

# Consent Settlement: Facts and Myths



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## Introduction

Most of the enforcement actions of the Securities Exchange Commission (SEC), US are resolved by settlement with defendants (accused), who generally consent to the entry of judicial or administrative orders without admitting or denying the allegations against them. These orders usually require the defendants to consent to be censured, to a cease and desist order, to be barred from appearing/practising/dealing in certain manner / before an authority, to a permanent injunction, to pay a civil monetary penalty, to pay disgorgement of illegal gain or illegally avoided loss, or to comply with numerous other undertakings. This kind of consent settlement is not unique to securities market or to the US. Some countries have explicit legal provisions to support, or even encourage, this kind of settlement of enforcement actions; many have implicit provisions. Despite its extensive use, however, scholars as well as policymakers still debate the propriety of consent settlement.

The advantages of this kind of settlement are many in Indian context. It frees up the scarce resources of the authorities and the judicial system which are already saddled with a very large number of enforcement actions awaiting disposal for years. It allows the authorities to have innovative deterrents on the accused while achieving equitable remedies for the victims. Most importantly, it achieves something in days or months, which decades of trial may fail to, and avoids the risk of the accused being scot free after prolonged, expensive and valiant legal battle for some technical reasons. Indian laws and courts, however, generally do not explicitly encourage consent settlement of enforcement actions, though this

pervades Indian legal system in one form or the other. For example, the Motor Vehicles Act, 1988 empowers police to discharge a person who violated traffic rules by paying up a prescribed amount.

Indian securities laws (the SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996) do not have explicit provision for consent settlement. These generally provide that no appeal shall lie to the Securities Appellate Tribunal (SAT) from an order made by SEBI or one of its Adjudication Officers, with the consent of the parties. These also provide for compounding of offences. In recognition of these powers, SEBI issued, vide its circular dated April, 2007, guidelines for consent orders and for considering requests for composition of offences (Consent Guidelines) and has settled over 1000 enforcement actions under the said Guidelines. A few other regulators are trying to emulate the framework in their respective jurisdictions. This article explains the settlement framework, the process, the outcome and the associated myths.

## Settlement Framework

SEBI takes various civil or criminal enforcement actions for violation of the securities laws and the relevant provisions of the Companies Act, 1956. The broad categories of enforcement actions along with the settlement mechanism envisaged under the Consent Guidelines are as under:

Category	Nature of Enforcement Action	Settlement Mechanism
A	Impending/ongoing civil proceedings before Whole Time Members (WTMs) for issue of preventive or remedial directions	Consent Settlement; Order by SEBI
B	Impending/ongoing civil proceedings before WTMs for suspension or cancellation of registrations of intermediaries	
C	Impending/ongoing civil proceedings before an Adjudicating Officer for levy of monetary penalties	
D	Impending criminal proceedings	
E	Civil proceedings pending before SAT/Court	Consent Terms to be filed before SAT/Court for Orders
F	Criminal proceedings pending before a Court of appropriate criminal jurisdiction	Compounding Terms to be filed before Court for Orders

Under the Consent Guidelines, SEBI may settle the proceedings under categories A to D above and issue the consent orders to the said effect. It can finalise the terms of consent with the party in respect of the proceedings under category E and file the same before the SAT / Court which may pass appropriate orders under the circumstances. Similarly, it can finalise the terms of settlement in case of proceedings under category F and file the same before the appropriate Court which may pass orders as it deems fit.

A party accused or likely to be accused of a violation can seek settlement through consent or compounding at any stage of the proceeding, including the stage when the proceeding is envisaged or contemplated, but not yet instituted. However, the process would be completed only after the fact finding process is over, as this would enable appreciation of the full gravity of the violation. Theoretically, any enforcement action, irrespective of its gravity, can be settled through consent or compounding subject, however, to the condition that the settlement terms are appropriate to the alleged violation. The terms can be very innovative and may include payment of money in the form of settlement charges, legal and administrative expenses, and disgorgement of illegal gains. These may include debarments from participating in markets, accessing the market, and acting as director of listed companies. These may also include undertakings to carry out investor awareness activities, modify systems and processes of business, make good loss of a third party, cease and desist from a practice, etc. However, the severity of terms may differ depending on if a party admits the guilt or it does not admit or deny the guilt.

