Article 2

SAT Protects Compliance Officers from Promoters' Understatement of Key Financial Parameters in the Public Announcement of Buyback

CS Gaurav Pingle
Practicing Company Secretary
gp@csgauravpingle.com

Facts of the case: Appellant was a Company Secretary in a listed company for years during 2009 – 2011. SEBI conducted an investigation into the company's scrip and issued a show cause notice to the appellant, alleging that the company had understated the outstanding loans and interest in finance charges, etc., in the annual reports for the FY 2008 – 2009, 2009 – 2010, and 2010 – 2011. It was also alleged that the appellant had misled the investors/shareholders as he was a signatory to the public announcement made by the company for the buyback of its equity shares without having adequate free reserves.

> "While criticising the SEBI's presumption, SAT observed that such a presumption is without any legal foundation and therefore the impugned order is unsustainable in law. Accordingly, SAT allowed the appeal and set aside the SEBI AO Order."

After the adjudication, SEBI has held that the company/promoters, and directors had knowingly contributed to the dissemination of factually incorrect and distorted information relating to the annual financial statements of the company to the public in their annual reports. SEBI found that the company carried out a buyback of its equity shares, which was more than 25% of the total paid-up capital limit during FY 2011 – 2012 without having adequate free reserves. SEBI observed that the investors and shareholders were misled about the valuation and free reserves of the company.

Accordingly, SEBI held that the company and its directors, promoters violated the provisions of buyback of equity shares under the Companies Act, 1956 (section 68 and 77A) read with Regulations 3 and 4 of the SEBI (PFUTP) Regulations, 2003 and Section 12A of the SEBI Act. SEBI also held that the appellant should have exercised utmost due diligence, checked the veracity of the buyback offer document, and its legal compliance before authenticating and signing. It was also observed by SEBI that the appellant was responsible as the Company Secretary for signing the public announcement for buyback of its equity shares is equally liable for violations of law along with the company and its directors.

Observations of SAT: SAT noted the precise allegation of the SEBI AO was that the Appellant was a signatory to the public announcement made by the company to buy back its equity shares without having adequate free reserves, and therefore, the Appellant was party to misleading the investors/ shareholders. SAT perused the public announcement and specifically noted the Director's Responsibility, which stated that "The Board of Directors of the Company accepts responsibility for the information contained in this Announcement". The said announcement was signed by 2 Vice Chairmen, the Managing Director, and the Company Secretary (i.e., Appellant). W.r.t. this statement in the announcement, SAT stated that "The above announcement makes it amply clear

that the Board of Directors of the Company had accepted the responsibility for the information contained in the announcement."

SAT Referred to the Two Important Paragraphs in the SEBI AO Order (Para. 39 and 41).

Paragraph 41 of the SEBI AO Order stated that "In my view, the allegations against the said Noticees' and more specifically the Noticee directors about understatement of financial statements are fully covered within the four walls of the findings of the Hon'ble Tribunal in the matter of V Natarajan vs SEBI (supra). Considering the foregoing, it is absolutely clear that the said Noticees have knowingly and consciously contributed to the dissemination of wrong, factually incorrect, understated, and distorted information related to the annual financial statements of DCHL to the public." SAT noted that the said allegations were specifically made against the directors. According to SEBI, the 'said Noticees' means directors only, and that they have consciously contributed to the dissemination of factually incorrect information.

In Para 39 of the SEBI AO Order, it was noted by SEBI that 2 directors had admitted that the interest paid on the loan taken in the name of the listed company was not charged to the Profit and Loss Account of the company. SEBI AO noted that "Thus the Company and its Directors have eloquently concealed the said revenue liabilities from the investors at large and their shareholders in particular. The Company and its Directors have not even disclosed these facts to the lenders."

A combined reading of the findings in para 39 and para 41 of the SEBI AO order, SAT stated that "….. it is amply clear that according to the AO it was the company and its directors who had manipulated the accounts and disseminated incorrect information to the public."

On the allegations of the liability of directors and the Company Secretary for signing financial statements, SAT made the following observations "…..It is relevant and surprising to note that in one breath the adjudicating authority records that the provisions of Section 215 of the Companies Act, 1956 fasten a duty on the Company Secretary to authenticate the Balance Sheet and the Profit and Loss Account of the Company on behalf of the Board of Directors and in the next breath he holds that the appellant was not merely required to attest but ought to have verified if the audited accounts had contained all the assets and liabilities or other facts needed to be incorporated in the accounts."

