cannot be compounded.

Advantages of Compounding of offences

To conclude the discussion, we can have a look at the advantages of compounding, which are as follows:-

- According to Part I of Schedule-XIII to the Companies Act, 1956, a person is not eligible for appointment as a Managing or Whole Time Director or Manager of a company if he had been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under the Companies Act, 1956, SEBI Act, 1992, FEMA, 1999, Securities Contracts (Regulation) Act, 1956 or any other Act specified in the list of Acts contained in Part I of Schedule XIII. Such an appointment can be made only after approval of the Central Government. It may be noted here that Compounding of an offence does not amount to conviction by a court of law hence there is no need for approval of Central Government for appointment of such a person as MD, WTD or Manager. Thus, Compounding of offence will save the botheration of applying to the Central Government for appointment of the concerned person as managerial person of that particular company or any other company.
- Court proceedings are too formal and rigid with respect to examination of witnesses, recording of evidence etc. and hence a lot of time is passed from the date of institution of the case till the date of its disposal. Compounding which is an alternate mechanism available to the Company/its officials is a summary procedure that can be effectively used for saving the time of adjudicators, investigating officers and the company officials who have committed default.
- Since compounding is in the nature of a compromise, normally penalty would be lesser than the penalty that is likely to be levied under the adjudication proceedings where guilt is proved as a result of evidence.
- Compounding of offences helps in the settlement of the matter in the office of the Regulator/Quasi-judicial body itself. Hence the number of cases to be decided by Courts don't get piled up. Accordingly, the Courts can concentrate on cases of serious nature where large number of investors have been affected.
- From the Regulator's perspective, passing of the consent orders/compounding of offences is beneficial since it reduces the regulatory costs and would also save time and efforts required in pursuing enforcement actions. □