

Investigating into the Affairs of the Company: Random Unnecessary Security?

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Abstract

The paper analyzes Sections 206 to 229, which are in respect to the investigating the affairs of a company. These sections are analyzed in order to reach an understanding if the investigating procedure mentioned in the Companies Act 2013 is very stringent which would affect the working of the company. The paper also analyzes the current fraud and misconduct caused by liquor baron Vijay Mallya and the subsequent cases that were led by Nirav Modi and former UCO Bank chief Arun Kaul that came to light.

Keywords: Abuse of power, Companies Act 2013, Investigation, Mechanism, Registrar, Shareholders

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INTRODUCTION

In this fast-paced world, keeping track of everything is a luxury which only some of us can afford. Therefore, when it comes to keeping a track of the company and having an effective control on it, the shareholders are ill-equipped to do so. This, in turn, transfers the affairs of such companies in the hands of its board of directors where the shareholders are by and large sleeping and passive partners [1]. Therefore, these situations might lead to abuse of power by the board controlling the affairs of the company. It was thus essential for the central government to assume certain powers in order to investigate the affairs of the company. Sections 206 to 229 of the Companies Act 2013 deal with this segment relating to inspection, inquiry and investigation of the affairs of the company.

Will it be correct to put forward the argument that overregulation and excessive supervision could dispute the functioning and decision-making process in a company?

The new Act, which is the Companies Act 2013, had some changes in the area of inspection and investigation. The new Act has brought in a few important changes to ensure that there is a better administration and effective complaint mechanism for the fraud and misconduct. The Act gives the power to

the Tribunal to freeze assets of a company under the inquiry/investigation for a period which is not exceeding 3 years. Thus, there have been major changes that have taken place making the administration stricter although the question is if such regulation will be considered as overregulation and excessive supervision which might harm the functioning and decision-making process in a company? As we have witnessed in the recent past, where the government had ordered the Serious Fraud Investigation Office (SFIO) to probe around 110 companies and 10 limited liability partnerships (LLPs) related to diamantaire Nirav Modi and his uncle who is the business associate Mehul Choksi in the Rs. 11,400 crore Punjab National Bank fraud, which has taken the Indian government and its stock market by storm [2]. Does this mean that overregulation and excessive supervision is a valid consequence a company has to face, if suspected of a fraud or misconduct? In order to protect the interest of the people of India, as big scams affect the people of the country at large, is such overregulation maintainable?

The methodology used in this paper is doctrinal by analytical research.

The paper is only limited to the analysis of various sections, which reflect the investigation of the company affairs and not

the appointment of the investigating authorities. The aim of the paper is to find out if the investigation into the affairs of the company is stringent and if such rules are essential. It reflects in the current situation of investigation that is followed in the country with the mushrooming of so many cases.

POWER OF THE REGISTRAR [3]

The Registrar is given the power where they might require the company through a written notice to produce books of accounts, books, papers and explanation at specified time and place. The reasons are [4]:

Firstly, if the company does not abide by furnishing information and explanation within the time specified in the notice; or

Secondly, the Registrar is of the opinion that the information that is provided is inadequate; or

Thirdly, the Registrar scrutinizes and considers that the state of affairs in the company is unsatisfactory and full and fair information has not been disclosed to them.

In the situations mentioned above, the Registrar has authority to serve notice and to record in writing the reason for issuing such a notice.

There are also specific grounds on which the Registrar can conduct the enquiry where according to the information that is furnished to them, they are of the opinion that the business of the company is being carried out for some fraudulent or unlawful purposes or in cases where the investor grievances are not being addressed. Even the central government has the power to give directions to the Registrar or an Inspector to conduct the inquiry. In cases where the business of the company is being carried out for fraudulent or unlawful purposes, every officer of the company who commits default is punishable under "fraud" [5].

If such information or explanation or any documents required have not been furnished then the officer who has defaulted is liable to pay a fine of one lakh rupees, and in case of a continuing failure, a fine of Rs. 500/- every day after the first during which the failure continues.

INSPECTION AND INQUIRY [6]

The Registrar or inspector who is making an inspection or inquiry has right to make copies of the books of accounts and other books and papers or highlight on the books as a mark of inspection having been made.

The Registrar or inspector has been vested with the power of that of a civil court, exercised under Civil Procedure Code 1908. This includes the discovery as well as the production of books of accounts and other documents at a point of time and place, summoning or enforcing the attendance of a person or persons and examining them under oath and inspecting any books, registers and other documents of the company at any place.

