INVESTOR PROTECTION AND CRIMINAL LIABILITIES FOR DEFECTIVE PROSPECTUSES: BANGLADESHI LAW COMPARED TO LAW IN OTHER JURISDICTIONS

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I Introduction

THE BANGLADESH securities market was established half a century ago. Despite its operation over such a long period, it remains in embryonic form. A chronic lack of investor confidence emanating from multifarious legal and regulatory problems has made the market moribund. Numerous companies with weak fundamentals have been raising funds by issuing prospectuses reportedly containing false and misleading statement.[1] The market is dominated by amateur investors and companies are taking advantage of them. A recent survey reveals that the performance of 72 companies out of 137 initial public offerings

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1. See, for some of these reports, I. Ahmed, "People's Leasing Hides Info Prior to Float IPO" *The New Age* Dhaka 15 Jul 2005; M. Mahmud, "SEC Halts Premier Bank IPO for 'Irregularity'' *The Daily Star* Dhaka 13 Feb 2005; K. Rahman, "NTV's Attempt to Raise Tk 20 cr from Share Market Failed Due to Exaggerated information" *The Daily Janakantha* Dhaka 16 Feb 2005; AIMS, "AIMS Ditches Modern Food" *Weekly Market Review* 10 Jul 2000 at 1; M.S. Rahman, "AIMS Backs Down on Pledge to Underwrite Modern Food: Audited Accounts Differ from Prospectus Statement" *The Daily Star* Dhaka 3 Jul 2000; M.S. Rahman, "Court Summons Wonderland Toys Directors for Alleged Deception: Fake IPO Info Make Investors Buy Scrips" *The Daily Star* Dhaka 19 Jan 2001; M.S. Rahman, "Auditing Firm under SEC-ICAB Fire" *The Daily Star* Dhaka 21 Apr 1998; T.I. Khalidi, "IPO to Raise Tk 5 cr by Taiwanese Tiles Producers: Fu-Wang Conceals Information" *The Daily Star* Dhaka 11 Feb 1998; M.S. Rahman, "SEC Turns Down Madina Shoe's IPO Petition: Allegation of Submitting False Documents" *The Daily Star* Dhaka 12 Jun 2000; M.S. Rahman, "SEC Suspends Raspit IPO, Orders Special Audits: Auditor to be Selected by the Company" *The Daily Star* Dhaka 15 Sep 2000; M.S. Rahman, "Alleged Tax Evasion by Keya: SEC May Ask Co to Issue Public Notice" *The Daily Star* Dhaka 15 Jun 2001. For a detailed discussion, see "Fraudulent Companies Dishonest Brokers and Careless Investors – These are the Share Market: ADB" *The Daily Jugantor* Dhaka 16 May 2005.

(IPOs) issued in the market from 1993 to July 2004 has been very poor because of weak fundamentals, and that many of those issuers are now nonexistent. The survey clearly identifies the issuance of 'defective prospectus' as one of the major reasons for the poor performance of many companies in the secondary market.[2] The absence of a code of corporate governance has worsened the situation further.[3] Despite widespread allegations of corporate malfeasance, however, no reported cases have been found in relation to defective prospectuses in Bangladesh. Although the Securities and Exchange Commission (SEC) has lodged a total of 94 cases, none of these cases has been finally disposed of as yet.[4]

The SEC unexpectedly adopted the Disclosure-Based Regulation (DBR) in January 1999 by discarding the previous merit regulation on a plea of protecting investors in the market. This new regime came into effect without any changes being made in the liability provisions, although the disclosure regime entails clear and stringent legal provisions regarding infringement on prospectus requirements. Such a situation calls for a reappraisal of the prospectus liability regime in Bangladesh.

Bangladeshi laws governing criminal liabilities for disclosures in prospectuses are flawed in multifarious ways, with weaknesses such as ambiguities and shortcomings in identifying potentially liable persons, and softness in terms of the scope for defences and penalties. Such flaws ultimately favour wrongdoers, at the expense of the investor affected by the contravention of the legal requirements of disclosures.

II Methodology and limitation

This article examines the prospectus criminal liability provisions in Bangladesh in comparison with their equivalents, mainly in India and Malaysia, from the perspective of investor protection. Whilst neither India nor Malaysia has been taken as a model, the reasons for choosing these two jurisdictions are threefold. Firstly, the securities markets in

2. H.Mahmud, "Half of the SEC Approved 137 Companies Do Not Give Dividends, Do Not Hold AGMs: Investors Are being Deceived Because of Legal Lacuna" *The Prothom Alo* Dhaka 4 Jul 2004 (translated from Bengali). See also "ADB's Capital Market Dev Project *Little Productive*" The *New Age*, Dhaka 1 Jun 2004. In this paper, the expression 'defective prospectus' refers to those prospectuses which include untrue, misleading, fraudulent or deceptive information or omit to include material information in a prospectus.

