

Corporate Fraud

under the Companies Act, 2013

A study and critical analysis of provisions relating to fraud under the new Companies Act, 2013



Introduction

In the backdrop of several corporate scams, there was widespread criticism that the Companies Act, 1956 ("Old Act") did not adequately cover detection, prevention and punishment of corporate frauds. The Old Act did not explicitly elucidate the concept of 'fraud'. It did not provide for an effective investigation mechanism. It did not provide for stringent punishment.

To address these shortcomings and effectively deal with corporate fraud, the new Companies Act, 2013 ("New Act") introduced certain new provisions and modified old provisions. Though it is widely believed that these new provisions will address the growing problem of corporate fraud, they are yet to be tested.

Definition of fraud

One of the salient features of the New Act is that, it provides for a definition of the term 'fraud'. Explanation to Section 447 of the New Act defines 'fraud' as under:

"fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss."

This definition is not an exhaustive definition; rather it is an inclusive definition. It leaves necessary scope for the courts to cover other commission/omission within the ambit of the definition. Further, the term 'any person' used in the definition gives it a wide coverage to include any person who has committed the fraud, instead of restricting it to certain officers, directors or employees of the company.

Punishment for fraud

The New Act has introduced stringent punishment for the persons who are found to be guilty of fraud. Under Section 447 of the New Act any person, who is found to be guilty of

fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years. The offenders are also additionally liable to pay fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Moreover, where the fraud in question involves public interest, the term of imprisonment cannot be less than three years.

The offence under Section 447 of the New Act is cognizable, non-bailable and non-compoundable.

Punishment for other offences

One of the distinct features in the New Act is that the punishment under Section 447 of the New Act is not only applicable to the cases of fraud, but also to various other offences as specified in about fifteen distinct provisions of the New Act. Some of these provisions found place in the Old Act as well; however, each offence was punishable with distinctive punishments.

Below is a comparative table of provisions/offences under the New Act having punishment as per Section 447 of the New Act with the corresponding sections and punishment under the Old Act.



Jyoti Singh
Partner
Phoenix Legal



Srisabari Rajan
Senior Associate
Phoenix Legal



Ranjini Ramesh
Associate
Phoenix Legal

Sr. No.	Section under the New Act	Offence	Corresponding Section under the Old Act	Punishment under the Old Act
1	7 (5) and (6)	Furnishing any false or incorrect particulars of any information or suppressing any material information, in relation to the registration of a company	NIL	NA
2	8 (proviso)	Affairs of a company, formed with charitable objects, being conducted fraudulently	NIL	NA
3	34	Misstatements in prospectus	63	Imprisonment for a term which may extend to two years , or with fine which may extend to fifty thousand rupees or with both.
4	36	Fraudulently inducing persons to invest money	68	Imprisonment for a term which may extend to five years or with fine which may extend to one lakh rupees or with both.
5	38 (1)	Personation for acquisition etc. of securities	68A	Imprisonment for a term which may extend to five years .
6	46 (5)	Issuance of duplicate certificate of shares	84 (3)	Imprisonment for a term which may extend to six months or with fine which may extend to one lakh rupees, or with both.

Sr. No.	Section under the New Act	Offence	Corresponding Section under the Old Act	Punishment under the Old Act
7	56 (7)	Transfer of shares by depository or depository participant with an intention to defraud a person	NIL	NA
8	66 (10)	Reduction of share capital (a) knowingly concealing the name of any creditor entitled to object to the reduction; (b) knowingly misrepresenting the nature or amount of the debt or claim of any creditor; or (c) abetting or being privy to any such concealment or misrepresentation	105	Imprisonment for a term which may extend to one year , or with fine, or with both.
9	140 (5)	Auditor acting in fraudulent manner or abetted or colluding in any fraud by, or in relation to, the company or its directors or officers	NIL	NA
10	206 (4)	Carrying out business for a fraudulent or unlawful purpose	NIL [However Section 234 (7) empowers the Registrar to call for necessary information]	NA
11	213 (proviso)	Business of the company being conducted with the intend to defraud	237 (b) [Investigation of company's affairs]	NA
12	229	Penalty for furnishing false statement, mutilation, destruction of documents	424L	Imprisonment for a term which may extend to three years or fine not exceeding 10 lakhs
13	251 (1)	Fraudulent application for removal of name	NIL	NA
14	339 (3)	Fraudulent conduct of business	542	Imprisonment for a term which may extend to three years or fine which may extend to ₹50,000 or both
15	448	False statement/ omission of material statement in any return, report, certificate, financial statement, prospectus, statement or other document required under the Act	628	Imprisonment for a term which may extend to two years and fine.