While considering if the terms are appropriate for settlement, various factors are taken into account keeping in view the objective of the relevant statutes, and the interests of investors and securities market. These factors include: gravity of violation, was the violation intentional, was it beyond the control of the party, was it technical and/or minor in nature, does it warrant penalty under the statute, party's conduct in the investigation and disclosure of full facts, history of violation of securities laws by the party, remedial / preventive measures undertaken since the violation to minimize recurrence of similar violations, the amount of investors' harm or party's gain, conditions necessary to deter future non-compliance, any other enforcement action for the same violation against the party, whether the party has admitted the guilt, other facts and circumstances, etc. These factors are assessed at three levels before settlement is arrived at: first by an internal committee of Division Chiefs of SEBI, second by an external high powered advisory committee (HPAC) and lastly, by a panel of two WTM's of SEBI.

The settlement framework casts certain obligations on the part of the parties. For example, the party seeking settlement furnishes a written waiver from taking any legal proceedings against SEBI concerning any of the issues covered by the consent settlement. It also undertakes to waive a plea of limitation for reopening the case, if the party violates the consent orders subsequently. If the party has consented to settle the proceedings without admitting or denying the guilt, it can never represent subsequently that it is not guilty. If SEBI is satisfied of the terms of settlement, it passes appropriate consent order or files the terms of settlement before the SAT or appropriate court for issue of appropriate orders. The settlement order is binding on the parties and in cases where the party undertakes any compliances, it has to comply with the same as per agreed schedule. Failure to comply with the consent orders invites appropriate action under the respective statute and revival of the pending proceeding. If SEBI is not satisfied of the terms, the party is informed of the same. Thereafter, both the parties are free to resort to legal recourse as may be available to them under the law. However, neither SEBI nor the party can use any information exchanged during the settlement process for any purpose, particularly in any proceeding against the party.

### **Settlement Process**

The process begins with receipt of an application from a party seeking settlement of an impending or ongoing proceeding before SEBI / SAT / Court. SEBI verifies the application to ensure that the application has identity of the applicant, is complete including terms of settlement and requisite waivers, and has the necessary enclosures. If not, the application is returned to the applicant. If the applicant seeks consent settlement of the proceedings under the categories A to D, the related proceeding is held in abeyance till disposal of the consent application. If, however, it relates to the proceedings under categories E and F, the related proceedings may go on as usual or be kept on hold, depending on the discretion of the SAT/Court. The application along with the comments of the Operational Department concerned is placed before an internal Committee of three Division Chiefs. This Committee and the applicant meet to appreciate each other's perspective of the violation and the evidence available on record. The Committee helps the applicant to work out appropriate terms of settlement. The applicant is at liberty to offer revised terms of settlement or stick to the terms offered originally in the application. The terms – original or revised, as the case may be - offered by the applicant are placed before the HPAC, which is headed by a former Judge of a High Court, to ascertain if the terms are fair and reasonable. The HPAC, after taking into account facts and circumstances of the case and the factors specified in the Consent Guidelines, makes its recommendations accepting, declining or suggesting modifications in the terms offered by the applicant. It may call upon the applicant for discussion and finalizing the consent/compounding terms. A panel of two WTM's of SEBI considers the recommendations of the HPAC and takes a decision whether to settle the enforcement action on the said terms