3. "Corporate Governance Code Vital to Cutting Corruption" *The Daily Star* Dhaka 20 Aug 2004.

4. H. Mahmud, "The Regulating Body in Question: SEC Runs Slow in Dealing with Cases Involved in the Share Scam?" *The Prothom-Alo* Dhaka 5 Jul 2004 (translated from Bengali); SEC, *Quarterly Review* 24 (Apr-Jun 2005), Dhaka.

India and Malaysia have been performing better than the market in Bangladesh over the last decade.[5] More importantly, the performance in recent years of the Malaysian market in particular demonstrates a great success in financing corporations. Secondly, as part of former British-India, Bangladesh has slavishly followed many of the legal reforms being made in India, including those regarding the securities market. Thirdly, Bangladesh is very similar to both India and Malaysia with respect to social, economic and legal traditions (common law). All of these aspects are relevant to the development of securities markets. Therefore, a comparison of prospectus liabilities amongst these three jurisdictions is reasonable when searching for flaws in Bangladeshi laws.

In addition to the laws in India and Malaysia, the relevant laws of some other jurisdictions such as Australia, the United States (federal law) and Arizona (state law) are also referred to, particularly where the laws of Bangladesh, India and Malaysia are found to be flawed or inadequate. It is understood that the Bangladesh securities market may not be comparable to the markets of developed economies. However, these jurisdictions are cited especially in addressing the liability of market professionals and intermediaries for a defective prospectus, where uniformity of securities law regardless of the level of market development is highly desirable.[6] The analysis relies heavily on judicial observations of some developed common law jurisdictions, mainly because of a serious dearth of case law in Bangladesh, India and Malaysia.

The paper concentrates on the liability of individuals associated with the preparation of a prospectus rather than the prospectus issuer *per se*. The liability of the issuer of securities is beyond the scope of this article. It is argued that the imposition of appropriate liabilities on the members of an 'IPO coalition',[7] and the proper enforcement thereof, will generate motivation for investment, as investors will have confidence that their investment will have no probability of bad outcomes.[8]

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5. Market capitalisation as per cent of GDP is 2.52 per cent in Bangladesh, whereas it is 32.40 per cent in India and 130.42 per cent in Malaysia: for details, see S.M. Solaiman, "Securities Market in Bangladesh: A Critical Appraisal of Its Growth Since Its Inception in 1954" (2005) 29 *Savings and Development* 169 at 193-95.

6. See, for arguments in favour of borrowing securities laws by developing countries from developed countries, A. Gillen & P. Potter, "The Convergence of Securities Laws and Implications for Developing Securities Markets" (1998) 24 *North Carolina Journal of International Law and Commercial Regulation* 85 at 120.

7. The expression 'IPO Coalition' has been taken from R.P. Beatty and I. Welch, "Issuer Expenses and Legal Liability in Initial Public Offerings" (1996) 39 *Journal of Law and Economics* 545.

8. R. Schwartz, 'Legal Regime, Audit Quality and Investment' (1997) 72 *The Accounting Review* 385 at 397.

In discussing the liability provisions, emphasis will be given to: persons liable for a defective prospectus, penalties that can be awarded for the contravention of disclosure requirements, and defences available to escape criminal liabilities.

III Criminal liability

The main objective of criminal liability for a defective prospectus is the creation of deterrence for the potential violators of the disclosure requirements. The term 'deterrence' is defined as the avoidance of a particular action or omission through fear of the perceived consequences.[9] In order to deter certain undesirable conduct, the criminal law has traditionally imposed some sanctions, which include imprisonment, fines or penalties, and the stigma of criminality. Although criminal sanctions in penal law may be seen as controversial in a general sense, their effectiveness has been persuasively argued as deterrence to corporate crimes.[10] Similarly, to combat the offences concerning securities, it has been further argued that crimes could be deterred by punishing either the company or its officers.[11] It is probably a sound proposition to have criminal liability hand in hand with civil liability as a means of deterring offenders from violating disclosure requirements as well as remedying the investors' grievance.[12] For example, in Australia, criminal sanctions are emphasised for securities regulation 'with additional remedies being available' to the securities regulator as well as civil liability to the injured persons.[13] It is widely recognised that 'investors are best protected' by a criminal liability regime that is based on deterrence.[14]

The above findings underpin that criminal sanctions are necessary to create deterrence. The objective of imposing criminal liability for a defective prospectus is thus to deter the persons violating rules in the preparation of disclosures for an IPO. Criminal liability for a defective prospectus has been imposed under the Companies Act 1994 (CA'94) and the Public Issue Rules (PIR'98) in conjunction with the Securities and Exchange Ordinance 1969 (SEO'69) in Bangladesh.

