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The Role of Criminal Sanctions in Investor Protection through Disclosure Regulations: An Indian Scenario

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ABSTRACT

India's regulatory system employs disclosure rules to ensure corporate governance and accountability. Corporate governance is built on the principles of transparency, disclosure, accountability, and integrity. The shift from merit-based to disclosure-based regulation has been portrayed as part of the globalisation of competitive economies. As a result of the internationalisation of national economies, the consequences of corporate failure in different countries, and the rivalry for corporate managerial roles, the demand for effective corporate accountability has increased. Adequate transparency is a cornerstone of a healthy capital market. Regulations on disclosure can only be effective if they are properly implemented. In order to efficiently enforce disclosure legislation, those responsible for non-disclosure and non-compliance with disclosure norms must be prosecuted and disciplined. The regulatory framework requires the issuer to provide full disclosure of its affairs to investors, who can then determine whether or not to invest based on the risk. The information provided should be adequate to satisfy the needs of a wide range of stakeholders. Managers are held more responsible for their decisions as they are made aware of their actions. But in spite of all these mechanisms we can see a number of corporate scandals and also vanishing companies. In India, there were numerous examples, where the general public lost money by buying shares based on faith in the prospectus, deceptive claims and false representations in the company's financial records. In this context it is vital to examine how far the criminal liability is used as a mechanism to render effective disclosure practices. This paper examines the importance of disclosure mechanisms in investor protection and the extent to which criminal sanctions are used to ensure that disclosure mechanisms work effectively.

I. INTRODUCTION

Disclosure regulations are used by India's regulatory framework to ensure corporate governance and transparency. Transparency, disclosure, accountability, and integrity are at

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the core of corporate governance. The focus of corporate sector regulation has shifted as a result of economic liberalisation and globalisation. The transition from merit-based regulation to disclosure-based regulation was visualised as part of the globalisation of competitive economies. The demand for effective corporate accountability has grown as a result of the internationalisation of national economies, the effects of corporate failure in different countries, and the competition for corporate managerial positions. Investor protection necessitates that all details required for a fair evaluation of the risks and benefits of a proposed investment be made available to the prospective investor. The pillar of a healthy capital market is adequate disclosure. Fair access to a minimum standard of information is a goal of disclosure regulations. The economic benefits of a well-managed transparency policy are commonly recognised by corporate management around the world. Regulations on disclosure will only be successful if they are properly implemented. Persons responsible for non-disclosure and non-compliance with disclosure norms must be prosecuted and punished in order to effectively implement disclosure regulation.

Communication through corporate disclosure is a very evident aspect of corporate governance in the sense that meaningful and adequate disclosure enhances good corporate governance. Under disclosure-based regulation, the issuer is required by the regulatory system to provide full disclosure of its affairs to investors, who can then decide whether or not to invest based on the risk. The quality of a company's disclosure reveals it’s financial and operating status, as well as its executives' incentives and discretion in revealing pertinent information. Investors, creditors, customers, employees, financial analysts, and regulators all need corporate data for various reasons. The information provided should be sufficient to meet the needs of a variety of stakeholders. Disclosure acts as a effective mechanism to make the managers more accountable for their actions. But in spite of all these mechanisms we can see a number of corporate scandals and also vanishing companies. In India, there were numerous examples, where the general public lost money by buying shares based on faith in the prospectus, deceptive claims and false representations in the company's financial records. In this context it is vital to examine how far the criminal liability is used as a mechanism to render effective disclosure practices. The first part of the paper focuses o n the significance and need of Disclosure based regulation and their shortcomings in assisting investors in making well-informed decision. Second part of the paper will analyse the method for disseminating corporate disclosure. Use of Criminal Sanctions for non compliance with Disclosure regulations will be analysed in the third part. The article ends by raising some concerns and suggestions regarding the use of criminal sanctions in ensuring investor

protection through corporate disclosure.

II. SIGNIFICANCE AND NEED OF CORPORATE DISCLOSURE

In today's business environment, corporate governance is becoming a critical investment criterion. Various committees associated with improving corporate governance often highlighted the role of disclosure norms in ensuring accountability and transparency in corporate governance.[2] For six factors, disclosure has been recognised as one of the most powerful instruments of corporate and financial market regulation.[3] They are *"(a) by increasing publicly available information, it enables market actors to make informed investment decisions, (b) it improves market efficiency: increased availability of information leads to better pricing of securities and of other financial instruments enhancing allocative efficiency, (c) it reduces the cost of information searches, which, when excessive, is pure social waste in zero sum securities markets; (d) it fosters fair, ethical, and competitive markets, as it obliterates (along with prohibitions of insider dealing) the information advantage that insiders enjoy over outsiders in financial markets, (e) it may help market stability by containing market volatility that is usually caused by limited information regarding the merits or risks of financial products, (f) it deters fraud*".[4]

The disclosure-based approach is based on the caveat emptor principle, which states that the investor must make his or her own judgement and investment decisions based on the information provided.[5] Disclosures are essential components of a strong corporate governance system because they enable shareholders, stakeholders, and investors to make informed decisions about capital allocation, corporate transactions, and financial performance monitoring. As a result, not only does disclosure benefit investors, but it also aids regulators in preserving market trust and system stability. Disclosure regulation is critical to corporate governance because they eliminate knowledge asymmetry between a company's management and financial stakeholders, thus reducing the agency issue in corporate governance.