It is the task of the Registrar to submit a written report to the central government [7].

SEARCH AND SEIZURE [8]

The Registrar or inspector after obtaining a court order has the authority to enter with such assistance as may be required and search the place where such books or papers are kept and also seize them. This can be done when the Registrar or the inspector has a reason to believe that these can be destroyed, mutilated, altered, falsified or held as a secret of the company or anything relating to key managerial personnel or any director or author or company secretary. It is within 180 days that the seized books and papers are returned to the company although the books and papers may be called for by the Registrar or inspector for another 180 days. The provision laid down in the Code of Criminal Procedure 1973 relating to search and seizure shall apply *mutatis mutandis* for every search and seizure made under this section.

SERIOUS FRAUD INVESTIGATION OFFICE (SFIO) [9]

SFIO is a multi-disciplinary organization included in the Ministry of Corporate Affairs that consists of experts in the field of accounting, forensic auditing, capital market, law and taxation that is concerned with the detection and prosecuting or recommending for prosecuting white-collar frauds. The SFIO considers the following types of cases:

1. A complex case of interdepartmental and multi-disciplinary difficulty.
2. Involvement of public interest depending on the size in terms of monetary misappropriation or in terms of the number of people affected.
3. In order to improve the system, laws or procedures, when it comes to investigation.

The objective behind it is to quickly unravel fraud or scam and to bring charges against the person who is involved in such kind of activities. Another reason is to recover the gains from fraud and restoration of the losses to the rightful owner. It is also to identify the weakness in the legal system or monitoring and reporting system due to which the fraud occurs.

INVESTIGATION BY SFIO [10]

SFIO is assigned the investigation into the affairs of the company by the central government on the basis of the following:

1. On a report of the Registrar or inspector
2. Public interest
3. If it is intimation by the company through a special resolution
4. On the request of any department of central government or a state government.

Thus, once the director receives the order from the central government, he may designate a number of inspectors as he may consider necessary for the investigation. These inspectors have the powers of an inspector under Section 217. Following are the points to be considered during the investigation by the company as well as the investigating officer:

1. The company has to provide all information, explanation, documents and assistance to the investigating officer as he may require for doing his work.
2. The report that is submitted to the central government has to be submitted within the specified time in the order by SFIO.
3. When such a case is assigned by the central government to SFIO for investigation under this Act, no other agency under the center or state shall proceed with an investigation in the case.
4. The SFIO shall submit an interim report to the central government if such is directed

by the central government. Once the investigation is complete the SFIO shall submit the investigation report to the central government.

5. The SFIO may be directed by the central government to initiate prosecution against the company, its officers, employees, etc., after receipt and examination of the investigation report and taking legal advice.
6. Any action or any initiation by the SFIO under the provisions of the Companies Act 1956 that is still continuing shall still continue as if the new Act had not been passed.
7. When the SFIO is conducting its task, the state government, police authorities or income tax authority shall provide all the information available to them about the case to the SFIO.

Limitation on Bail [11]

The limitation on the grant for bail shall be in addition to those under Code of Criminal Procedure or any other statute for the time being in force.

Procedure of Arrest

The arrest memo has to be sent with the material in possession and all the documents to the office of director by the authorized officer of SFIO in a sealed envelope with a forwarding letter after signing on every page of the document latest by the next working day through the quickest possible means which includes a special messenger or through secured electronic means, if required.

The authorized officer of SFIO shall keep a copy of the arrest memo along with the documents up to 2 years after disposal of the last appeal in the court. At every office of SFIO and the arresting officer shall be maintained an arrest register with the necessary entries made in the arrest register. This arrest register also has to be maintained in the office of Director, SFIO, and the director or any other officer nominated by the director.

Investigation into the Affairs of the Company [12]

In the following cases when there is an application made by:

1. Not less than 100 members or members holding at least 1/3 of total voting power in case of a company having a share capital, or
2. Not less than 1/5 of the person on the company's register of members in case the company has no share capital.

And this has to be supported by such evidence as may be necessary to prove that the applicant has a reasonable ground for seeking an order for conducting such investigation into the affairs of the company. If an application is made by other people and if there is a circumstance suggesting that:

1. The intent to conduct a business of the company is to defraud its creditors, members or any other person or otherwise for a fraudulent purpose or in a manner that is oppressive to any of its members or that the company was formed due to any fraudulent or unlawful purposes.
2. If a person who is involved in the formation of a company or management of the affairs of the company, has been guilty of fraud, misfeasance or other misconduct towards the company or any of its members;
3. All the information with respect to the affairs of the company is not given by the members of the company which they might reasonably expect including information relating to calculation of commission payable to managing or other director or manager of the company.