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9. See generally, D. Beyleveld, "Identifying, Explaining and Predicting Deterrence" (1979) 19 *British Journal of Criminology* 205 at 205-24.

10. See H. Packer, *The Limits of the Criminal Sanction* 39-45, 356-57 (1968).

11. "'Developments in the Law - Corporate Crime: Regulating Corporate Behaviour Through Criminal Sanctions" (1979) 92 *Harvard Law Review* 1227 at 1365.

12. *Id.* at 1374.

13. V.R. Goldwasser, "The Regulation of Stock Market Manipulation—A Blue-Print for Reform" (1998) 9 *Australian Journal of Corporate Law* 1 at 17.

14. G. Golding, "Underwriters' Liability in Australian Securities Offerings" (1993) 11 *Company and Securities Law Journal* 401 at 406.

Sections 146 and 147 of the Companies Act 1994 (CA'94) deal with criminal liability for a defective prospectus. These two sections create liability respectively for an 'untrue statement'[15] in a prospectus which fraudulently induces people to invest their money. Neither of the sections imposes liability on the issuing company. The above sections impose liability on individuals but the identities of the individuals who are potentially liable for a defective prospectus are unclear. This will be examined in the following section.

IV Persons liable for untrue statements in a prospectus

Section 146(1) of the CA'94 provides for penalties for the inclusion of any untrue statement in a prospectus. This section imposes liability on 'every person who authorised the issue of the prospectus', but the section does not provide any explanation for individuals who fall within its scope of application. It is therefore unclear as to who is actually liable under this section.

In construing the expression 'authorise or cause the issue' judicial decisions of some common law jurisdictions in the same context have expressed the view that directors will be liable for the authorisation of a prospectus.[16] Along with the directors, promoters are also liable. This is so because, it is generally agreed that the term 'promoter' is used only for the purpose of the prospectus. A promoter identifies the first directors of the company and brings the entity into existence.[17] In *Weavers Mills Ltd* v. *Balkis Ammal*[18] the court held that 'certain fiduciary duties have been imposed' on the promoters. Thus, in respect of fiduciary duties, directors and promoters are treated equally and promoters are liable together with the directors.[19] Hence, it appears that only the directors and promoters may be penalised under section 146(1) of the CA'94. The liability of auditors, lawyers, underwriters and issue managers is uncertain.

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15. The meaning of the untrue statement in respect of a prospectus has been described in s.143. According to that description: '(a) statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included; and (b) where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed in respect of such omission to be a prospectus containing untrue statement'.

16. *Flavel* v. *Giorgio*, (1990) 2 ACSR 568; *ASC* v. *Burns*, (1994) 12 ACLC 545; *Geipel* v. *Peach*, [1917] 2 Ch 108; *Barrow* v. *De Garis*, (1926) 29 WAR 4; *Registrar of Companies* v. *Brierley*, (1965) NZLR 809.

17. S Agarwal, C. M. Bindal & V. K. Jain, *Commentary on The Companies Act 1956* 637 (2001).

18. AIR 1969 Mad 462 at 469.

19. *Supra* note 17 at 638.

Section 146(2) of the CA'94 makes their position more ambiguous by saying that:

> A person shall not be deemed for the purpose of this section to have authorised the issue of a prospectus by reasons only of his [or her] having given-
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> (a) the consent required by section 137[20] to the inclusion therein of statement purporting to be made by him [or her] as an expert; or
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> (b) the consent required by sub-section (4) of section 138.[21]

According to section139 (2) of the CA'94, the term '"expert" includes an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him [or her]'. It is again ambiguous, because the CA'94 does not stipulate the professions that fall within the ambit of the professions implied in section139 (2). On the other hand, section138 (4), as referred to in section 146(2)(b), provides that the prospectus will not be registered by the registrar of the joint stock companies (RJSC) unless, amongst other persons, the respective auditors, legal advisers and attorneys of the company give their consent in writing on the registration of the prospectus. Thus section 146(2)(b) in conjunction with section138 (4) imply that the auditors and lawyers are not liable for their consents to the prospectus under section146(1).

The corresponding provision in India, section 63 of the Companies Act 1956 (CA'56) is exactly the same as section146 of the CA'94. However, section 47 of the Companies Act 1965(CA'65) of Malaysia is partially different from section146 of the CA'94. Under section 47(2) of the CA'65, experts are not deemed to have authorised or caused the issue of a prospectus, and therefore are not liable for a defective prospectus. The section does not explain the position of other participants such as auditors, lawyers, underwriters and issue managers. No judicial pronouncements by the Malaysian courts with regard to the criminal liability of these other participants are available.

