Consent Order- A Bailout Package for Violators in the Indian Securities Market

Anurag Tripathi
Abhishek Chanda
Abstract

Since SEBI was given statutory power in 1992 it has done great deal in both securing the interest of the investors and development of securities market in India. Under the SEBI act, 1992 SEBI came up with elaborate procedure for punishing the violators of the securities laws so as to cause deterrence. However, soon it was realised that SEBI was overburdened with piling up of cases and had short fall in collection of penalty which led to revenue losses to the government.

Thus, SEBI came up with the Consent Order Mechanism which is a sort of out of court settlement between the parties with or without admission of guilt. This certainly gave a boost to the collection of penalty but the legality as well as the constitutionality of the consent order mechanism is still under scrutiny which the paper aims to shed light upon. Further, the paper tries to highlight the pros and cons of this mechanism and goes on to propose certain modifications to the existing mechanism.

Keywords- SEBI, Bailout Package, Consent Order, Transparency
INTRODUCTION

The object with which SEBI was constituted was to protect the interests of the investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit. The Securities Justice Administration in India has been strengthened as SEBI has developed a well-marked out procedure to punish the violators of the securities laws in force in India and protect the interest of the investors.

It is not only the SEBI Act, 1992, which provides for such mechanism but there is gamut of laws including the Securities Contracts (Regulation) Act, 1956 (SCRA) and the Depositories Act, 1996 which contributes to proper working of Securities Justice Administration. In India SEBI pursues two streams of enforcement actions i.e. Administrative/Civil or Criminal matters.

Under the existing system SEBI has the power to initiate appropriate administrative and civil proceeding against the violator under sections 11, 11B, 11D, 12(3) and 15I of SEBI Act. SEBI has the power under section 11C of the SEBI Act, 1992, to investigate any matter wherein it has reason to believe that either 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 SEBI Act, 1992, or the rules or the regulations made or directions issued by the Board.

Thereafter, the board appoints an adjudicating officer under section 15I of the SEBI Act, 1992, who under rule 5 of Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer Rules, 1995, upon consideration of the evidence produced before him, if satisfied that the person has become liable to penalty under any of the sections specified in sub-section (1) of section 15-I, the adjudicating officer 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 section 15-I. An appeal can be made against the order of the adjudicating officer to the Securities Appellate Tribunal (SAT) and further appeal can be made to the Supreme Court.

This detailed procedure has its own demerits. There has been a huge backlog of cases over the years, which now has grown into a major concern for the Securities and Exchange Board.

* Abhishek Chanda, Student, 4th Year, B.B.A.LL.B.(Hons.), National Law University, Odisha, India.
** Anurag Tripathi, Student, 4th Year, B.B.A.LL.B.(Hons.), National Law University, Odisha, India.
1 Sec. 11, Securities and Exchange Board of India Act, 1992 (hereinafter as SA).
3 SA, Supra note 1, Sec 15T.
4 Id., Sec. 15Z.
of India (SEBI). To solve the piling up of cases SEBI came up with procedure of Consent Order. On 20th April 2007, SEBI, vide a circular no.EFD/ED/Cir-1/2007 introduced the consent order mechanism which 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. SEBI gets its power to issue circulars under section 11(1) of the SEBI Act, 1992. It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. It is majorly based on the similar lines of the US Securities and Exchange Commission’s strategy to settle a substantial number (over 90%) of administrative/civil cases.  

Under Indian scheme of things consent order can be used to settle 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. Consent order may be passed at any stage after probable cause of violation has been found. 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. 

It has been stated in Para 2 of the circular that ‘The Parliament of India has recognised 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 offence.’

However, such power of the SEBI is disputed and the first part of the paper aims to throw light upon question as to whether SEBI, has the power to issue a circular so as to incorporate the consent order mechanism. The second part will deal with the SEBI’s, in its wide discretionary power can introduce a mechanism which puts into jeopardy the interests of the investors and the development of Securities market. This part will also include the demerits of the said mechanism which will include a detail analysis of the consent orders issued and would present an analysis on the transparency of these orders

---

5 SEBI circular, supra note 2, Para. 4.
7 SEBI circular, supra note 2, Para. 2.
The paper will then in its third part will also propose certain amendment in the consent order mechanism introduced by SEBI.