On the role of Statutory Auditors, board of directors, and the Company Secretary, SAT further observed that "This implies that according to the Adjudicating Officer appellant was required to sit in appeal over the audited accounts. We may record that the audited accounts are certified by a qualified Chartered Accountant and approved by the Board of Directors. Therefore, in our opinion, the finding that the appellant ought to have verified whether the audited accounts had contained the assets and liabilities is wholly untenable and liable to be set aside."

SAT observed that SEBI AO has neither during the hearing nor in the lengthy written has pointed out as to which provision of law has been violated by the Appellant. SAT analyses the SEBI AO Order (Para. 46) and observed that "…. adjudicating authority has found fault with the appellant on an incorrect presumption that the appellant ought to have verified whether the audited accounts had contained all the assets and liabilities. If this reasoning is to be accepted, the appellant ought to have read, understood, and re-audited the certified accounts of the Company already approved by the Board of Directors. That is not the duty of either the Company Secretary or the Compliance Officer."

On the role of Company Secretary/Compliance Officer, SAT observed that the said Compliance Officer is appointed under the SEBI Buyback Regulations. The company has the power to buy its own securities under the provisions of the Companies Act, 1956. SAT noted that section 77A(11) of the Companies Act, 1956 renders the company or any officer of the company who is in default shall be punishable, and as per Section 5(f) of the Companies Act, the Compliance Officer becomes liable for penal action. After perusing section 5(f) of the Companies Act (which provides for the definition of 'Officer in Default'), SAT stated that "…… As far as the facts of this case are concerned, except stating that the appellant, being a signatory, has misled the investors, no specific charge or violation is pointed out by SEBI. It is settled that when an allegation against a delinquent is likely to meet with consequences, the charge must be clear and unambiguous."

SAT concluded that the SEBI AO order leads it to infer that SEBI has presumed that the Company Secretary/Compliance Officer ought to have re-examined the veracity of the certified accounts. While criticising the SEBI's presumption, SAT

observed that such a presumption is without any legal foundation and therefore the impugned order is unsustainable in law. Accordingly, SAT allowed the appeal and set aside the SEBI AO Order.

Analysis and Conclusion: Before analysis and observations, it is necessary to take note of the laws applicable then. The public announcement for the buyback was made by a listed company in May 2011. During this time, the provisions of the Companies Act, 1956 (sections 68 and 77A) and SEBI (Buy Back) Regulations, 1998 were applicable. Also, the Listing Agreement was applicable then, and now we have SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. SEBI Act, 1992 and SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 were applicable then and now, though the same have been amended over a period of time.

Under the extant SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015,

a listed entity shall appoint a qualified Company Secretary as the Compliance Officer. According to the said Regulation, Key Managerial Personnel (KMP) means KMP as defined in section 2(51) of the Companies Act, which means Chief Executive Officer or Managing Director or Manager, Company Secretary, whole-time director, Chief Financial Officer, such other officer, not more than one level below the directors who is in whole-time employment, designated as KMP by the board of directors and such other officer as may be prescribed. By the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2024, effective from December 12, 2024 – the Compliance Officer shall be an officer, who is in whole time employment of the listed entity, not more than one level below the board of directors and shall be designated as KMP.

The roles and responsibilities of the Compliance Officer / Company Secretary of a listed company have also been defined in Regulation 6(2) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The role of CS as KMP has undergone significant change vis-à-vis the provisions of the Listing Agreement and under the Companies Act, 1956. In spite of this fact, one observation of SAT (in the given case) which is relevant event now is that the Company Secretary is not required to sit in appeal over the audited financial statements, i.e., when accounts are certified by a qualified Chartered Accountant and approved by the board of directors.

One more crucial observation of the SAT is that the SEBI AO initiated proceedings against the appellant only on the fact that the appellant was a signatory to the public announcement. However, there has been no specific charge or violation that is precisely pointed out by SEBI. SAT made a very important observation that the charge must be clear and unambiguous, which was not the case in the present matter before it. This observation is not just relevant in the present case but also relevant for other cases where any person (director or any other officer) is charged by SEBI. In my view, this SAT order is relevant from this perspective only.

The Ministry of Law, Justice and Company Affairs, by its Circular No. 7/12 dated March 12, 1972, had clarified the role of a Company Secretary in respect of balance sheets to be attested by him by stating that the authentication by the secretary is “on behalf of the Board of directors” and not in his personal capacity, the Company Secretary can be held responsible regarding errors etc., (in the Balance sheet) only as an ‘Officer’ of the company within the meaning of Section 628 (of Companies Act, 1956) and not because of authentication by him under Section 215 (of Companies Act, 1956) as such. These were the arguments by the appellant, and SAT has not made any comment or observation in this regard. Also, the said Circular may not be valid now, considering that significant changes have taken place in the Companies Act, 2013, and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.