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20. S. 137 is as follows: 'Expert's consent to issue of prospectus containing statement by him [or her]: - A prospectus inviting persons to subscribe for shares in or debenture of a company and including a statement purporting to be made by an expert may be issued, if—

(a) he [or she] has given his [or her] written consent to the issue thereof, with the statement included in the form and context in which it is included, and has not withdrawn such consent before the delivery of a copy of the prospectus for registration; and

(b) another statement that he [or she] has given and has not withdrawn his [or her] consent as aforesaid appears in the prospectus'.

21. S. 138(4) is discussed below the quotation.

The enforcement of any liability regime depends greatly on the identification of the persons who are liable for a particular offence. Ambiguities with regard to the identity of the persons who should be liable for an alleged contravention of disclosure requirements tend to give advantage to wrongdoers. All such uncertainties preclude the investors from access to justice and inhibit the prosecutors and regulators from taking punitive actions against the contravention of the disclosure regulations. Although the laws of Bangladesh, India and Malaysia are ambiguous in this regard, there are statutes in other jurisdictions that have more certainty in relation to the imposition of criminal liability for a defective prospectus on the persons involved in an IPO coalition which are discussed later in the article. In the meantime, all other pertinent provisions currently in operation in Bangladesh will be examined to determine whether or not any securities law[22] imposes criminal liability for defective prospectuses.

V Penalty for untrue statements in prospectuses

In addition to the ambiguity of the scope of application of section146 of the CA'94 in identifying potentially liable persons as stated above, the section provides for much lesser penalties as compared with its counterparts in other jurisdictions such as India and Malaysia. The penalties stipulated under section146 (1) in Bangladesh are imprisonment for a term not exceeding two years or a fine which may extend to 5,000 taka (approximately US$88) or both. In terms of imprisonment, section 63 of the CA'56 of India is identical to the above section146 (1), but largely different in respect of fines. For example, the fine under section 63 of the CA'56 may extend to Rs. 50,000 (approximately US$1,035)[23] as opposed to only US$88 in Bangladesh. At the discretion of the court, the fine may be lower than this small fixed amount. The corresponding laws of Malaysia are far more stringent than those of Bangladesh and India. Section 47 of the CA'65 prescribes for imprisonment of five years and a fine of 0.10 ringgit (approximately US$26,330). The figures clearly show that the maximum pecuniary penalty in Bangladesh is too little. Similarly, the laws in Bangladesh are 'soft' in terms of the term of imprisonment too. For example, the judge in Bangladesh may punish an offender under section146 (1) with imprisonment for any term not exceeding two years. But in Malaysia, the penalty has to be exactly five years. Its Indian counterpart is similar to the provision in Bangladesh.

22. The CA'94 is a company law. There are some securities laws which separately deal with the prospectus apart from the company law.

Further, the court in practice may punish any liable person either with imprisonment or with a fine or with both. If the court opts for a fine only, the offender shall have to pay a small amount not exceeding 5,000 taka. In the real sense, therefore, it may not be an exaggeration to say that section146 (1) in Bangladesh does not provide for a sufficient penalty to work as deterrence. If the court chooses imprisonment, the term may even be less than a day or few hours since there is no minimum threshold limit. Thus, the penalty very much depends on the honesty and efficiency of the courts. At the same time, the honesty of the judiciary, especially in the lower judiciary has been a serious concern as reported by the national and international media.[24] Even the lower judiciary has been described as one of the most corrupt organs of the government.[25] The fact is, that providing wide discretion mentioned above is perceived to be detrimental to the protection of investors.

VI Defences against criminal liability for untrue statements in prospectuses

Two defences are available to the accused in respect of untrue disclosure in a prospectus under section146 of the CA'94. One relies on an objective test and the other rests on a subjective test. The objective test requires the accused to prove that the untrue statement, which the prosecution has presented, is immaterial. There is no explanation or specification of the information that should be regarded as 'immaterial' under the CA'94. It is difficult to determine the materiality of a statement and there is no single definition of the term 'materiality'.[26] From that point of view, the defence is ambiguous and favours the accused. This is so because, according to the general principle of criminal law, any benefit of doubt helps the accused to escape liability.

The subjective test requires the accused to prove that the accused 'had reasonable ground to believe and did, up to the time of the issue of

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23 In India, the fine was Rs. 5000 until the end of 2000. This amount has been substituted by the Companies (Amendment) Act 2000 under s.23.

24. For an analysis of the judicial dishonesty and continued erosion of public confidence in the present judiciary in Bangladesh, see M. R. Islam & S. M. Solaiman, "Public Confidence Crisis in the Judiciary and Judicial Accountability in Bangladesh" 13 *Journal of Judicial Administration* 29 (2003).