Investors and creditors may make sound and informed investment decisions according to

[2] See the Adrian Cadbury Committee on Financial Aspects of Corporate Governance, U.K., (1992); the Hampel Committee on Corporate Governance, U.K., (1998);the Kumara Mangalam Birla Committee on Corporate governance 1999; the Naresh Chandra Committee on Corporate Audit and Governance (2002); the Narayanmurthy Committee on Corporate Governance (2003) and the Malegam Committee Report on Disclosure Requirements in Offer Documents (1995), The J.J.Irani Committee on Company Law 2005 .

[3] Gary S. Becker, The *Economic Approach to Human Behaviour (*1976), 14 and Richard Posner, *Economic Analysis of Law* (6th ed., 2003), chs. 1-3.

[4] Emilios Avgouleas, What Future for Disclosure as a Regulatory Technique? Lessons from the Global Financial Crisis and Beyond, Paper presented in the University of Glasgow and ESRC World Economy and Finance Conference: The Future of Financial Regulation, 30-31 March 2009

[5] Hans Tijo, "Enforcing Corporate Disclosure", 2009, *Singapore Journal of Legal Studies* 332 at p.337.

disclosure regulations. Prospective investors would have more trust in the stock market and the number of investors would increase if they had access to adequate and reliable information. The shareholder rights are given substance by the disclosure regulations, which include the details needed to exercise them.[6] The main aim of corporate disclosure is "to communicate firm performance and governance to outside investors".[7] It lowers the likelihood of insider trading.[8]Managers are compelled to handle better as a result of disclosure requirements, which improve corporate governance.[9] It aids in the assessment of management's stewardship role. Disclosure also provides value to shareholders by minimizing a company's capital costs.[10] External funding, acquisitions, and development are all aided by disclosure. Debt levels are reduced where there is a strict regulatory provision for disclosure.[11]

In the case of *Milan Mahindra Securities Pvt. Ltd. vs. SEBI,*[12] the Securities Appellate Tribunal[13] emphasised the importance of disclosure standards. According to SAT, "*disclosures made under the SEBI Regulations serve a critical function in the market. If a corporation fails to make a necessary filing at any given time, it means that an investor was denied access to this information, and this asymmetry may have influenced his decisions. The tribunal went on to say that the obligation to report information in the market is critical for ensuring transaction integrity and allowing the regulator to efficiently track transactions in the market."*

Disclosure exists in different forms. The first distinction is made by contrasting financial and non-financial disclosure. Financial disclosures provide financial reporting, which consists of financial statements that are specified by accounting principles. The latter provides information about the company's social and environmental responsibilities, corporate governance, and operating procedures, as well as information about the managers' wellbeing.[14] The opposition between voluntary and mandatory disclosure is the basis for the

[6] Lowenstein, "Financial Transparency and Corporate Governance: You Manage What You Measure", 96 Colum.L.R.1335 (1996).
[7] Healy, P.M. and Palepu, K.G., Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature, 2001 Journal of Accounting and Economics 31 at p.405–440.
[8] Goshen & Parchomovsky,"The Essential Role of Securities Regulation", 55 DukeL.J.710 at p.738 (2006).
[9] Elliott J.Weiss and Donald E. Schwartz, "Using Disclosure to Activate the Board of Directors", 41 L. Contem. Prob.63(1977).
[10] Botosan, C.A., Disclosure level and the cost of equity capital", 1997, Accounting Review, July, Vol.72 Issue 3, p323-349
[11] Khurana, I.K., Pereira, R. and Martin, X., Firm Growth and Disclosure: An Empirical Analysis, 2006, Journal of Financial and Quantitative Analysis 41 (2): 357–380.
[12] Appeal No. 66 of 2013, available at https://www.sebi.gov.in/satorders/milansatorder.html
[13] hereinafter "SAT"
[14] Supra Note 6

second distinction. A measure of self-regulation or a response to stakeholder and civil society demands for further transparency is voluntary disclosure.[15] Mandatory disclosure necessarily involves Legislation or Regulation.

Disclosure rules aid in the monitoring of controlling shareholders' transmission of corporate properties.[16] Disclosure deters bad behaviour and aids in the detection and prosecution of corporate frauds. Shareholders gain confidence as a result of increased disclosure. Disclosure also provides value to shareholders by minimizing a company's capital costs.[17] It ensures that the price of securities represents the intrinsic value of the securities, which encourages market performance.[18] Better corporate transparency will encourage investment and mobilise funds for economic growth.

The disclosure regulations increase the accuracy of financial forecasts. Better informed investors would benefit unfairly from trading if they had unequal access to information. Disclosure responsibilities reduce the time and money required to search and gather information.[19] Investors would have to spend a lot of time and money uncovering non-public information if mandatory disclosure obligations were not in place. Investors can assess and track their company's relative performance by disclosing financial data from peers. Mandatory disclosure will compel businesses to reveal information that they would otherwise refuse to reveal. Mandatory notification of the company's defaults allows prospective investors to get a sense of the company's compliance with laws and regulations.[20]

Disclosure based regulation gained popularity in the 1980's.[21] The legal disclosure standards vary by country and are determined by the company's governance structure. In countries with centralised ownership systems, mandatory disclosure provisions play a significant role.[22]Prior to 1992, India adopted merit-based regulation in securities offerings, in which the regulator plays a major role in policy decisions and the offering or listing takes place only with their