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or decline the settlement. If the panel accepts the settlement terms, the applicant is called upon to comply with the same. On compliance of the terms of settlement, as approved by the panel, a consent order is passed by SEBI, if the matter is pending before it. This order is publicly disseminated. If the terms are not complied with as per the agreed schedule, the consent application is disposed of as withdrawn. The agreed consent terms are placed before the Securities Appellate Tribunal or Courts, as the case may be, if the matter is pending before them, for appropriate orders. In case of compounding, the approved settlement terms are submitted before the Court for its consideration. If the terms are not accepted by the panel, the applicant is informed of the same and the proceedings revive from where it was held in abeyance. While settling the enforcement actions under the Consent Guidelines, apart from debarment from market and other restrictions for appropriate periods, money is received under three heads, namely, settlement/compounding charges, legal charges and disgorgement. The settlement/compounding charges are remitted to Consolidated Fund of India, while the legal charges are retained by SEBI to recover legal and administrative expenses incurred on the proceeding. The disgorgement amount is distributed among the investors who have suffered loss on account of the related misdemeanor.

### Settlement Outcome

Till March 2011, SEBI has approved 1089 consent and compounding applications as under:

Settlement	Terms	Particulars	2007	2008	2009	2010	2011*	Total#
Consent	Settlement Charges	No. of Orders	21	284	324	199	26	854
		No. of Entities	21	371	469	312	42	1215
		Amount (Rs. lakh)	121	2960	4108	2990	5674	15853
	Disgorgement	No. of Orders	0	53	11	4	0	68
		No. of Entities	0	39	14	5	0	58
		Amount (Rs. lakh)	0	803	1695	399	0	2897
	Debarments	No. of Orders	0	24	67	12	4	107
		No. of Entities	0	35	85	15	13	148
	Legal Charges	No. of Orders	8	42	87	13	0	150
		No. of Entities	8	46	166	16	0	236
		Amount (Rs. lakh)	5	34	54	15	0	109
	Total	No. of Orders	21	290	327	199	26	863
		No. of Entities	22	381	479	312	42	1236
Amount (Rs. lakh)		126	3797	5857	3404	5674	18859	
Compounding	No. of Orders	35	18	10	4	2	69	
	No. of Entities	68	57	32	14	12	183	
	Settlement Charges (Rs. lakh)	34	63	5	3	1	106	
	Legal Charges (Rs. lakh)	21	11	4	2	1	39	

\* For three months up to March. # The number of applications is not the number of orders passed.

These include 74 consent applications where consent orders have been passed by the SAT and the Supreme Court after the consent terms were placed before them. These also include 69 compounding cases where the compounding orders have been passed by the respective criminal courts. The issue of consent orders by the SAT and Courts, including the Supreme Court, bestow legal sanctity to the consent settlement of enforcement actions. As on March 31, 2011, a total sum of Rs. 190 crore has been realized from such settlement. This amount of Rs. 190 crore received through consent and compounding comprises of Rs.29 crore towards disgorgement, Rs. 160 crore towards settlement/compounding charges and Rs. 1.5 crore towards administrative and legal charges. During this period, SEBI has rejected 769 applications seeking settlement through consent and compounding as the terms offered were not appropriate.

### Settlement Myths

It is believed in some circles that a person can violate any provision of the securities laws and settle the violation, if at all caught, through the consent procedure. The statistics, however, do not support this. Consent settlement is not a matter of right. The three layers in SEBI have to be satisfied that the settlement terms are appropriate to the alleged violation. In fact, they were not satisfied in case of 769 applications, as stated earlier. Settlement proposed in about 40% of the applications has, thus, not been accepted by SEBI. Even assuming for the sake of argument that a proceeding could be settled through the consent procedure, it is not a cause for concern as long

as the objectives of enforcement actions are fully realised. For example, the same outcomes, as would have been obtained if the proceedings were adjudicated on merits, are being achieved through the consent settlement. At times, the consent settlement achieves more than the adjudication on merits simply because the terms of settlement could be more innovative. They are more effective because these orders are passed only after compliance with the terms of settlement. The disposal of proceedings on merits directs the party to pay the penalty which may not be realized always. Since Consent Guidelines were issued in 2007, SEBI has recovered about Rs. 190 crore through consent settlement. In contrast, it has realized a cumulative amount of Rs. 25 crore towards monetary penalty through adjudication on merits during the last decade.