In these above cases, the tribunal may order after giving a reasonable opportunity of being heard to the parties concerned that the affairs of the company have to be investigated by an inspector appointed by the central government. In a situation where the order is passed, the central government shall appoint inspectors to investigate into the affairs of the company.

After the investigation, it is concluded that the business of the company is being conducted with intent to defraud creditors or anyone else or due to fraudulent and unlawful purposes that the company was formed for any

fraudulent or unlawful purposes or any person connected with formation or management of company has been guilty of fraud and will be punishable under Section 447.

Security for Payment of Cost and Expenses [13]

When an investigation is ordered by the central government then the applicant has to give a security of not exceeding Rs. 25,000/- towards the cost and expenses of investigation before appointing an inspector. Thus, the cost and expenses of investigation are as follows:

Turnover as per Previous Year Balance Sheet	Amount of Security
Turnover up to Rs. 50 crore	Rs. 10,000
Turnover more than Rs.50 crore and up to Rs. 200 crore	Rs. 15,000
Turnover more than Rs. 200 crore	Rs. 25,000

The security will be refunded to the applicant if the investigation leads to prosecution.

A firm, body corporate, or association is not appointed as an inspector for inspection and investigation of the company [14].

Investigation of Ownership of Company [15]

Upon the direction of the tribunal, if the central government has a reason to believe that the affairs of the company ought to be investigated with respect to the membership of company, appoint one or more inspection to investigate and report on a matter relating to the company and its membership in order to determine the person who:

- i. Who are or who have been financially interested in the success or failure whether real or deceptive of the company;
- ii. Who has been able to control or materially have been able to influence the policy of the company

There has to be an appointment of one or more inspectors by the central government if the tribunal in course of any proceeding before it directs by an order that the affairs of the company have to be investigated.

Procedure of Inspector

The former officers, employees and agents of the company that is under investigation within

the provision or the body corporate that is being investigated:

1. Has to preserve and produce all the books and papers relating to the company or another body corporate or person which are in their custody or power to the inspector.
2. All assistance has to be given to the inspectors with respect to the investigation

The powers vested in the inspector include:

1. To provide information or produce books and papers before him, which he may consider relevant for the purpose of investigation for the body corporate to investigate. The books and papers shall not be kept in custody for more than 180 days although these may again be called for a future period of 180 days by giving an order in writing. The books and papers have to be returned to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced.
2. In order to examine someone under oath under Section 271(1), a prior approval has to be taken from the central government, although in case of an investigation under Section 212, the approval of Director, SFIO is enough. The notes of the examination shall be taken down which have to be written, read over to or by and signed by the person examined and thereafter be used in evidence against him [16].
3. The powers of the civil court mentioned under the Code of Civil Procedure 1908 have been vested with the following powers:
 - i. Books of accounts and other documents have to be discovered and produced at such time and place as may be specified.
 - ii. Summoning as well as enforcing the attendance of person and examining them on oath.
 - iii. Inspection of any books, registers and other documents of the company at any place.

Reciprocal arrangement with a foreign government for inspection, inquiry and investigation [17]:

Reciprocal arrangements can be made with a foreign government to get assistance with respect to any inspection, inquiry or investigation by the central government [18].

If during the investigation into the affairs of the company, an application is made to the competent court in India by the inspector mentioning that the evidence is or may be available in a country or place outside India then, in that case, the court may issue a letter of request to the court or authority in such a country or place and vice versa.

The evidence that is collected or its authenticated copies shall be forwarded by the court to the central government in order to transmit to the court or authority in a country which is outside India that had issued the letter of request.

Protection of Employees during Investigation [19]

At the time of investigation under Section 210, 212, 213 and 216 or during the pendency of any proceeding against anyone who is concerned in the conduct and management of the affairs of the company, such company, other body corporate or person who proposed to take any of the following actions against the employees, it shall obtain the approval of the tribunal in order to:

- i. Discharge or to suspend an employee; or
- ii. Dismissal, removal, reduction in rank or otherwise punishment to an employee; or
- iii. Change in the terms of employment to the disadvantage of employee(s).

The tribunal shall notify in writing its objection to the action proposed. If the company or other body corporate or person concerned does not receive the approval of the tribunal within 30 days of making such an application, it may proceed to take the action proposed against the employee.