[15] Chandler, R., Accountability and disclosure: Director's remuneration in privatized utilities. Public Money & Management, 1997,17 (2), at p 43–48.
[16] Betrand, Mehta, and Mullainathan, "Ferreting out Tunnelling: An Application to Indian Business Groups", 47 *Quarterly Journal of Economics* 121 (2002).
[17] Supra note 9
[18] Merrit B Fox, "Required Disclosure and Corporate Governance", 62 L.Contem.Probs.113 at p.123 (1999).
[19] Ibid
[20]The Companies Act, 2013, s.74-76 provides that a corporation that has failed to repay a deposit from a small investor must report the default in any future advertisement or application form soliciting public deposits. Nondisclosure of the failure to repay deposits is punishable with imprisonment up to seven years or fine which may extend up to 2 crore.
[21] Paula J Dalley, "The Use and Misuse of Disclosure as a Regulatory System", 34 Florida State Uni.L.R.1089 at p.1093 (2007).
[22] Allen Ferrell, "The Case for Mandatory Disclosure in Securities Regulation Around the World**",** Harvard Law School, John M.Olin Center for Law,Economics and Business Discussion Paper Series, Discussion Paper No. 492/200. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=631221

consent. The merit based regulation unnecessarily constrained the independence of investors. So in late twentieth century India substituted administrative regulations with disclosure based regulations. The Companies Act, and also the SEBI Act mandated public disclosure of corporate activity from its inception to its dissolution. SEBI has enacted a range of regulations to protect investors' interests, with disclosure regulations serving as the primary mechanism for controlling corporate activities.[23] The informational requirements of the users and the willingness on the part of the management to disclose the information, also plays very important role in corporate disclosure.

III. LIMITATIONS OF CORPORATE DISCLOSURE

Along with the ostensible advantages, the mandatory disclosure regime has its own set of disadvantages**.** The information disclosed can only be useful if the recipients can process and understand it.[24] This is due to the information's sophistication and a lack of experience in comprehending the complexities of the disclosures made. Owing to their limited cognitive skills, investors are overwhelmed with knowledge and do not use the information revealed effectively. This is a particular issue for stock markets, which have a large number of ordinary citizens participating in increasingly complex financial transactions. As a result, the SEBI and those interested in financial disclosure worked hard to increase the utility of disclosure by carefully designing the information format. It is decided to publish the disclosure requirements in simple English.

Excessive transparency can reflect poorly because too much information can render a document unreadable and relevant information can get lost in a sea of relatively unimportant data.[25] Disclosure has costs, such as those associated with gathering, compiling, and publishing relevant data, and the costs of any given disclosure scheme may outweigh the benefits.[26] As in any legislation, disclosure mechanisms may have unintended consequences. [27] When disclosers are expected to reveal derogatory information about themselves and the information must be produced from scratch, disclosure mechanisms are less likely to

[23] See SEBI DIP(Disclosure and Investor Protection) Guidelines 2000, SEBI ICDR (Issue of Capital and Disclosure Requirements) Regulations 2009 which prescribes dos and don'ts during public offers and also the LODR (Listing Obligation and Disclosure Requirement) Regulations 2015.

[24] William O. Douglas, Protecting the Investor, 23 Yale Rev. (N.S.) 521, 523-524 (1934); The Wheat Report, at p. 78-80

[25] The Malegam Committee Report on Disclosure Requirements in Offer Documents,2005 (India).

[26] Cass R. Sunstein, "Informing America: Risk, Disclosure, and the First Amendment," 20 Florida State University Law Review 653 (1992).

[27] Elizabeth Garrett & Adrian Vermeule, Transparency in the Budget Process, Univ. of S. Cal. Law & Econ. Working Paper Series, Jan. 23, 2006 (Note that early in the budget process, transparency will cause special interest groups to interfere in the legislative process.)

succeed.[28]

All disclosures must meet the relevant and non-duplicative criteria. Companies who complain of being overburdened with filing massive amounts of information to various agencies will waste time if disclosures were duplicated. It will raise the possibility of technical breaches.[29] According to some academics, transparency norms are unnecessary because market forces can usually ensure that companies reveal the appropriate amount of information.[30] According to the claim, the company would voluntarily reveal the details needed for investors to assess the company and its shares.

To summarise, while disclosure systems can achieve their objectives in a variety of ways, their efficacy will be constrained by a number of factors that must be considered during the system's design. Furthermore, only by comprehending the process by which the disclosure scheme can work can one determine the probability that it will accomplish its purpose and the true costs of the disclosure provision. However, disclosure systems are often implemented without this awareness and evaluation because they are politically acceptable and relatively inexpensive.

IV. CORPORATE DISCLOSURE DISSEMINATION IN INDIA

The Companies Act of 2013, as well as the SEBI Act, both requires public disclosure of corporate activity from the time it is formed to the time it is dissolved. Different methods are used to make information accessible. The different ways in which information is disseminated to the public include registration at the registrar's office, the company's obligation to keep registers, the release of annual reports, half-yearly reports, director's reports, and auditor's reports. The company's trading activity is reported in financial disclosures. Non-financial disclosures, on the other hand, provide information about the company's governance system and activities. All registered companies are required to file details about the company's constitution, officers, registered office address, share capital, charges on the company, and company goals, ad so on .