It is also believed that SEBI settles the enforcement actions only in monetary terms signaling that a person can do all illegal activities and get away by paying some amount of money. It is thus perceived as an escape mechanism for anyone who is caught violating securities laws. This is not borne out by facts. As stated earlier, all applications are not approved for settlement under the Consent Guidelines. Besides, the enforcement actions are settled not in monetary terms only. In appropriate cases, the terms of settlement are in kind in the sense that these include debarment from trading or accessing securities market, disgorgement, suspension of certificate of registration, etc. For example, the consent settlement in 107 orders debarred 148 persons from dealing in securities market for different periods. A potential violator of law cannot take a chance that his violation would be settled by SEBI through consent procedure and that too, at best, by payment of money.

It is also believed in some circles that SEBI settles most of its enforcement actions under the Consent Guidelines and rarely on merits. The following table, which indicates disposal of enforcement actions since consent settlement mechanism was introduced in 2007, does not support this belief:

Year	Disposal by Consent/compounding		Disposal on Merits	
	No. of Orders	No. of Entities	No. of Orders	No. of Entities
2007	56	90	287	771
2008	308	438	247	726
2009	337	511	722	1819
2010	203	326	985	2010
2011 (Till March 2011)	28	54	336	397

It is alleged at times that the consent terms are neither commensurate to the violations committed by the party nor uniform in similar violations. The consent process passes through application of mind at three levels, namely, Internal Committee, HPAC and the panel of WTMs. Any application for consent is discussed at length at all the three levels, including the HPAC which is an external body headed by a retired Justice of a High Court. Besides, a proceeding may involve a serious violation of an important provision of law, such as, insider trading. Though it is a grave violation, the proceeding could be settled at times on lenient terms if there is no full proof evidence or there are mitigating factors. Otherwise, the accused may be completely let off when the said proceeding is disposed of on merits on its revival after the failure of consent settlement. There have been a few such instances, where SEBI refused to settle a proceeding through the consent procedure as the terms offered by the party were not commensurate to the nature and gravity of the violation. These were subsequently disposed of on merits without any finding of the guilt on the part of the accused. Therefore, there cannot be a fixed formula to arrive at the consent terms commensurate to the violation as it would depend a lot on the strength and kind of evidence it has against the accused. Further, two apparently identical proceedings may have different mitigating factors which could lead to different terms of settlement. If these two identical cases were adjudicated on merits, these would in all probability lead to two different outcomes. Different terms of settlement for two apparently identical proceedings should not, therefore, be viewed unusual, though care has to be taken to ensure that similar cases end up in similar outcomes.

It is believed that SEBI uses the consent procedure to enrich itself. As stated earlier, the settlement charges received through consent settlement is remitted to the Consolidated Fund of India and does not come to the kitty of SEBI. The disgorgement amount is disbursed amongst the victims. SEBI retains only the legal charges to recover its legal expenses on those proceedings. It has retained so far a cumulative amount of Rs. 1.5 crore towards legal charges.

## Conclusion

There is a robust process in place to avoid miscarriage of justice. Nevertheless, there is tremendous scope for improving the consent process. The process is being misused by some entities to make repeated offers of revised terms of settlement to delay the disposal of the proceedings on merits. At times an innocent person files consent application to suffer a lighter punishment or to buy peace of mind at a cost which may otherwise be incurred in going

through a tortuously expensive legal proceedings. An accused at times offers much higher terms of settlement than warranted by the proceedings just to ensure that his offer does not fall short of expectation and is accepted. The consent orders are quite often not detailed, at least as compared to similar orders issued by the SEC, to provide the confidence to the public that the process has been followed objectively and to deter the potential offenders of law. Notwithstanding these, the consent process has brought certainty to SEBI and the accused in over 1000 proceedings and enabled expeditious disposal of enforcement actions. It has achieved the public good that there should be an end to litigation, *Expedit republicae ut sit finis litium*.

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