Power to Conduct Investigation into the Affairs of Other Related Companies [20]

The powers of the inspector under Section 210, 212 or 213 or investigate into the affairs of the company which is or has been during relevant time been the company's subsidiary or holding or subsidiary of its holding

company, which is or has been at a relevant time managed by any person as a managing director or manager who is or was at any relevant time the managing director or the manager of the company, whose board of directors has company's nominees or is accustomed to act as per the directions of the company or any of its directors, or any situation where any person at any relevant time has been the company's managing director or manager or employee.

In these cases, a prior approval has to be taken by the inspector from the central government so that the results of the investigation are at par with the investigation of the affairs of the company for which he is appointed.

For a period not exceeding three years, the tribunal has the power to freeze the transfer, removal or disposal of funds, assets, properties of a company to such an extent as the tribunal may deem fit.

The order of the tribunal has to be based on:

1. The reference made to the tribunal by the central government
2. Has to be based on any inquiry or investigation into the affairs of a company under the chapter; or
3. One complaint that is made by the number of members as mentioned in Section 244(1); or
4. On the complaint of any person who had a reasonable ground to believe that the removal, transfer or disposal of funds, assets, properties of the company may take place in the manner which is prejudicial to the interest of the company or its shareholders or creditors or in public interest.

If this order issued by the tribunal is not followed, there are penalties issued against it which may extend up to twenty-five lakh rupees.

Imposition of Restriction on Securities [21]

When it appears to the tribunal that there is a good reason to find out relevant facts about any securities that are issued or to be issued by the company during the investigation, and the

tribunal is of the opinion that such facts cannot be found other than by imposing certain restrictions, it may, by order, subject the securities to such restrictions as it may deem fit for a period not exceeding 3 years.

In a case where the securities are issued or transferred or acted upon on contravention of the tribunal order under Section 222(1), the company shall be liable to a fine which is not less than one lakh rupees and shall not exceed 25 lakh rupees. Every officer who is at the default of the company shall be liable to imprisonment which shall not exceed six months or with fine of not less than Rs.25,000/- but this may extend to five lakh rupees or both.

Inspector's Report [22]

It depends on the central government and on the nature of direction that is given to the inspector to submit an interim report, and on the conclusion of the investigation, he will submit the final report. Every report has to be in writing or printed or as directed by the central government. Any person may obtain this report by filing an application to the central government. The report has to be authenticated by:

- i. The seal of the company whose affair has been investigated, or
- ii. A certificate of the public office that has the custody of the report that is provided in Section 76 of the Evidence Act, 1872.

The report shall be admissible in any legal proceeding as evidence of the matter contained in the report, although this section does not apply to report in Section 212.

Action in Pursuance of Inspector's Report [23]

When it is proved that the person is criminally liable in the inspector's report, the central government has the right to prosecute such person. Necessary assistance has to be provided by the officers and employees of the company with respect to the prosecution.

Once the inspector's report is checked through, if it seems proper to wind up the company by reason of the circumstances that is mentioned in Section 213, the central government may give an authority to a person to present the

following to the tribunal unless the company/body corporate is already wound up:

1. A petition for winding up on the just and equitable ground
2. An application under Section 241; and
3. Both

Winding-Up Proceedings for Recovery of Damages or Property

The central government shall bring winding up proceedings against the company or body corporate in public interest for the following purposes:

1. In case of fraud, misfeasance or misconduct, the recovery of damages with respect to promotion, formulation or management of affairs of the company or body corporate; and
2. Recovery of the property of the company that has been wrongfully retained or misapplied.

For the costs or expenses incurred, the company or body corporate shall indemnify the central government for any cost or expenses incurred in connection with any proceedings that are brought under Section 224(3).

Investigation of Foreign Companies [24]

The provisions with respect to inspection, inquiry as well as investigation are also applicable mutatis mutandis to foreign companies.

Penalty when a false statement, mutilation, destruction of documents is furnished:

In cases where the person has to provide an explanation or make a statement during the course of investigation, inquiry or inspection, which is also under the inspection:

1. Destroys, falsifies, conceals, mutilates or tampers or unauthorizedly removes or is a party to such destruction, mutilation as well as falsification, etc., of documents that are related to property, assets or affairs of the company or body corporate; or
2. False entry was made by the party in any of the documents concerning the company or body corporate; or
3. Mentioning an information that is known to him as false Then the person shall be punishable under Section 447.