Serious Fraud Investigation Office

The New Act empowers the Central Government to establish an office to be called the Serious Fraud Investigation Office (SFIO) to investigate *frauds* relating to a company. Though SFIO had been set up by the Central Government by way of a resolution in 2003 itself, it attained a statutory recognition only under this Act. SFIO, under the New Act, will have more powers, including the power to arrest.

Key issues

(a) Same punishment for distinctive offences

As mentioned above, various offences which had distinctive punishments will now be punishable under one provision, i.e. Section 447 of the New Act. Though some of these offences could be interrelated with each other, it cannot be said forthrightly that these offences are similar in nature. Visibly, there is no coherent reasoning as to why all these offences are required to be punished under Section 447 of

the New Act with such stringent punishment, particularly when definition of 'fraud' itself gives a wide coverage. This could possibly lead to overlapping of offences and thereby cause confusion.

(b) Investigation by other agencies

Section 447 of the New Act provides that a person will be held liable for 'fraud' under the Section '*without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force*'. Though it appears that the intention is to ensure that a person who is punished under Section 447 of the New Act is not absolved of his liability of repayment of any debt, use of the terms '*including*' and '*any other law*' may lead to a possible ambiguity. Given a literal interpretation of this clause, a person can be held liable under Section 447 of the New Act as well as any other provision of law. For example, this could mean that, if a person commits an act which falls under Section 447 of the New Act as well as Section 420 of the Indian Penal Code, 1860, then he could be prosecuted under both the provisions separately and simultaneously.

Though Section 212 of the New Act provides that where any case has been assigned by the Central Government to the SFIO for investigation under the New Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under the New Act, it could lead to possible confusion in the scenarios where: (i) other investigating agency investigates the same act/omission which is also an offence under a different Act, and (ii) other investigating agency investigates offences under the New Act combined with few other offences under a different Act.

These provisions might create confusion, particularly when a special investigating agency, like Economic Offences Wing or Central Bureau of Investigation, will investigate a case which will also partially or fully fall under the scope of SFIO.

(c) Nature of cognizance

An offence that is punishable under Section 447 of the New Act is cognizable. A cognizable offence, as defined under the Code of Criminal Procedure, 1973 means a case in which, a police officer may arrest without warrant. In case of an offence under Section 447 of the New Act, though it is a cognizable offence, SFIO can investigate into the affairs of a company only upon direction from the Central Government. SFIO does not have any power to take *suo motu* cognizance.

It is also to be noted that the Special Court cannot take cognizance of any offence except upon a complaint in writing made by SFIO or Central Government.

Though the New Act has granted vast powers to the SFIO, absence of *suo motu* cognizance and requirement of direction from the Central Government will only mean that it may not be practically possible for SFIO to take urgent and immediate measures.

(d) Limitations on granting bail

Section 212 of the New Act provides that no person accused of any offence under certain sections which are punishable under Section 447 of the New Act shall be released on bail or on his own bond unless:

- (i) The Public Prosecutor has been given an opportunity to oppose the application for such release; and
- (ii) Where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

Further, the limitation on granting bail specified above is in addition to the limitations under the Code of Criminal Procedure, 1973 or any other law for the time being in force on granting of bail. Considering the wide range of offences which can be brought into the ambit of Section 447 of the New Act, the aforesaid bail condition, if not implemented in the right spirit, can be draconian and also against the basic fundamental rights. In order to draw a parallel, these are the same bail conditions which are enshrined in: The Terrorists Affected Areas (Special Courts) Act, 1984 [Section 15(5)], Maharashtra Control of Organized Crime Act, 1999 [Section 21], The Drugs and Cosmetics Act, 1940 [Section 36AC], and The Narcotic Drugs and Psychotropic Substances Act, 1985 [Section 37].

A long road ahead

The provisions under the New Act relating to fraud, as elaborated above, are ambiguous and may possibly lead to confusion. However, these provisions are novel and yet to be tested. Implementation of these provisions will be the key factor to determine whether they will achieve the main objective of curbing corporate frauds or not.



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