25. See U.S. Department of State, "Bangladesh - 2005 Investment Climate Statement" *available at* http://www.state.gov/e/eb/ifd/2005/41981.htm (visited on 22 Dec 2005); U.S. Department of State, "Country Report on Human Rights Practices 2002" *available at* http://www.state.gov/g/drl/rls/hrrpt/2002/18309.htm (visited on 17 Dec 2003).

26. See *Cackett* v. *Keswick*, [1902] 2 Ch 456; *Arnison* v. *Smith*, (1889) 41 Ch D 348; *TSC Industries Inc* v. *Northway Inc.*, (1976) 426 US 438 and *R* v. *Rada Corp Ltd.*, (1990) 5 NZCLC 66,624.

the prospectus, believe that the statement [in question] was true'.[27] It is difficult to prove whether or not the person did believe in the truth of the impugned statement.

In the absence of judicial interpretation, it is submitted that an illustrative list of information which can be regarded as 'immaterial' would be effective for the purpose of protecting the investors in Bangladesh. Otherwise, the term 'immaterial' remains unclear and confusing for the participants in the IPO market. As regards the second defence, that of providing a reasonable ground to believe in the truth of the impugned statement, there is wider scope for the accused to escape criminal liability for producing a defective prospectus. This defence, in other words, implies that the accused can be punished only for wilful disclosure or non-disclosure. The 'wilful' defence will be examined later. It will be shown that this defence has been omitted from the statute in some jurisdictions and the availability of this defence is not considered to be necessary for imposing criminal liability for a defective prospectus. It is thus argued that the defence of personal belief of the accused in an untrue statement serves to protect the accused against the interest of investors.

As a whole, section146 of the CA'94 is unclear and ambiguous in terms of the identification of persons who are potentially liable for untrue statements in a prospectus. The section is very 'weak' or 'soft' with regard to penalties as compared with its counterparts in India and Malaysia. Further, defences provided in the section are conducive to potential offenders escaping liability. This is so because of the lack of explanation about the immateriality of information and difficulties of proving the personal belief of the accused in the truth of the untrue statement in question. Taking these factors into account, it can be said that section146 of the CA'94 is not a useful provision for the protection of investors in the IPO market in Bangladesh.

VII Liability for fraudulently inducing persons to invest in securities

Section 147 of the CA'94 imposes a penalty for fraudulently inducing persons, *inter alia*, to subscribe for, or underwriting, shares.[28] The section

27. Companies Act, 1994, s.146(1).

28. S.147 of the CA'94 provides that: 'Any person who either by knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into, or to offer into-

(a) any agreement for, or with a view to acquiring, disposing of, subscribing for, or underwriting shares or …; or(b) any agreement, the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or …, or

prescribes penalty for 'knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading' or any dishonest concealment of material facts to induce any person to invest in securities. In other words, to be punishable under this section, the inducement should be the result of a false, deceptive or misleading statement made knowingly or recklessly; or dishonest concealment of material facts in the prospectus. The most distinctive feature of this section is that, it is not a requirement that a statement or omission must induce a person to invest in securities. The person who is involved in the above prohibited actions or omissions shall be punished merely for attempting to induce another person. Section 147 of the CA'94 is self-explanatory to some extent in respect of its scope in covering various offences. For example, it is an offence to attempt to induce another person to invest his or her money. However, there are some flaws in the section. Those flaws will be analysed in the following discussion.

VIII Persons liable for fraudulently inducing others to invest in securities

Section 147 of the CA'94 does not mention any particular person who is liable under this section. Rather, it imposes liability on a person regardless of their relation with the issuer of securities. It stipulates that any person who is involved in inducing or attempting to induce another person to invest in securities will be punished. A similar provision can be found in the legislation of some developed jurisdictions in imposing criminal liability on wrongdoers in the IPO market.[29] Nonetheless, it is argued that certainty about the persons who are liable for a contravention of the law generally works better than any ambiguity or uncertainty in respect of the identification of the potential accused. Moreover, the enforcement of section 147 of the CA'94 will be more convenient for both the judiciary as well as the prosecutors inexperienced in dealing with securities cases in Bangladesh, if the potentially liable persons are categorically mentioned in the section. However, an illustrative list of those persons is more advisable than the exhaustive one, so that unlisted persons, if any, involved in an inducement in question can be included as accused in dealing with a given case.

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by reference to fluctuation in the value of shares or …;shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifteen thousand taka or with both'.

29. See, for example, Securities Act 1933 (US) S.24; Corporations Act 2001 (Australia) Parts 6D.3 and 6D.4.

IX Penalties for fraudulently inducing others to invest in securities

In Bangladesh, a person may be punished with imprisonment for a term which may extend to five years or with a fine which may extend to 15,000 taka (approximately US$263) or with both under section 147 of the CA'94. The amount of the fine seems to be very low.

