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SEBI's consensus ad idem

By **Natasha Garg**

The initial framework for consent orders by Securities and Exchange Board of India ("SEBI") was set out in SEBI Circular No. EFD/ED/Cir.-01/2007 of 20th April 2007. In recent times, the SEBI's consent orders were criticised for lack of transparency and that at times, serious violators walked away by paying a small penalty, which was miniscule compared to the nature of the breach or the profit made through such acts. In order to further streamline the consent process by adding more clarity and transparency on the scope, applicability and procedure of Consent Orders, SEBI has recently amended the Consent Scheme vide Circular No. CIR/EFD/1/2012 dated 25th May, 2012, the salient features of the modified circular are discussed in this write-up.

Genre of matters

The previous position of the SEBI has remained that consent was permissible in violations under Sections 11, 11B, 11D, 12(3) and 15I of SEBI Act and such equivalent proceedings under the Securities (Contracts) Regulation Act, 1956. However, serious violations that have caused substantial losses to the investors like insider trading, front running, failure to make an open offer, fraudulent and unfair trade practices, failure to redress investor grievances and respond to the summons issued by SEBI, among others, have been excluded from the consent process. However, SEBI has retained a discretionary power to settle even such serious breaches, based on the facts and circumstances of each case.

Frequency of violations

In order to act as a strong deterrent for repeat offenders, consent will be denied for the second breach of the same violation within 2 years of the consent order and after two consent orders, a cooling off period of three years has been prescribed before any further consent applications are considered.

Scope and timing of consent

SEBI has also changed its policy of entertaining consent applications before completion of any investigation/ inspection. This new explicit power enables SEBI to protect the market with an interim order even though it suspends passing of a final order. This is a positive development as it enables SEBI to pro-actively protect the market without waiting for the entire procedure to be completed. Another development in the consent scheme is in respect of proceedings pending before SEBI. The new guidelines mandate that no consent application can now be considered if filed after sixty days from the date of service of show cause notice.

Speedy disposal of consent application

In order to speed up the process, SEBI must now dispose of the consent application expeditiously preferably within a period of six months from the date of registration of the consent application. Also, in case of rejection of the consent application, no subsequent application with respect to the same default shall be considered by SEBI at any stage thereafter.

High level of transparency

Lastly and perhaps the most important change is the higher level of disclosure imposed upon SEBI itself in respect of its orders. The new rules impose an obligation upon SEBI to spell out in its orders - the alleged misconduct, legal provisions alleged to have been violated, facts and circumstances of the case and the consent terms. In fact, SEBI has been required to go a step further and open these proceedings to RTI enquiry, after a gap of six months.

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CIRCULARS

Overseas Direct investments – E-mail confirmation of UIN allotment

Confirmation of allotment of the Unique Identification Number (UIN) generated by the Authorised Dealers in case of overseas direct investments under the online reporting system would now be done through an auto generated e-mail to the email-ID made available by the AD/Indian Party. This change has come into effect from 1st June, 2012. As per Reserve Bank of India's A.P. (DIR Series) Circular No. 131, dated 31-5-2012, this auto generated mail has to be treated as confirmation of allotment of UIN. For the purpose of reporting subsequent remittances under automatic route, part II of the ODI form shall be filed only after receipt of e-mail conveying the UIN.

Declaration of Financial Institutions as Public Financial Institutions – Guidelines

The Ministry of Corporate Affairs has framed guidelines for declaration of financial institutions as Public Financial Institutions under Section 4A of the Companies Act, 1956. As per General Circular No. 10/2012, dated 21-5-2012, a company or corporation should be established under a special Act or the Companies Act with its main business being industrial or infrastructural financing. The company should be in existence for atleast 3 years and its income from infrastructural or industrial financing should be more than 50% of its total income. Minimum net worth of the company should be Rs. 1000 crore and the company should have been registered as Infrastructure Finance Company with RBI or as a Housing Finance Company with National Housing Bank. In case of PSUs, no restriction will apply with respect to financing specific sectors and minimum net worth requirement specified in this circular will also be not applicable.

Auditing of Cost Accounting Records – Clarifications

The Ministry of Corporate Affairs has clarified that for companies wherein their products/activities are for the first time covered under any of the revised industry specific Cost Accounting Records Rules notified in December, 2011 and where the threshold limits as mentioned in the specified Cost Audit Orders have been met, the records have to be audited in respect of each financial year commencing on or after 7-12-2011. The General Circular No. 12/2012, dated 4-6-2012 also clarifies that companies engaged in production, processing, manufacturing or mining of multiple products/activities, if any of their products are not covered under the industry specific Cost Accounting Records Rules and under specified cost audit orders but are covered under the Companies (Cost Accounting Records) Rules, 2011, such companies will be required to file a compliance report as clarified in para (a) of the MCA's General Circular No. 68/2011 dated 30-11-2011. It may be noted that General Circular No. 11/2012, dated 25-5-2012 further extends exemption from the mandatory cost audit to all units located in the SEZs, EPZs, FTZs and EOUs subject to specified conditions.

