

Show cause for litigation

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Courts take regulators seriously. Better, then, to respond to the latter by being upfront about business practices.

Regulatory supervision of economic behaviour has increased manifold; this is due to new laws governing information technology and media, foreign exchange, competition, environment, drugs and cosmetics, among other areas. Companies need to be prepared on legal and public relation strategies.

Moving courts against regulatory authorities is not like a commercial dispute. Even High Courts in exercise of their constitutional jurisdiction are loath to interfere with findings made by regulatory authorities.

It is, therefore, important for a company to be aware of the appropriate strategy to be followed in such cases. A response to show cause notices should satisfactorily explain the business, the transaction and regulatory compliance.

The notice

Generally, a notice from an authority directs the recipient to furnish information and at times, record statements of key personnel. The authorities are trying to ascertain the facts and understand the business or the transaction.

Dilatory tactics are counterproductive; it is imperative that a notice is responded to at the earliest by providing information as requested or seeking additional time to comply. Unless a case of violation of principles of natural justice or transgression of jurisdiction can be made out, High Courts do not interfere at this stage. Companies must, therefore, focus on an appropriate reply. It is important for a company to ascertain the circumstances under which the notice has been issued. Sometimes, the investigation is initiated on the basis of a complaint by disgruntled employees or competitors. Even if there is no recourse against such action, a company should be aware of the background for investigation.

The reply

A common mistake committed is that in the anxiety to put the best case forward, companies rely on judgments to

explain the law with respect to their transaction or business. However, authorities are not interested in law and are keener on understanding the business and transactions of the company.

Often, notices are issued to newly incorporated subsidiaries of foreign entities, and in such cases the company should place on record its international credentials. This helps inform the authorities about the credibility and the business of the company.

Indian courts look with strong disapproval at arbitrary and peremptory action by statutory authorities. Therefore, the substance of the transaction is the most crucial aspect in the reply, and this cannot be over-emphasised.

The reply should clearly articulate background of the company, business strategy, economic models, including financials and audit reports, where required. These statements must be corroborated with literature on products and services and accounting entries that give effect to the transactions.

A comprehensive reply with the advice of lawyers, based on substantive transactions and procedural compliance, helps build the case if the need to litigate arises.

General strategy

Litigation is costly and collateral damage from litigation outweighs notional benefits. Once the stage is set for litigation, it is difficult to turn the clock back. Therefore, an attempt must be made to resolve issues at the level of subordinate authorities. Once the decision is made, a company should be prepared to litigate till Supreme Court.

Regulatory uncertainty due to multiple authorities or ambiguity in notifications causes unintended transgressions. Courts have recognised that there has to be clarity with respect to law, and businesses need to plan their activities ahead.

In such cases, a company should consider making a representation to the authority that time is required for compliance. A company may exercise its right to file a writ petition when an authority has acted without jurisdiction or arbitrarily. An action is arbitrary or violates principles of natural justice if it lacks reasons, is unreasonable or based on extraneous and irrelevant considerations.

Although High Courts would quash such notices, they would also seek a response on the substance of the transaction.

Although the right to approach the High Court and seek remedy under the Constitution is fluid, such an action should be carefully taken on advice of lawyers. In appropriate cases, a company should also consider compounding of offences to ensure expeditious resolution of regulatory proceedings. Compounding offences ensures that there are no adverse observations by the authorities.

When an issue affects an industry, making a representation through chambers of commerce to the relevant ministry should be considered.

Such representations would demonstrate the complexity of the issue. Issues relating to policy are better resolved through interaction with government than litigation, as courts anyway defer to the government on policy issues.

Role of individuals

Sometimes notices are addressed to an individual by office, such as the managing director or the CEO. Unless personal liability is sought to be affixed, the response should always be on behalf of the company. Criminal action is generally initiated as a measure of last resort, or in grave cases where the material on record shows a manifest intention to defeat the law.

In appropriate cases, the company would need to explore obtaining anticipatory bail for key management persons.

For their part, regulators can also ensure, in line with rulings of the Supreme Court, uniform and consistent application of laws. A holistic approach of the regulatory authorities would help ensure certainty in the business environment. Regulators should engage with industry prior to formulation of a policy.

This would help avoid litigation and ensure compliance of the law in letter and spirit. However, this must be achieved without regulatory capture or crony capitalism.

Ensuring transparency

The best way to manage litigation – is to not be part of it! Litigating in a regulatory environment is fundamentally different from litigating commercial contracts.

The degree of deference accorded by courts to the regulatory authorities is high. Therefore, companies must ensure that when transactions relating to foreign exchange, telecom, mergers and acquisitions, including transfer pricing, are envisaged, legal advice is taken on regulatory compliance.

The importance of documentation cannot be exaggerated. In appropriate cases, a company should consider a regulatory audit which would highlight non-compliance and exposure to litigation risk. Such documentation would help a company in defending its stand on regulatory compliance.

In sum, litigation is costly and perpetuates an air of uncertainty. It benefits no one - except the lawyers!

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