Section 147 of the CA'94 seems to be a true copy of its Indian equivalent, section 68 of the CA'56 except for the recent amendment to the amount of fine therein. Section 68 has been amended in 2000 and the maximum fine has been increased from Rs. 10,000 (approximately US$207) to Rs. 0.10 million (approximately US$2,070).[30] However, the term of imprisonment has not been enhanced, and at present, is exactly the same as in Bangladesh.

The CA'65 of Malaysia does not contain any provision which is similar to the above section. However, in this respect, section 86 of the Securities Industries Act 1983 (SIA'83) prohibits the inducement of any person to sell or purchase securities knowingly and recklessly by false or misleading statement. Section 86 of the SIA'83 of Malaysia seems to be the equivalent of section 147 of the CA'94 and section 68 of the CA'56 in Bangladesh and India, respectively. Section 88B of the SIA'83 provides for a penalty for the contravention of section 86. Unlike its equivalent in Bangladesh, section 88B of the SIA'83 prescribes concurrent penalties of fine and imprisonment leaving no option for the court to choose one or the other. The penalty may extend to a fine of not less than one million ringgit (US$263,296) and to imprisonment for a term not exceeding 10 years. The distinctiveness of the provisions is evident from the minimum threshold of the fine and the maximum limit of imprisonment. The SIA'83 fixes the minimum fine in Malaysia and leaves the discretion of determining the maximum amount of fine with the court. Conversely, the CA'94 of Bangladesh limits the maximum amount of fine and empowers the court to determine the minimum fine.

The penalties for fraudulently inducing persons to invest in securities in the three jurisdictions stated above demonstrate that the Bangladesh law provides for the lowest penalty in terms of both imprisonment and fine for the same offence. The term of imprisonment in Bangladesh is just half of that in Malaysia and the maximum amount of fine is negligible as compared with those in other two countries.[31] The law of Malaysia is

30. Companies (Amendment) Act 2000, s.25.

31. The maximum amount of fine in India is nearly 8 times higher than that in Bangladesh. In Malaysia, the minimum amount of this fine is 979 times higher than that in Bangladesh. Moreover, in Bangladesh, the courts may choose either imprisonment or fine or both, but the courts in Malaysia do not have such a discretion: Securities Industries Act 1983 S.88B.

significantly stringent being needed to protect the investors in the IPO market. But in Bangladesh, the provision of penalising the accused with any minimum amount of fines without imprisonment should not reasonably have any deterrent effect on the wrongdoers. In addition, the discretion of judges to choose either an insignificant term of imprisonment or negligible amount of penalty may have some frustrating implications on the prosecutors as well as on the investors.[32] Such discretion of judges is not conducive to investor protection as alluded to earlier in respect of section146 of the CA'94.

In addition to the above weaknesses of section 147 of the CA'94, there is an uncertainty about the onus of proof. No judicial interpretation regarding this uncertainty is available in Bangladesh owing to a dearth of prosecution under section147 of the CA'94, although there have been many allegations for fraudulent inducement in respect of public issues.[33] Neither of the identical provisions of section 147 of the CA'94 and section 68 of the CA'56 (in Bangladesh and India respectively) explicitly imposes the burden of proof on anyone. In this regard, the Rajasthan High Court in India in *Dahanukar* v. *Khaitan*[34] observed that the onus of proof lies on the investors who have been induced by the statement in question under section 68. The court held that the complaint could not be admitted, as it was not proved that the investment decision of the plaintiff was caused by any fraudulent inducement.

In the absence of judicial interpretation by the courts in Bangladesh, the participants in IPO coalitions may have regard to the judicial observations of the Indian courts. Pursuant to the *Dahanukar* decision, the accused persons will be in an advantageous position since the onus of proof is vested in the victims. The onus of proof, thus, ultimately goes against the spirit of the protection of investors. From that point of view, the liability and remedy provided in section147 of the CA'94 have not been an effective recourse to protect investors from the fraudulent inducement for subscribing to, or underwriting of, IPOs in Bangladesh.

X Defences against penalties for fraudulently inducing others to invest in securities

There is no statutory defence as such under section 147 of the CA'94. However, the terms 'unknowingly' and 'recklessly' as envisioned in the section in connection with disclosures imply that the defendants

32. Such an implication is, for example, the prosecutors and the victims of the contravention of the law may feel discouraged to take the offenders to the courts.

33. *Supra* note 1.