The paper will confine itself to the enforcement actions relating to Administrative or civil matters. Further, the scope of the paper limited to the legality of the consent order with respect to the provisions of SEBI Act, 1992, Depositories Act, 1996 and object of SEBI Act, 1992. The paper will also analyse the constitutionality of the mechanism. The paper will further throw light on the advantages and disadvantages of the consent order mechanism. Further, the paper will discuss the changes which can be introduced in the mechanism.

The research paper questions the legality of SEBI action to introduce the consent order mechanism. Further the paper questions the pros and cons of the mechanism and what all amendments can be made such that all the discrepancies can be removed.

The statement of problem for this paper is regarding the legal power of SEBI while giving green signal to the consent order mechanism and the advantages and disadvantages of such a scheme to the investors and in the development of the securities market.

**PART 1:** Legality of Consent Order

The day when the consent order Mechanism came into effect i.e. on 20th April 2007, the entire business world was packed with discussions regarding the benefits and fallouts in the mechanism. However, the question which arises at first is whether this consent order mechanism at all legal or not.

SEBI brought the consent order mechanism into effect vide a circular no.EFD/ED/Cir-1/2007 wherein it mentioned in that the Parliament of India has recognised 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.8

Section 15T (2) of the SEBI Act, 1992, post the Securities Law (Second Amendment) Act, 1999, states that no one can appeal to the Securities Appellate Tribunal from an order reached by consent with the Board or the adjudicating officer. Thus, the section in fact provides for a mechanism for reaching to settlement by consent of the parties.

---

8 Id.
Taking a cue from this provision SEBI came up with the consent order mechanism and imputed to itself such powers by which the SEBI can settle 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.9

However, the power provided to SEBI to settle by consent is limited by the section 15T (2) till the stage of appeal made from the order of adjudicating officer or the board to the Securities Appellate Tribunal. Thus, there is neither any explicit or implicit power which has been granted to SEBI under the aforementioned section to introduce such mechanism even for matters pending before the Securities Appellate Tribunal and courts as well.

The situation is similar in case of section 23A of the Depositories Act, 1996 wherein it provides for settlement by consent between the party (prima facie accused of violation) and the Board or adjudicating officer of which no appeal can be made to the Securities Appellate Tribunal.

It is quite clear from the bare reading of section 15T(2) of the SEBI Act, 1992 and section 23A of the Depositories Act, 1996 that both the sections does not confer in any manner such powers to SEBI so as to introduce a mechanism by which matters could be settled at any stage i.e. even when they are pending before the Securities Appellate Tribunal or the Courts.

However, this situation has been taken care of by Section 24A of the SEBI Act, 1992 which was inserted after the deliberation of the Joint Parliamentary Committee in wake of the Stock market scam.10 The provision provides for compounding of offence either before or after the institution of any proceeding by the Securities Appellate Tribunal or a Court before which such proceedings are pending. Further, section 23N of the SCRA, 1956 and section 22A of the Depositories Act, 1996 provides for the same.

Thus, SEBI acquires the required power for bringing into force the consent order mechanism by which matters pending before the Securities Appellate Tribunal and the courts could be settled between the party and SEBI. The procedure for doing so has been well laid down in SEBI, circular no. EFD/ED/Cir-1/2007 dated 20th April, 2007 wherein it has been provided that a matter is pending before SAT/Court, the same consent process will be undertaken and

9 Id., Para 5.
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.

The Procedure in no manner infringes any of the rights or the power of the Securities Appellate Tribunal or the Courts. On the other hand the drafting of the consent order by the committee consisting of a retired judge of a High Court and two other external experts will provide for a useful assistance to the Securities Appellate Tribunal and the Courts in reaching to a just conclusion. Further the recommendation is not at all binding on the courts as it has all the power to any amendment as it may deem fit.