The prospectus and the registration of the memorandum and articles of association with the registrar of companies are the primary sources of initial disclosure. The need for knowledge

[28] Cynthia A. Williams, The Securities and Exchange Commission and Corporate Social Transparency, 112 HARV. L. REV. 1197, 1294-1296 (1999)
[29] The Report of the Sub-Committee on Integrated Disclosures, Securities and Exchange Board of India (2008), para 2.1.
[30] Roberta Romano, "Empowering Investors: A Market Approach to Securities Regulation", 107 Yale L.J.2359 (1998); Paredes, "Blinded by the Light: Information Overload and its Consequences for Securities Regulation", 81Washington University Law Quarterly 417(2003).

among investors does not end when the shares are released. A continuous flow of information about the company and its securities is needed for efficient secondary trading in shares. The legislative provision of regular reporting by managers to shareholders and the requirement for listed companies to issue half-yearly reports ensure continuous disclosure. Every company shareholder has a right to know how the company's business is conducted, as well as information about the company's financial situation, including whether funds are used for the intended purpose, and so on. Financial statements and accounts submitted by the company may be used to gather information on the subject. The Companies Act of 2013 mandates the laying of accounts before the company's annual general meeting, which allows for the distribution of this information.

Certain transactions necessitate immediate or rapid information dissemination. This category includes information on changes in the company's shareholdings, disclosure of important events, and information that is relevant to determining the valuation of its shares. The aim of requiring the disclosure of a company's shareholdings is to make its representatives aware of who is accumulating a stake in the company. According to Indian insider trading laws, anybody who acquires more than 5% of a company's voting stock must notify the company within four working days of the transaction, and the company must notify the stock exchanges on which the company is listed within five days of receiving such details.[31]

Every year company directors have to prepare a report for the company’s members to explain what the company has been doing and its plans for the future. The director’s report is prepared on a quarterly and annual basis. It includes detailed items such as the accountant's financial analyses and management recommendations.[32] The report is usually unaudited. The report is intended to report, to all interested stakeholders, the directors' explanations and interpretations of the profit/loss, the state of affairs of the group and any other matters which may be material for the stakeholders' attention. Section 129 (2) of the Companies Act, 2013 provides that at every annual general meeting, the Board of Director’s should lay before the meeting a balance sheet and profit and loss account for the financial year.[33] Section 188 of the Act says about the disclosure by the directors about related party transactions.[34] Apart from the existing requirements of disclosing full particulars and reasons for proposing a resolution, as well as the location and date for inspection of relevant documents, section 188

[31] See SEBI (Insider Trading) (Amendment) Regulations, 2002, Sec 12 (3) Policy on Disclosures And Internal Procedure For Prevention Of Insider Trading
[32] Devesh Pandey, Director’s Report – Disclosure Requirements Under Companies Act, 1956 ,available at https://cacscorporatelaw.blogspot.com, viewed on April 2021
[33] The Companies Act, 2013.S.129(2)
[34] The Companies Act , 2013, S.188

of the Companies Act 2013 also mandates disclosure of not only the names of the interested parties, but also the nature and extent of their interests as directors, managers, key managerial personnel (KPM), and relatives of directors, managers, and KPM.[35]

Manipulation and ante-dating of records filed with the registrar of companies is no longer possible due to MCA -21.[36] The use of a digitalized database of companies and e-filing of forms has made investigation and prosecution easier. These details will be available to law enforcement officers at the touch of a button. A new feature added as part of the project is the Directors Identification Number.[37] Wherever a reference to the director is needed in an e-form, DIN must be used. SEBI required Strict Disclosure practises in the framework to protect the interests of investors. SEBI named an expert committee in 1994-95, chaired by V.H. Malegam, to recommend steps to improve transparency standards.[38] SEBI released the SEBI Disclosure and Investor Protection Guidelines, 2000 to enforce the recommendations after adopting them. SEBI's stringent entry and disclosure norms have made it difficult for most new businesses to gain access to the capital markets. To prevent frequent changes in the norms, SEBI replaced the Disclosure and Investor Protection (DIP) Guidelines, 2000 with the Issue of Capital and Disclosure Requirements (ICDR) Regulations, 2009, which also gave them legal sanctity. In 2015 in order to enable transparency and fair disclosures, SEBI mandated for a new regulation called as LODR regulation 2015(Listing Obligation and Disclosure Requirement Regulation 2015). It details about the principles governing disclosure of information and the obligations to be complied with.[39] This will help the investors to get an update on the repayment capabilities of the entity under consideration and can take wise decision on their investment.

V. NON-COMPLIANCE OF DISCLOSURE REGULATIONS: USE OF CRIMINAL SANCTIONS

Regulations on disclosure are ineffective unless there is a system in place to ensure that they are followed. Since the cumulative impact of these breaches can be catastrophic and eventually manifest itself in the form of corporate scandals, the breach of the disclosure law

[35] Ibid
[36] Clause 49 of the listing agreement mandates corporate disclosures of related-party transactions, accounting treatment, contingent obligations and risks, risk control practises, proceeds from different types of share issues, director remuneration, and a management discussion and review portion of the annual report that covers general market conditions. It mandates that publicly traded corporations send a quarterly compliance report to stock exchanges in a specified format.
[37] Hereinafter referred as DIN.
[38] See SEBI Malegam Committee Report, 1997
[39] SEBI LODR Regulations 2015, Regulation 30 o Disclosure of events or information

should be treated as a severe offence rather than a minor administrative error.[40] One way of ensuring compliance with disclosure requirements is by civil liability. Civil remedies are more remuneration-oriented. The only way to accomplish the deterrent objective is to impose criminal liabilities for non-disclosure and false misstatements. There should always be criminal sanctions at the top of the regulatory pyramid to deal with fraudulent misstatements. It is criminalised in almost all countries like US, UK, Australia and Singapore.[41]

At the time of incorporation, all legal structures require the filing of a company's memorandum and papers with the registrar of companies. The Companies Act, 2013, in India, specifies the basic clauses that must be included in a memorandum of association.[42]Any member is entitled to receive a copy of the company's memorandum and articles.[43] Any officer of the company who fails to provide copies of the company's memorandum and articles to its members will be punished. It is compulsory for all the companies to register their articles of association with the registrar.[44] Any individual has the right to examine and copy these documents.