34. (1996) Cr LJ 1569 Raj at 1575-76.

under this section have two defences. These include ignorance defence and due diligence defence. In addition, 'honesty' may be a defence with regard to omission to disclose any information in the prospectus, because, only 'dishonest concealment' has been made an offence under the section. The Indian equivalent of section147, namely, section 68 of the CA'56, provides for exactly the same defences. In Malaysia, although the wording of section 87 of the SIA'83 is little different from that in the Bangladesh and Indian legislation, the defences are similar.[35] Thus, all the three jurisdictions provide for the same three defences for the act of fraudulently inducing persons to invest in securities.

None of the terms, 'unknowingly', 'recklessly' and 'dishonestly' have been defined in any of the above three statutes.[36] Therefore, the meanings of those terms have to be understood from their ordinary meanings as well as from judicial interpretations.

The Central Criminal Court in *R* v. *Bates*[37] in a similar context held that the word 'recklessness' should be understood in its ordinary meaning and to prove guilt, the word should not be restricted to involving dishonesty. In this case, the court further explained that '[t]he ordinary meaning of the word reckless in the English language is careless, heedless, inattentive to duty'.[38] In the present context, the House of Lords in the celebrated case *Derry* v. *Peek*[39] expressed the view that the term 'recklessness' refers to 'carelessness' regardless of the truth or falsity of the impugned statement. In this respect, Cotton LJ in *Derry* v. *Peek* strongly held that '… a man who makes a statement without care and regard for its truth or falsity commits a fraud'.[40] The Australian court observed that recklessness is something that is less than 'intent' but more than 'mere negligence'.[41]

The above case law implies that a person cannot be punished under section147 of the CA'94 unless he or she is careless in inducing or attempting to induce another person to invest in securities. Actually, the term 'recklessness' is a complex word and half a century ago, the court in *R* v. *Bates* pronounced that ' [r]eck is simply an old English word, now, perhaps, obsolete, meaning heed, concern, or care'.[42] Further, in *R* v. *Mackinnon*, [43] it was held that '…the word "reckless" is capable of

35. See Securities Industries Act 1983 Malaysia S.87(1)(a)-(c).

36. Companies Act 1994 (Bangladesh), Companies Act 1956 (India) and Securities Industry Act 1983 (Malaysia).

37. [1952] 2 All ER 842 at 845.

38. *Ibid.*

39. (1889) 14 App Cas 337 at 350.

40. *Ibid*.

41. See *R* v. *Crabbe,* (1985) 156 CLR 464 & *R* v. *Nuri,* [1990] VR 641.

42. [1952] 1 All ER 842 at 845.

43. [1959] 1 QB 150 at para 7 (per Salmon J).

either of two rival meanings for which the Crown and the defence respectively contend'. In view of such conflict, Salmon J said that 'I know of no canon of construction that compels the court to adopt the wider of the two meanings merely because it is the wider'.[44]

From the interpretation of the term 'knowingly' as provided by Cockburn CJ in *Twycross* v. *Grant*[45] with regard to the issue of a prospectus, it means 'neither more or nor less' than making a statement in a prospectus 'with a knowledge of the existence of contract' and 'the intentional omission of them from the prospectus'. It clearly refers to the exact knowledge of the impugned statement of the person who was involved in the inducement complained of under section147 of the CA'94. By confirming the penalty awarded by the trial court, the chancery division in *Tait* v. *Macleay*[46] held that the defendant should have tried to know the fact before making the statements in the prospectus, but he did no inquiries for which judgment in appeal should be affirmed. The ignorance defence is therefore subject to reasonable inquiry.

The term 'dishonesty' is commonly 'associated with lying, stealing or cheating'.[47] In other words, 'dishonesty' implies a deliberate choice to flout a known law.[48] In respect of a prospectus, in a context similar to section147 of the CA'94 the court held that: [49]

> If the omission is dishonest, it can only be dishonest because the person who makes it known that what he [or she] has said is false, misleading or deceptive by reason of the omission.

A relation between personal care and honesty is found in *Derry* v. *Peek*[50] in which the court strongly suggests that a statement made not caring whether it be true or false is a dishonest or fraudulent statement as distinct from one which is made with an honest belief in its truth.

The defence of honesty is thus a subjective test. This test involves individuals' awareness of the law and related facts embodied in a statement included in a prospectus, and awareness that the impugned conduct will contravene that law.[51] The court in *R* v. *Mackinnon*[52] indirectly conceded the difficulty of proving the non-existence of an honest belief in a forecast of company business (in a prospectus).

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44. *Ibid.*
45. [1877] 2 CPD 469 at 542.
46. [1904] 2 Ch 631 at 642.
47. A.R. White, *Misleading Cases* 74(1991).
48. J. Blanchard, "Honesty in Corporation" (1996) 14 *Company and Securities Law Journal* 4.
49. *Supra* note 43 at para 11 (per Salmon J).
50. *Supra* note 39.
51. *Supra* note 48.
52. [1959] 1 QB 150.