The other set of arguments challenging the legal validity of the consent order mechanism is that SEBI does not have any power to issue such a circular under the SEBI Act as it violates several sections (Sections 11, 15 A to 15 H, 15 I, 15 T and 24 A) on the mandatory obligation of SEBI to impose a penalty for violation and SEBI has no discretion.

Under the SEBI Act, 1992 section 15A to 15H provides for levying of penalty for non-compliance with the requirements under these sections and their continuance. The penalty to be imposed in monetary in nature and is a mandatory one. The penalty to be imposed on the violators is fixed and no discretion is available to the regulator i.e. SEBI. Under Section 15I the penalty to be imposed can be in the nature of suspension, cancellation and monetary as well.

Similar is the case with the consent order mechanism which incorporates the concept of imposing penalty in both monetary terms and restriction in the natures of bars such as suspending the violator from trading, cancellation etc. The only difference is the penalty imposed in reached by a mutual consensus between the parties and the SEBI.

Further, the consent terms will be finalized by a Committee, comprising of retired judge of a High Court and two other external experts who 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 and guidance as set out at para 11 of the SEBI, circular

---


no.EFD/ED/Cir-1/2007 dated 20th April, 2007 and upon agreement by the party the consent terms shall be forwarded to the Adjudication Officer. This mechanism does give discretion to the committee to decide the quantum of penalty and its nature however there is no discretion as to whether there will any penalty or not.

However, while considering the constitutionality of the consent order mechanism one comes to the logical conclusion that the mechanism does not provide equal protection of laws to all and thus is in violation of article 14 of the constitution of India. The mechanism does not provide for a standardised penalty for violations which leads to putting similar individual at unequal footings, therefore further leads to unequal treatment. For one who is a stock broker on commission of violation Rs50,000 penalty would be sufficient to deterent him, however, for a multinational corporation a penalty of Rs2,00,000 for a similar violation would cause no deterrence as even after paying the penalty they would still have enough left back out of their unjust earning. Thus, the mechanism clearly discriminates the individual on basis of their paying capability i.e. money and this is mainly due to absence of any set guidance to be followed. The constitutionality of the consent order mechanism seems to be standing on very fragile grounds.

PART 2: Pros and Cons of the Consent Order Mechanism vis a vis interest of the investors and securities market.

SEBI has been given very wide powers under the SEBI Act, 1992, which is quite apparent from the term measures as it thinks fit in the section 11(1). Such measures are referred in but not limited to section 11(2) of the SEBI Act, 1992, it also extends to framing of regulations, issue of directions, circulars and so on. As there is no adherence to separation of power principle and to add to that availability of such broad powers in legislation as well as execution, make the need for checks and balances felt even dearer.

The existing system incorporates checks and balances at two levels, one being the constitution and the other being the provisions of SEBI Act, 1992. Of all the provisions of the SEBI Act, 1992 one which is the most sacrosanct is section 11, which provide that all action of the SEBI must confirm to the twin goal of protecting the interest of the investors and development of the securities market. Thus, the consent order mechanism has to pass the ultimate test of adhering to the twin goal of SEBI set out in section 11 of the SEBI Act, 1992.
SEBI on 20th April, 2007, decided to bring into force the consent order mechanism vide a circular and the reason cited for doing so was to reduce the pressure of caseloads on the courts and tribunals. However, how far the consent order mechanism goes in order to protect the interest of the investors and the development of securities market has got a big question mark hovering over it.

Paragraph 4, of the SEBI, circular no.EFD/ED/Cir-1/2007 dated 20th April, 2007, states that consent orders may provide flexibility of wider array of enforcement actions which will help achieve 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.

The major aim behind the introduction of the consent order mechanism was to get rid of the lengthy proceedings and the failure to extract money out of those who were the violators of the securities laws in India. The consent order mechanism in its current prevailing state does cater to both the requirement as on one hand it gives a quick fix solution to the lengthy litigation problem on the other hand it does help to easily extract money.

