Articles

# Compounding of Offences and Passing of Consent Orders Under SEBI Act, 1992 – An Analysis

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**The SEBI being the regulator of the Securities Market has been empowered to compound certain offences under the securities laws and pass consent orders therein. All important aspects relating to this function of the SEBI have been explained here.**

## Background

The SEBI vide Circular No. EFD/ED/Cir-1/2007[1] issued Guidelines for Consent Orders and Considering Requests for compounding of Offences under SEBI Act, SC(R) Act and Depositories Act. The Parliament empowered SEBI to pass consent orders under the SEBI Act and Depositories Act. The will of the Parliament to empower SEBI could very well be viewed from Section 15T of the SEBI Act 1992 and section 23A 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.

SEBI has been authorized to pass Consent orders in respect of all types of enforcement or remedial actions, including administrative proceedings and civil actions, e.g. proceedings under Sections 11, 11 A (1)(b), 11B and 11D of the SEBI Act or under the Enquiry Proceedings Regulations or Adjudication Rules or equivalent proceedings under the Securities Contracts (Regulation) Act (1956), Depositories Act (1996) and other civil matters pending before SAT/ courts.

Administrative/civil actions by SEBI includes 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.

*1. This circular is intended to supplement and not to supplant the SEBI Act, SCRA and the Depositories Act and the Rules and Regulations framed there under as also the Guidelines, Circulars and other declarations of policy issued by SEBI from time to time.*

## Concept and meaning of Consent Order

The concept of the consent order has been derived from the success of the US Securities and Exchange Commission (US SEC) in resolving the dispute among different entities. US SEC settled a substantial number over 90% of the administrative and civil cases through the consent orders. Motivated by the success of US SEC, SEBI announced a new system for settling disputes under which it can slap penalties on defaulters without taking recourse to long drawn litigation in courts.

Three major reasons can be ascribed to Consent Orders scheme being promulgated: (1) Prolonged and costly court litigations can be avoided. (2) If one loses in trials, one has to suffer the costs and efforts go waste, as well as incur penalty, which is likely to be stricter than what you one has to pay in consent orders. (3) There is no stigma in cooperating and confessing for a securities laws violation as these laws are so much complex that inadvertent violation do happen. Even if one commits a wrong knowingly, why aggravate it further?

It was considered that passing of the consent orders eventually will reduce regulatory costs and would save time and efforts of SEBI consumed 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. It provides flexibility to enforcement actions which in turn helps in achieving the twin goals of sanction and deterrence without being dragged into long litigation process before SEBI, Tribunal or courts.

A consent decree (also referred to as a consent order) is a judicial decree expressing a voluntary agreement between parties to a suit, especially an agreement by a defendant to cease activities alleged by the government to be illegal in return for an end to the charges. Consent decrees are used most commonly in criminal law and family law and sometimes in United States antitrust law.

It had been made clear that 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.

## Commencement and Scope of Compounding of Offences & Consent orders

A cause of action can arise at any stage of the violation of the Securities Laws; hence defaulters can make an application for Consent Order. Consent orders may be passed at any stage after probable cause of violation has been found. Where SEBI is of the view that there is a serious and intentional violation; the process shall not be completed till the fact finding process is completed after proper investigation or otherwise.

Section 24A of the SEBI Act, 1992 permits compounding of offences by the court where prosecution proceedings are pending. Compounding of offence allows the accused to avoid criminal prosecution, which would save costs, time and mental agony in return for payment of compounding charges. 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.

Compounding of offence can cover appropriate prosecution cases filed by SEBI before criminal courts. Any person who is notified that a proceeding will be initiated against him or any party to a proceeding already initiated/ instituted can propose in writing for the settlement. Consent orders are passed by the Competent Authority or SAT or court where proceedings are pending, subject to the party taking remedial action and consent terms. Consent orders can be passed by admitting guilt or without admitting or denying guilt. If an order is passed without admitting or denying guilt, such a person should never represent subsequently that he is not guilty. If such a representation is made, the enforcement process may be reopened. Similar appropriate terms will be sought by SEBI from the court where the prosecution is pending.