VI. INITIAL PUBLIC OFFER & DISCLOSURE

In all jurisdictions, issuing a prospectus is a prerequisite for raising capital from the general public. The law specifies the details that must be revealed in the prospectus. Non-disclosure of information and the use of false or misleading claims in a prospectus are also illegal. The Companies Act of 2013 makes it mandatory in India to submit a prospectus. Making public offerings without following the protocol outlined in the Companies Act of 2013 and related laws will result in criminal charges. The prospectus' main purpose is to educate the public about the feasibility of the company's venture.[45] The Act mandates that such information be revealed in prospectuses, and failure to do so is a criminal offence.[46]

The information to be disclosed in the prospectus is prescribed in detail under the 2013 Act.[47] The primary goal of the regulations requiring mandatory disclosure of the listed matters is to prevent prospective stakeholders from being defrauded by promoters and directors. SEBI has been given complete authority over the issue and transfer of shares, including the ability to

[40]See Hemraj, "Preventing Corporate Scandals", 2004 J.F.C.268. The Enron debacle and the Satyam episode were perpetrated by means of misstatements, falsifications, and accounting malpractices.
[41]*Supra* n.3 at p.337.The Securities and Futures Act, 2001 (Singapore), Part XII provides for criminal sanctions for market misconduct which can extend to a fine up to $250,000 and imprisonment of up to 7 years.
[42] The Companies Act, 2013, S.4
[43] Ibid
[44] The Companies Act, 2013, S.5
[45] Avtar Singh, *Company Law*, Eastern Book Company, Lucknow (2004), p.101.
[46] The Companies Act, 2013, S.26(9)
[47] Ibid

prosecute companies for misrepresentations in offer documents and fraudulent inducement to invest. SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009[48] have to be observed in addition to the requirements of section 26 of companies' act 2013. The breach of the ICDR regulations' disclosure provisions is punishable by a fine of up to one crore rupees.[49] In the case of non-disclosures, the SEBI guidelines offer no protection. The law makes no distinction between the parties who commit the infringement and their intentions. When a violation is discovered, a penalty is imposed.

To prove that a statement in a prospectus is false, the offence of misstatement in a prospectus must be proven. The rosy image painted in the prospectus, brochures, and advertising attracts gullible investors. If the assurances made in the prospectus are not kept, there is a prima facie case of criminal liability for misrepresentation in the prospectus[50]. The allegation in *Hafez Rustom Dalal v. Registrar of Companies*[51] was that the prospectus' various statements and forecasts had not been enforced. The Gujarat High Court determined that the omission and delay in starting production activities in question were not intentional omissions. Companies have complete discretion about whether or not to disclose forecasts and other forward-looking statements. Forecasts should not, however, be false, deceptive, or misleading.

Any person who authorises the distribution of the prospectus can be held criminally liable for misstatements in the prospectus. The directors of the corporation are primarily responsible for issuing a prospectus that complies with the Act's requirements. Various other intermediaries are involved in the prospectus distribution process and are held liable under the Act.[52] The lead merchant bankers are in charge of ensuring the accuracy and authenticity of the disclosure in the offer document.[53] Their primary responsibility is to vet prospectuses to ensure that they comply with legal requirements. The role of lead merchant bankers in the

[48] Hereinafter referred as ICDR regulations

[49] The Securities and Exchange Board of India Act, 1992, s.15A reads, " Penalty for failure to furnish information, return, etc.- If any person, who is required under this Act or any rules or regulations made there under:-
(a) to furnish any document, return or report to the Board, fails to furnish the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
(b) to file any return or furnish any information, books or other documents within the time specified therefore in the regulations, fails to file return or furnish the same within the time specified therefore in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
(c) to maintain books of accounts or records, fails to maintain the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less."

[50] *Anil D. Ambani* v. *Santosh Tyagi*, (2000) 99 Com.Cas.334 (Raj.)

[51] (2005) 128 Com.Cas.883 (Guj.)

[52] The Securities and Exchange Board of India (Intermediaries) Regulations, 2008,cl.27 provides the actions that can be taken against intermediaries in case of default

[53] The Securities and Exchange Board of India (ICDR) Regulations, 2009, cl.6 and 8requires the due diligence certificate in respect of offer documents to be filed by lead merchant bankers.

issuance of prospectuses has been institutionalised by SEBI regulations. Directors, promoters, lead managers, consultants, and other intermediaries involved in the prospectus issue are considered "persons who approved the issue" and may be sued if the prospectus contains false information.