Annual Return by LLPs – Time for filing extended

The Registrar of Companies has been authorized to function as Registrar of Limited Liability Partnerships (LLPs) with effect from 11th June, 2012. As the LLP system was closed from 31-5-2012 to 10-6-2012, time limit for the filing of Annual Return by LLPs in Form 11 has been extended by 30 days in respect of the financial year ended 31st March, 2012. As per Ministry of Corporate Affairs Circular No. 13/2012, dated 6-6-2012, the time limit would now be 90 days instead of 60 days.

RATIO DECIDENDI

Arbitration Agreement survives even on the death of a named arbitrator

The Supreme Court of India has held that the death of a named arbitrator in an arbitration agreement would not result in the termination of an arbitration agreement. In the present case the agreement stated that if there was any dispute between the parties *'at any time'* the dispute shall be referred to the arbitrators who were respectively former Chairman and Director of the appellant-company. Since both the named arbitrators had passed away it was argued that the arbitration agreement had no life. The Court held that in such a case the parties can take recourse to Section 11 of the Arbitration and Conciliation Act, 1996 to appoint an arbitrator unless the parties had intended not to supply the vacancy of the arbitrator and which intention should be clearly spelt out in the arbitration agreement. The Court further held that the expression *'at any time'* manifested the intention of the parties to arbitrate whenever there was a dispute at any time under the agreement without reference to the life time of the named arbitrators. It was held that the arbitration agreement did not prohibit or debar the parties in appointing a substitute arbitrator [*ACC Limited* v. *Global Cements Ltd.,* decided by Supreme Court on 11-6-2012 in SLP(C) No. 17689 of 2012].

"Dominant position" – Scope clarified

The Competition Commission of India has held that Orissa Mining Corporation did not occupy dominant position in the market and hence there was prima facie no violation of Section 4 of the Competition Act, 2002 to call for investigation by DG. The Commission held that dominant position in *Explanation* (a) to Section 4 of the Competition Act, 2002 means enjoying position of strength in the relevant market in India enabling the enterprise to operate independent of the competitive forces prevailing in the relevant market or affect its competitors or consumers or the relevant market in its favour. On the facts of the case, the Commission held that since the market share of the opposite party was a miniscule 9.52%, the applicant can obtain iron ore from other manufacturers/miners also. It was observed that the market was fragmented and many other players were present to cater to the informant association. As per the informant, the opposite party was abusing its dominant position by fixing arbitrary and unreasonable price of iron ore [*All Odisha Steel Federation* v. *Orissa Mining Corporation* – Case No. 13/2012, decided on 18-6-2012].

Power to blacklist delinquent bidder is inherent

Failure to mention blacklisting as one of the probable actions that could be taken against the delinquent bidder does not, by itself, disable the government organisation (NHAI) from blacklisting a said bidder, if it is otherwise justified. Such power is inherent in every person legally capable of entering into contracts. The Supreme Court in its recent order has held that the very authority to enter into contracts conferred under Section 3 of the National Highways Authority Act, by necessary implication, confers the authority not to enter into a contract in appropriate cases i.e. to blacklist. It was observed that the authority of State to blacklist a person is a necessary concomitant to the executive power of the State to carry on the trade or the business and making of contracts for any purpose, etc. and that there need not be any statutory grant of such power. The Supreme Court held that the State has, however, to act fairly and rationally without in any way being arbitrary – thereby such a decision can be taken for some legitimate purpose. Earlier the appellant after being declared a successful bidder had declined to enter into a contract founding it to be non-viable and had argued that the power to blacklist is available only in the cases of the commission of any

or some of unacceptable practices by the bidder or his agents. The Court also held blacklisting as justified in the facts of the case. [*Patel Engineering Ltd.* v. *Union of India* – SLP(C) No. 23059 of 2011 decided on 11-5-2012].

Appointment of an independent and impartial arbitrator when not expressly provided in contract

Deciding on a petition seeking reference of disputes to an independent and impartial arbitrator the Supreme Court has held that even when the contract expressly provides for referring all disputes to the Chairman and Managing Director of the respondent-company or his nominee, the Court could appoint a sole arbitrator to ensure impartiality in the proceedings. The petitioner pleaded that being a subordinate the named arbitrator would not be independent and impartial. Differing with view adopted in, *inter alia, Indian Oil Corporation Limited & Ors* v. *Raja Transport Private Limited* [(2009) 8 SCC 520] that the Court's intervention was not required when parties to the contract had agreed to be bound by certain terms, the Court in this case appointed a sole arbitrator [*Bipromasz Bipron Trading SA* v. *Bharat Electronics Limited (BEL),* Supreme Court order dated 8-5- 2012 in Arbitration Petition No. 19 of 2011].