However, the consent order mechanism has problems of its own. The existing mechanism of consent order gives us a different picture all together as it by no means seems to cause deterrence in the minds of the violators of the securities laws in place in India. The major lacuna of the mechanism is that it allows the violator to get away without accepting the liability of the violation he has committed. They can do whatever they want and then even without attaching any bad name to their records bail themselves out by paying a certain sum. Thus, the mechanism leaves the investors in a dilemma as to the whether they are investing in scrip which is managed fairly or by committing gross frauds. This will certainly affect the investors’ confidence in the market as they will never be certain about the credibility of the companies and whether the company actually committed the wrongful act or a mere innocent lapse.

Further, the entire mechanism has no sting attached to it tail. The consent order does not cause any kind of deterrence in the minds of the violators as all that they have to do post violation of the laws and unjust earning thereof is to stand at the doors of SEBI with a cheque in their hand. It is felt by the investors that the consent process is encouraging serious
offences to be made as the offenders knew they would eventually get away.\footnote{Radhey Sharma, \textit{Is SEBI consent order a fair process}?(Feb. 27,2012),http://www.thewealthwisher.com/2011/11/24/is-sebi-consent-order-a-fair-process/.} Moreover, there is no stopping to it as one can go committing any number of violation and get away with it. This surely is not in the interest of the investors and the securities market.

Mr. C. Achuthan, former president officer of SAT said “while in procedural matters, consent is welcome, in other cases (the regulator should not) encourage consent, otherwise they (the guilty) will get emboldened to repeat the same. No escape route should be given to market manipulators.”\footnote{Dinesh Unnikrishnan&Aveek Datta, \textit{SEBI Consent Order System Under Review} (Feb. 28, 2012).http://www.livemint.com/2011/07/25003504/Sebi-consent-order-system-unde.html.}

Further, the lack of transparency in the consent orders is a major lacuna which is reducing the investors’ confidence in fair market play. The investors are never sure of the fact that the the companies in which they will be investing their money will act in accordance with the law or they will also be dissuaded by those who violate the laws and then get bailed out by paying a meagre amount out of their unjustly earned profits. The entire issue of investor protection and development of securities market becomes hollow without investors having confidence or reliance in the market.

The reason for such lack of transparency is that two fold; one being that the applicant is not given any opportunity to make a representation to the High Powered Committee (HPC). It is the Investigation Committee (IC), who puts forth applicant’s proposal to HPC. Hence, there is always a lurking doubt as to whether the IC has made an appropriate representation to the HPC, which is the final deciding authority.\footnote{Prachi Pande, \textit{SEBI’s Consent Proceedings – Brickbats, bouquets or a bit of both}?(Feb. 20, 2012).http://barandbench.com/brief/3/1692/sebis-consent-proceedings-brickbats-bouquets-or-a-bit-of-both.}

And the other being that the consent order does not determine the actual amount of gain which has been made out of the alleged violation by the company. This leaves the investors in doubt that whether or not the company going for the consent process is coughing up the entire unjust gain or is getting away by only paying a part of their unjust earning.
This is not the case with just one or two consent order but all high profile case ranging from RNRL and Anil D. Ambani matter\textsuperscript{16} to Merrill Lynch Capital Markets consent order\textsuperscript{17} none have described the actual amount of gain the alleged violators have made out of their actions. The consent order neither determines the actual commission of the violation nor does it ensure that the violator has paid back the entire amount of gain the violator has unjustly earned. This presents a very vague picture in the mind of the investors, which further has a worsening effect on the development of securities market.

Although it can be said that the consent order mechanism can be brought into force under section 15T and 24A of the SEBI Act, 1992, however its legal standing on the twin test posed by section 11 of SEBI Act, 1992 seems very fragile.