On the basis of the disclaimers and disclosures made under the heading of "risk factors," directors have been able to avoid responsibility for fraudulent misstatements in the past. A Private Placement Memorandum (PPM) was floated in *Iridium India Telecom Ltd. v. Motorola Incorporated*[54] in order to raise funds for the 'Iridium Project.' Many claims were made that the device would have a global subscriber connection that would be accessible from virtually anywhere on the planet's surface. The project cost Rs 150 crores, and the respondent put Rs 150 crores into it. The Iridium System was discovered to be a complete failure, and all of the material representations made were completely false and fraudulent. Iridium filed for bankruptcy protection under the US Bankruptcy Code nine months after making a large investment in the metal. The respondents lodged a complaint for unjust enrichment. The proceedings were quashed by the Bombay High Court on the grounds that the promoters had given ample notice about the project's risk factors. On appeal, the Supreme Court looked over the claims in the PPM and determined that there was a prima facie case of fraudulent inducement in the case.

VII. ANNUAL RETURNS & DISCLOSURE

Annual returns must be filed with the registrar of companies by every company. After the annual general meeting, the return must be filed within 60 days. The Act specifies about the information that must be included in annual returns.[55] The purpose of filing annual returns is to allow the registrar to keep track of any changes to the company's constitution. If a company fails to file its annual reports, the company, as well as any of its officers who are in default, will be fined.[56]

In *Sevaram Pasari v. Registrar of Companies*,[57]the Court observed that the managing director was primarily responsible for calling a general meeting of the company. If he fails to call such a meeting he cannot be permitted to take advantage of the omission and plead that he could not lay the balance sheet or profit and loss account because no meeting was called.

[54] A.I.R.2011 S.C.20.
[55] The Companies Act , 2013, S.92
[56] Ibid at S.92(5)
[57] A.I.R.1964 Ori.14.

However, in *State of A.P. v. A.P Potteries Ltd*.[58], the Supreme Court held that if an annual general meeting is not held, the duty to file accounts does not occur. As a result, failure to register the accounts in situations where the annual meeting is not held is not a crime. In response to this ruling, the Companies Act of 1956 was amended in 1977 to require the balance sheet and profit and loss account to be filed within thirty days of the last date on which the annual general meeting could have been held.[59] The amendment's aim was to prevent defaulters from escaping since the annual general meeting was not held.

According to Section 403 of the Act,[60] the return must be submitted within 270 days of the due date on payment of the charge and additional fee. If the Annual General Meeting is not held, management cannot avoid the burden of filing the return. Similarly, even though the corporation is inactive, the obligation cannot be abandoned. This section imposes a significant duty on management to file returns, which can only be waived if the firm is wound up or its name is struck from the Registrar of Companies' Register.

At every annual general meeting of a company, the annual accounts showing the performance of the company's trading over the relevant time must be laid before the shareholders of the company. [61] Each financial statement of the company must provide an accurate and reasonable view of the company's state of affairs at the end of the financial year.[62]The annual report is comprised of the details found in the balance sheet, the profit and loss account, and the director's report. Investors will find it difficult to make intercompany comparisons due to the use of various accounting principles. If the accounts do not conform to accounting principles, the corporation must report the deviation from accounting standards, the reasons

[58] A.I.R.1973 S.C. 2429
[59] The Companies Act, 1956, s.220
[60] The Companies Act , 2013, S.403
[61] Supra note 52
[62] The Companies Act, 2013, S.129 (1) & (2). True and Fair view in respect of financial statement means-

(a) financial statements and items contained should comply with accounting standards notified under section 133;
(b) financial statement shall be in form or forms as provided for different class or classes of companies in Schedule III;
(c) in case of any insurance or banking company or any company engaged in the generation or supply of electricity or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company, not treated to be disclosing a true and fair view of Accounts of Companies, the state of affairs of the company, merely by the reason of the fact that they do not disclose –
- in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
-in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
-in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
- in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

for the deviation, and the financial impact of the deviation.[63]

Every director of the company who fails to take reasonable steps to lay the annual accounts and the balance sheet at the annual general meeting is punishable.[64] Non-disclosure of required details in financial statements is also punishable.[65] Any profit and loss account should adhere to the Act's requirements.[66] Any member of the board must receive a copy of the balance sheet, profit and loss account, and auditor's report twenty one days before the meeting.[67] Failure to comply with this clause is also punishable. Thus criminal sanctions are provided for failure to lay the annual accounts at the AGM, for failure to send copy of annual report to the members and for failure to file it with the registrar of companies. Furnishing false information in any of the documents required to be maintained under the Act is prohibited.[68]

In *BEML Limited v. The President, Mysore Division General Labour Association*[69], the question before the Karnataka High Court was "Is it appropriate for the Court to take notice of the complainant's criminal case, and should directors of a corporation be drawn into action without any clear allegations, solely on the basis of vicarious liability?" The Court held that the directors and officers of the Company cannot be held liable for acts by a company in the absence of any averments that they are involved in the alleged crime and that criminal proceedings cannot be filed against the directors as a matter of routine. The Court further quashed the complaint on the ground that the compliant is only abuse of process of law. I this case the court relied upon the apex court Judgement in *Satish Mehra vs. State (NCT of Delhi) and Another.*[70] it was observed that:

"A criminal trial cannot be allowed to assume the character of fishing and roving enquiry. It would not be permissible in law to permit a prosecution to linger, limp and continue on the basis of a mere hope and expectation that in the trial some material may be found to implicate the accused. Such a course for action is not contemplated in the system of criminal jurisprudence that has been evolved by the courts over the years. A criminal trial on the

[63] The accounting standards are prescribed by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949.
[64] Supra note 59
[65] The Companies Act , 2013, S.134(8)
[66] Ibid at S.129 & Schedule III of the Act.
[67] Ibid at S.136
[68] Ibid at S. 448 reads as "Unless otherwise provided in this Act, if any person makes a statement 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 there under:
(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.
[69] http://judgmenthck.kar.nic.in/judgmentsdsp/bitstream/123456789/89735/1/CRLP718-15-26-11-2015.pdf
[70] (2012), 13 SCC , 614

contrary, is contemplated on only on definite allegations, prima facie, establishing the commission of offence by the accused which fact has to be proved by leading impeachable and acceptable evidence in the course of the trial against the accused….."