A consent decree can be either interlocutory or final. The former is given on some plea or issue arising in the cause which does not decide the main question; the latter settles the matter in dispute, and a final decree has the same effect as a judgement at law.

Once entered, a consent decree is binding on the consenting parties and cannot be reviewed except on a showing that the consent was obtained by fraud or that the decree was based on mutual error or a failure of consent.

## Procedure for Consent Orders

### *1. Where Adjudication Proceedings are Pending*

The guidelines issued by SEBI for the consent order have made adequate provisions for the procedure of passing the order to be fool proof. The scheme has in place a system of checks and balances. Any party against whom an adjudication proceeding is pending can propose in writing for the settlement by passing a consent order.

The proposal may be referred to a high-powered Committee consisting of a retired judge of a high court and two other external experts, if the party against whom an adjudication proceeding is pending, proposes passing of a consent order.

Then, the Committee will consider the proposal of consent, requisite waivers by the party, the facts and circumstances of the case, material available on records and take into account the factors. Where the committee finds the terms for passing a consent order inadequate, it may ask the party to revise the consent terms. The consent terms finalised by the committee and agreed to by the party shall be forwarded to the adjudication officer for passing a suitable order in line with the consent terms.

### *2. In any other case*

(a) Any person (party) who is notified or who has reasonable grounds to believe that a civil/ administrative proceeding may or will be instituted against him/her, or any party to a proceeding already instituted, may, at any time, propose in writing along with requisite waivers for an offer of consent. The application can be made to the Division of Regulatory Action, Enforcement Department, Securities and Exchange Board of India, G-Block, Bandra Kurla Complex, Bandra (East), Mumbai 400 051. This application is then forwarded to the High Powered Committee.

(b) Any person (party) who is notified or who has reasonable ground to believe that a criminal proceeding may or will be instituted against it, may, before SEBI files a criminal complaint before any criminal court, propose in writing along with requisite waivers for consent at the address mentioned in para (a). The proposal then would be forwarded to the high powered Committee.

The Committee, while granting a 'consent order' sought by a defaulter, will consider factors such as the object of the violated law as also the interest of the investors and the securities market and other factors wherever applicable such as gravity of charge, nature of violation– whether the violation was intentional or technical and minor, party's conduct during investigation, history of non-compliance, circumstances being beyond the control of the defaulter, to deter future non–compliances by the same or another party, benefits accruing for delaying compliance, whether party has undergone any other regulatory enforcement action for the same violation or any other factors relevant in the given facts and circumstances of the case.

If the committee finds the terms for passing a consent order inadequate, it may ask the party to revise the consent terms. If the proposal is acceptable to the Committee, suitable consent terms shall be recommended to a panel of two Whole Time Members, who may pass a suitable order in view of the recommendation of the Committee.

The consent orders will detail remedial action and payment of consent penalties, in cases where the proceedings are pending or are likely to be instituted. The guidelines also allow the committee to revise the terms of consent orders proposed by defaulters if they are found inadequate in light of the gravity of offences committed.

## Waivers

The party seeking consent order has to furnish as a condition precedent a written waiver from taking any legal proceedings against SEBI concerning any of the issues covered by the consent order. The party shall waive all hearings pursuant to the statutory provisions under which the proceeding has been instituted; the filing of proposed findings of fact and conclusions of law; proceedings before the Board or any officer; all post-hearing procedures; and appeal/review before/by SAT/ courts.

Further the party shall waive such provisions of the Regulations or other requirements of law which 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, or conclusion of law to be entered pursuant to the offer; and 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 proceedings.

In addition, the party will undertake to waive a plea of limitation for reopening the case, if the party violates the consent order subsequently.