**PART 3: Amendments to the Consent Order Mechanism**

The consent order mechanism in its present shape and form seems to be far away from harbouring investors’ confidence in the securities market. Further, the lack of definiteness and transparency in the consent order does no good towards the development of the securities market.

On a harmonious and a holistic reading of the Circular it seems that India today has a fairly apt law in place, however it has to go through multiple changes to instil any kind of investor confidence. Further there is need for proper and judicious implementation of the same. Only when there is proper execution and transparent implementation of the Circular, in letter and in spirit, that the true intent and objective with which the legislature framed and introduced the Circular would be met.\textsuperscript{18}

The consent order mechanism must include in itself proper written guidelines so as to restrict the availability of consent process to the persistent violators of securities market. Moreover, there should be stricter norms laid down to be adhered for repeated violators.

SEBI should also do away with the scheme of allowing the violator to bail themselves without determination or admission of guilt. Further the consent order must mention whether the violation was intentional or a mere slip off. This will bring in certainty in the minds of the investors as they will be able to make an able judgement as to the companies they wish to

\textsuperscript{16} SEBI Consent Order No CO/IVD/426/2011, on the application submitted by RNRL and Anil D. Ambani in the matter of Reliance Infrastructure Ltd., dated 14.01.2011 (hereinafter as SEBI CO).
\textsuperscript{17}SEBI Consent Order No.CO/ID-6/441/2011, on the application submitted by Merrill Lynch Capital Markets, dated 13.05.2011.
\textsuperscript{18}Prachi, *Supra note* 15.
invest. This will further improve the securities market as it will have a deterrence effect on the violators.

Further, the consent order must be transparent which it lacks under the present scheme. The consent order must disclose to a sufficient degree of certainty as to the amount of gain which has been made by the alleged violator through his actions. Then, the violator should be made to cough up the gain as it will make the investors believe that they are not in a losing position and will also help to build confidence in the securities market.

Also consent terms can be filed at any point of litigation. The case of *Shilpa Stock Broker (P.) Ltd. v. Securities and Exchange Board of India*,\(^{19}\) was filed using the provision of special leave petition (SLP) and was admitted by the Supreme Court (SC). The SLP was appealing on an order given by Securities Appellate Tribunal (SAT). Even at this stage, i.e. even after the case was being admitted by SC, a consent order was issued. This shows an urgent need to lay down the parameters for deciding the consent terms and the kind of cases that can be taken for consent orders. At present, the authorities are given wide discretion for deciding the consent terms.\(^{20}\)

These little but significant changes will definitely help the consent order mechanism in it goal of providing appropriate sanction and deterrence on the violators of the securities laws. Further the consent order mechanism will stand tall on the twin test of protecting the investors and development of securities market.

**CONCLUSION**

SEBI punishes all violation of securities law irrespective of whether it affects a large or a smaller section of the society. Generally that violation which has an impact on wide range of people is settled through consent at higher amounts. There are number of cases relating instances of fraudulent and unfair practises, insider trading and failure to follow guidelines and norms whose settlement has extended to crores in amount. On the other hand there have been multiple instances where the settlement has been for a meagre amount.

Thus, the consent order mechanism works for all range of violators be it the worlds the biggest investment banker or a small or medium budget company. The consent order

---

\(^{19}\)Shilpa Stock Broker (P.) Ltd. v. SEBI, MANU/MH/0063/2012.

\(^{20}\)Irani, Supra note 6.
mechanism as it is in its present state does in no manner cause any kind of deterrence moreover it is damaging the investors’ confidence in the securities market.

There is immediate need for change in the entire mechanism of consent order by way of including determination or admission of guilt and increasing the transparency level in the consent order. This will certainly be a move forward with harmonizing with SEBI’s goal of investor protection and development of securities market.

BIBLIOGRAPHY

ACTS AND CIRCULARS
- Securities and Exchange Board of India Act, 1992
- Securities Contract Regulation Act, 1956
- Depositories Act, 1996

CASES

CONSENT ORDER

WEBSITE