Through BHEL Case, the Court has established a precedent that no criminal complaint can be made against the company's directors without clear allegations, and that an offence must be proven rather than inferred by the filing of a complaint. In addition, the court determined that there was no prima facie case because the complaint was vexatious in nature and arose from a personal motive to annoy the accused. The ruling reiterates that no complaint should be taken into consideration without first considering the prima facie case.

VIII. DISCLOSURE THROUGH BOOK OF ACCOUNTS

Every company is required to keep proper books of accounts.[71] Accounts must provide an accurate and fair picture of the company's financial condition. The books of account should include all amounts of money collected and spent by the company. The managing director, whole-time director, and chief financial officer are all responsible for filing the books of accounts in compliance with the Act's requirements.[72] If the company does not have a managing director or a manager, the directors are responsible for any disclosure violations. Any other person can be entrusted with the duty of keeping proper books of accounts by the managing director or the board of directors. Account books for the previous eight years must be held in good condition.[73] During business hours, any company director has the right to inspect the books of account.[74] The right to audit the accounts is granted to the Registrar of Companies and SEBI authorised officers.

The Calcutta High Court held in *Amit Kumar Sen v. K.A. Rao, Deputy Registrar of Companies*[75] that the company's contractual obligation to send a statement showing the names of workers receiving remuneration in excess of that drawn by the managing director or whole-time director or manager occurs only if such an employee worked for the company during the relevant period. The failure to make a statement stating that no such employee worked for the company during the relevant time does not imply criminal responsibility.

Falsification of books of accounts and other company records is punishable under the Act.[76] However, the offence only refers to businesses that are being wound up. Regulators must

[71] The Companies Act 2013 , S. 128 (1)
[72] Id.S.128 (6)
[73] Id.S.128 (5)
[74] Id.S.128 (3)
[75] (2006) 132 Com.Cas.675 (Cal).
[76] The companies Act , 2013, S.71

keep a close eye on the reports made, and prosecutions for accounting fraud and misstatements. This will go a long way toward preventing Satyam-style episodes. It's a shame that the Securities and Exchange Board of India (SEBI) was unable to discover the falsifications hidden in Satyam's accounts and claims.

IX. DIRECTORS' REPORT

A report from the board of directors should be attached to any balance sheet presented to a company's general meeting.[77] A declaration of director accountability should also be included in the board's report. Any director of the company failing to take reasonable steps to submit the board's report is punishable with imprisonment. However no such person is liable to be sentenced to imprisonment unless the offence was committed wilfully.

X. DISCLOSURE AND RELATED PARTY TRANSACTIONS

Related party transaction is defined as "a business deal or arrangement between two parties

[77] There shall be attached to statements laid before a company in general meeting, are port by its Board of Directors, which shall include—
(*a*) the extract of the annual return as provided under sub-section (*3*) of section 92;
(*b*) number of meetings of the Board;
(*c*) Directors' Responsibility Statement;
(*d*) a statement on declaration given by independent directors under sub-section (*6*) of section 149;
(*e*) in case of a company covered under sub-section (*1*) of section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (*3*) of section 178;
(*f*) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—
(*i*) by the auditor in his report; and
(*ii*) by the company secretary in practice in his secretarial audit report;
(*g*) particulars of loans, guarantees or investments under section 186;
(*h*) particulars of contracts or arrangements with related parties referred to in sub-section (*1*) of section 188 in the prescribed form;
(*i*) the state of the company's affairs;
(*j*) the amounts, if any, which it proposes to carry to any reserves;
(*k*) the amount, if any, which it recommends should be paid by way of dividend;
(*l*) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;
(*m*) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed;
(*n*) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;
(*o*) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;
(*p*) in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors;
(*q*) such other matters as may be prescribed.

who are joined by a special relationship prior to the deal.[78] The directors have a responsibility to prevent conflicts of interest between the company's interests and their personal interests as representatives of the company. In a meeting of the company's board of directors, directors with some personal interest in the transactions or contracts to be entered into must report the extent of their interest.[79]

The main intentions behind these sections are to avoid personal gain by the interested director. But mere approval from the Board to enter in to transaction doesn't serve the purpose as the outsiders are unaware of these transactions. Failure to make this disclosure should be treated as a default. Director concerned should be held liable to penalties and he should be deemed to have vacated his office. Director's responsibility statement should include a clause to the effect that every director has made relevant disclosures.

Contracts with the corporation are not forbidden for the director. He does, however, have a responsibility to disclose his concern or interest. Any business is required to keep a register that contains the details of all arrangements and contracts in which the directors have an interest. The registry would be held at the company's registered office and would be available for review by any company member. Any company officer who fails to keep the register up to date is subject to disciplinary action.