## Passing of Consent Orders and Charges for Settlement

Consent orders are passed by the Competent Authority or SAT or court where proceedings are pending, subject to the party taking remedial action and consent terms. Consent orders can be passed by admitting guilt or without admitting or denying guilt. If an order is passed without admitting or denying guilt, such a person should never represent subsequently that he is not guilty. If such a representation is made, the enforcement process may be reopened. Similar appropriate terms will be sought by SEBI from the court where the prosecution is pending. Consent Order may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved.

If the Committee is of the view that the proposal of consent does not commensurate with the violation or the factors considered for consent are not satisfied or the waivers are not given, it may decline to consider the proposal of the party. In such circumstances, the Board and the party are free to resort to legal recourse as may be available to them under the law.

The party has to pay the settlement/compounding charges including legal expenses incurred by SEBI and levied by SEBI keeping in mind the facts and circumstances of the case, gravity of violation/ offence, interest of investors and the securities market and deterrent effect. The Committee recommends the charges to be paid by the party for mitigating the violation/offence.

## Consequence of Non-acceptance

(i) In case the proposal is not acceptable to the Committee it rejects the proposal and inform the party and the offer of settlement shall be deemed to be withdrawn.

(ii) The rejected offer shall not constitute a part of the record in any proceeding against the person making the offer, provided, however, that rejection of an offer of settlement does not affect the continued validity of waivers.

(iii) SEBI and the Party will be free to resort to legal recourse as may be available to them under law and neither SEBI nor the Party would be entitled to use any information relating to the settlement process in such proceedings.

(iv) Any proceeding which had been kept in abeyance pending the consent process will begin from the stage at which it was kept in abeyance.

## Settlement before Securities Appellate Tribunal (SAT)/ Courts

Where a matter is pending before SAT/Court, the same consent process will be undertaken and the draft consent terms recommended by the Committee and approved by the panel of two Whole Time Members will be filed before the SAT/ Court. The SAT/Court may if found fit, pass an order in terms of the consent terms and subject to such further terms as the SAT/Court may find appropriate in the facts and circumstances of the case.

## Notice to the party

In all notices/ show cause notices sent by SEBI or its officers to the party, it should clearly be mentioned that the party may, if it so desires, propose for suitable order for agreed penalty/ action by consent along with requisite waivers and undertakings.

## Publication

The consent order shall be published through a press release and put on SEBI's website. In cases where a Party undertakes compliances as per agreed schedule, the concerned department in SEBI shall monitor the same.

All information submitted and discussions in pursuance of the consent orders shall be in a fiduciary capacity and may not be released to the public, as it would prejudice SEBI and/or the party.

## Enforceability

(i) The consent order shall be binding on the party and in cases where the party undertakes any compliances, it has to comply with the same as per agreed schedule.

(ii) Failure to obey consent orders shall invite appropriate action under the respective statute, revival of the pending administrative/civil action. Any proceeding which had been kept in abeyance pending the consent process will revive from the stage where it was kept in abeyance.

## Conclusion

SEBI is considered to be the watch dog to protect the interests of investors as well as of market participants. Consent orders have beyond doubt helped ease the burden of the regulator in clearing long-pending cases. But at times cases involving manipulations in the market have been settled for as low as Rs 10,000 which legal experts say raises the question of moral hazard. A question of moral hazard arises in one's mind when consent orders are issued in cases involving IPO manipulations and other market irregularities, as it creates no deterrent for offenders. Even some of the habitual offenders take benefit of the scheme.

In order to build enough confidence in the common investors mind to participate in the market operations, the regulator should keep two things in mind while passing the consent orders. It should ensure that the penalty should be manifold compared to the unlawful gains by the guilty market player from any market transaction, secondly, the consent orders should not be an escape route for the guilty committing frauds of a criminal nature. ❑

*Reference :*

Circular No. EFD/Ed/Cir-1/2007, dated 20-04-2007

*www.sebi.gov.in*