THE PRACTICAL SCRUTINY: THE INFAMOUS FRAUDS [25]

Last few weeks have seen a series of cases registered against multiple companies for fraud investigation. The government had ordered SFIO to investigate around 110 companies and 10 LLPs with respect to Nirav Modi and his business partner Mehul Choksi for the Rs. 11,400 crore Punjab National Bank fraud [26]. At the beginning of April 2018, SIFO has also received a complaint against Larsen and Toubro which has been alleged to have committed “thousands of crores” of financial irregularities that include tax evasion and money laundering. Recently, the CBI has booked another case against Rs. 737 crore frauds by former UCO Bank chief Arun Kaul and several others [27]. Not to forget, the case filed by SFIO against the fugitive liquor baron Vijay Mallya and Captain Gopinath founder of Air Deccan and 18 others for a range of issues from window dressing of published finance to noncompliance of compulsory accounting standards [28]. Thus, with the rampant issues of frauds, the Central Bureau of Investigation (CBI) has registered cases against a number of companies for bank frauds.

Due to the infamous case of Nirav Modi, the government had to ask the public-sector banks to evaluate potential frauds in all bad loans that are above Rs. 50 crores. Thus, it can be expected that there will be an increased scrutiny by banks by authorities like CBI, enforcement directorate (ED) and serious fraud investigating office (SFIO).

It was by way of the Finance Bill 2018 that the government amended the Prevention of Money Laundering Act 2002 (PMLA). The handling of proceeds from corporate frauds is considered to be a money laundering offence. As the PMLA authorizes ED the power to attach and confiscate the property that is determined to be proceeds of crime. The consequence for this is that innocent parties being questioned about their dealings with a company where fraud is discovered and there is a chance that the assets will be seized, or the directors will be arrested.

Thus, it is critical for the directors and officials of companies to maintain a high watch. The Supreme Court in the case of *Sunil Bharti Mittal v. CBI* [29] held that the individual will be held liable for an offence by the company if the criminal intent is present in individual's active role in the case or where the statute itself stipulates the liability of directors and other officials. An exception for the same has been mentioned under the Companies Act 2013 for independent and non-exclusive directors ensuring that they are liable only in cases where their knowledge, as well as involvement, can be established or where they failed to act diligently despite having the knowledge. These kinds of exceptions are not generally prevalent in PMLA. As investor director is not exclusive in nature; they are not generally liable for actions which are largely promotor-driven although they often have to answer that they were not involved, or they had often acted diligently. Once the fraud is confirmed, the authorities are suspicious of everyone and being a non-exclusive director does not absolve an individual from liability or criminal prosecution.

Reserve Bank of India has issued master directions on fraud identifying certain early warning signals for identification of fraud. The signals for such cases can be detected when there is a tendency for the bills to remain undue for a significant period of time, and a substantial increase in unbilled revenue year after year. Once these signs are identified once or more than that, then the account is red flagged and sent for further investigation and reporting. If there is an identification of fraud, the banks are required to report to the state police/CBI/SFIO as per the effected fraud and type of bank. It is wise to be cautious for the foreign joint venture partners, directors and officers of a company for such early warning signals so that they are not caught unawares. It is necessary that appropriate questions are asked for the business plans and confirmation from the audit committee, internal auditors and external auditors, as the business plans, as well as the accounts of the company, are usually placed before the board of directors.

Tendering a registration is traditionally viewed to be a better way of protection against liability and is usually advisable, although that does not entirely cover. Stepping down shall also have unwanted consequences like disabling an investor from exercising his contractual rights like reserve matter rights. The authorities CBI, ED or SIFO have their own way to deal with the nature of investigation; thus, every authority has to be handled differently.

CONCLUSION

With the fast increase in the investigation in fraud cases for crores of rupees, one cannot help but wonder if the security system is strong enough. There are a lot of regulations that have to be complied with during the time of investigation which may affect the affairs of the company but that is bound to happen when an investigation takes place in a company. The rights of the employees are protected under such circumstances, but it is believed that in case of such fraud or misconduct an investigation like this is essential and the effected harm to the working of the company is valid. With circumstances like this, where every week there is a case for investigation, it is high time for better security that could be provided with safeguards against such hefty scams and protect the happening of such cases in the very first place. Although it can be analyzed from the above-mentioned cases and the statute that investigation against the blacklisted company is taken very seriously and steps like these lead to the consequences that would lead to interference in the working of the company, but such investigation is essential and there is no other way that it could be conducted.

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