XI. DISCLOSURE OF MAJOR TRANSACTIONS AFFECTING THE COMPANY

Investors are expected to be informed of all significant transactions affecting the business. Its aim is to assist the investor in making a well-informed decision about whether or not to remain a shareholder of the firm. It also makes it easier for the investor to understand how the proposed transaction would affect his or her shareholder rights, especially minority shareholder rights. Takeovers and buybacks are two big transactions that impact the business and necessitate immediate disclosure of relevant information to the members.

The SEBI (Buy Back of Securities) Regulations, 1999 should be followed when buying back shares or other stated securities listed on any recognised stock exchange. The company's general meeting must pass a special resolution authorising the buyback of shares.[80] The company should keep track of the securities/shares it has repurchased.[81] Companies must file a return with the registrar of companies and the Securities and Exchange Board of India after

[78] The Companies Act , 2013, S.2(76), describes the transaction with a director of the company, relative of the director, a firm in which such a director or relative is a partner, or any other partner in such a firm as related parties in transactions.
[79] The Companies Act 2013, S.188
[80] Ibid, S.68(2)
[81] Ibid , S. 68(9)

the buy-back is completed, detailing all aspects of the transaction. If a company fails to comply with the provisions, the company, as well as each of its officers, is subject to punishment.[82]

The takeover of a company is governed by disclosure laws. The key goal of the legislation is to ensure that transactions involving the purchase of shares and voting rights in a target business are transparent. Any individual who owns more than 5% of a company's shares or voting rights should inform the company of his total shareholding.[83] The company should notify the stock exchange of the total number of shares owned by these individuals.

The trigger points for disclosure have been changed several times in the takeover regulations.[84] After making an open bid, no acquirer can buy 25% or more of a publicly traded company's stock or voting rights. An announcement in the newspapers will be made to the general public. The primary goal of the public announcement is to make sure that the target company's shareholders are aware of the exit options available to them in the event of a merger or significant acquisition of the target company's stock.

The Bombay High Court stated the following about the intent of the disclosure rules in the takeover regulation:

"*The regulations disclose a scheme to bring about transparency in the transactions relating to acquisition of large block of shares which may ultimately lead to a take-over. That is why it insists on public announcement being made when the shareholding and, consequently, the voting power is increased beyond the extent contemplated by regulations 9 and 10. By obliging the acquirer to make a public announcement or a public offer, it ensures that a member of the company or an investor is able to take an informed decision on such public offer. The particulars which are required to be disclosed in the public offer are intended to give a clear picture to a member of the company or a prospective investor, as the case may be, as to the purpose for which such shares are being acquired and by whom. It also ensures to existing shareholders a fair return on their investment, and permits any other person to make a matching bid which may ultimately benefit the shareholders of the company. On the basis of the particulars furnished, the shareholder is enabled to take a decision as to whether he should retain his holding or dispose of them for the price offered. Thus, transparencies in dealings as well as fairness to the shareholders of the company are ensured."*[85]

[82] Id, at S.68(11)
[83] The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, cl. 6, 8.
[84] *Id.*, cl.10.
[85] Shirish Finance and Investment Ltd. v. M Sreenivasulu Reddy (2002)2 Comp.L.J.286 at p.312.

XII. CONCLUSION

The Companies Act of 2013 contains a slew of clauses that make it illegal to violate disclosure regulations. However, mensrea has been made a mandatory component of the crime. This makes it simple for the directors to avoid criminal penalties by claiming ignorance of the violation. The Mensrea provision weakens the mandatory disclosure regime. The 47th Law Commission Report proposes a number of options for dealing with corporate criminal liability. However, legislators have rejected the Law Commission's advice and have refused to implement all of this, making it impossible for courts to discipline criminals. The effectiveness of the mandatory disclosure regime is severely harmed by this strategy. In the case of a breach of disclosure standards, the stigma of punitive penalties such as incarceration is seldom realised. Instead of focusing on whether the directors took appropriate measures to comply with disclosure standards, the emphasis should be on whether the breach was done wilfully.

Many of the violations under Companies Act 2013 are non-compliances that result in fines or penalties (or in some cases are punishable with fines or imprisonment or both). Offenses of this kind may be compounded. There are, however, a few serious infractions that are punishable solely by imprisonment or by imprisonment and fines (such as fraud) in which officers of the company who are in default or individuals involved in the establishment or management of the company's affairs become liable and cannot be compounded solely by depositing fines or penalties. There should be a system in place that imposes severe civil and criminal penalties for failure to disclose information.

The Act requires that all corporate activity be made public from its inception to its dissolution. In India and other jurisdictions, disclosure laws are commonly used to facilitate investor privacy. Violations of the disclosure rules will result in criminal penalties. If these laws are not adequately applied, they may become obsolete. Corporate scams and scandals are not the result of a lack of provisions, but rather of prosecuting authorities' failure to take appropriate action at the appropriate time. Given the Indian situation, where investors are vulnerable to fraudulent inducements, SEBI should remain cautious and bring criminals to justice as soon as possible so that investors are not defrauded. The serious fraud Investigation office under the companies Act must implement the penalties in a stricter way. The intermediaries should be held responsible for the claims they certify. The law should also provide a regime for enforcing accounting, audit, and non-financial disclosure requirements by establishing those standards and effectively tracking and enforcing them.

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At the same time, the government should ensure that standard setters have professional freedom, that their practises are transparent, and that they have effective means of disciplining defaulters. So it's probably time for us to put in place a system that imposes serious criminal penalties for failing to report information or disclosing information incorrectly.

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