Therefore, the subjective test of ignorance of an accused person would preclude criminal liability, and the restriction on the liability is unacceptable in criminal law. For example Bowen L J in *Hutton* v. *West Cork Railway Co* held that: [53]

> *Bona fides* cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly *bonâ fide* yet perfectly irrational.

In terms of implementation, the above 'concepts are complex'.[54] For the sake of clarity and smooth enforcement, legal provisions should be drafted in simple language.[55] Over the decades, the momentum of plain language is bearing its principles into the affairs of corporate investments worldwide.[56] The demand for plain language in corporate functioning is now regarded as law.[57] In dealing with the language similar to section147 of the CA'94 which involved inducement to invest in securities, it was observed that '…the courts are now slow to construe a statute as creating a criminal offence unless the statute does so in the plainest terms'.[58] Because of the complexities and terms like- recklessly, knowingly, dishonestly, the prosecution failed to establish the case for inducement to invest in securities.[59]

None of the above terms, 'recklessness', 'unknowingly' and 'dishonestly' exits in the relevant laws of many developed countries.[60] As is evident from the above discussion on the 'recklessness', 'unknowingly' and 'dishonestly' a common 'reasonable' inquiry is required before there can be a reliance on such defences. At the same time, a clear and simple language in corporate law has to be ensured. All the above three defences may be substituted by a single 'due diligence' defence.

In a legal sense, the expression 'due diligence' means 'close examination… of a transaction and its related documentation'.[61] In

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53. (1883) 23 Ch D 654 at 671.

54. *Supra* note 48 at 13.

55. See generally, M.M. Asprey, *Plain Language for Lawyers* (1996).

56. A.T. Serafin, "Kicking the Language Habit: The SEC's 'Plain English Disclosure' Proposal" (1998) 29 *Loyola University Chicago Law Journal* 681 at 717.

57. See M.G. Byers, "Eschew Obfuscation-The Merits of the SEC's Plain English Doctrine" (2000) 31 *University of Memphis Law Review* 135 at 173.

58. *R* v. *Mackinnon,* [1959] 1 QB 150 at para 7(Salmon J).

59. See for example, *R* v. *Mackinnon, ibid*.

60. See, for example, Securities Act 1933 (US) S.24; Securities Act 1990 (Ontario) Ss.122-29.

61. P. E. Nygh & P. Butt (eds), *Butterworths Australian Legal Dictionary* 393 (1997).

Universal Telecasters (Qld) Ltd v. *Guthrie*, [62] it was held that 'due diligence' refers to a minimum standard of behaviour which is used to defend oneself against the violation of regulatory or supervisory provisions so as to ensure that the particular system was properly carried out. In *Martin* v. *Hull*,[63] the court observed that the ignorance of a defendant is no defence under the prospectus liability and that some degree of competence in the performance of due diligence is expected.

In keeping with judicial observation to prevent any misuse of the due diligence defence in Bangladesh, mere personal belief may not be sufficient to establish the due diligence defence. In this respect, the court in *SPCC* v. *Kelly*[64] held that general precautions are unlikely to be sufficient to establish this defence; rather the defendants must show that their minds concentrated on the potential risks associated with the transaction. The persons who seek the due diligence defence 'must always conduct the due diligence investigation in person'.[65]

There are some countries especially the developed countries like the US and Australia which have clearly established the requirement of reasonable enquiries about the statements included in the prospectus.[66] It is broadly recognised that financial transactions in those countries are much more transparent than those in Bangladesh.[67] Despite this fact, reasonable inquiries by the defendants are required for this defence under the laws of those countries, even if they rely on experts, public documents or opinions of respective public officers.

The application of the due diligence defence in accordance with the qualifications as stated above will satisfy the requirement of 'exercising reasonable care'[68] and avoid the complexities or obsoleteness of the above three terms as encapsulated in section147 of the CA'94. It can be

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62. (1978) 18 ALR 531; 32 FLR 360.

63. 92 F 2d 208 (1937) at 210.

64. (1991) 5 ACSR 607 at 608-09.

65. See J. R. Lovejoy, "Initial Public Offerings: The Due Diligence Process and Blue Sky Problems"(1981) 13 *Annual Institute on Securities Regulation* 369 at 371.

66. See Securities Act, 1933 (US) S.11(3)(A)-(B), Corporations Act, 2001(Cth) S.731 in Australia. Although these provisions are concerned with prospectus civil liability, the due diligence standard may be applied to criminal liability as well.

67. In terms of transparency in the activities of, amongst others, business people the scores/points of the United Kingdom, Australia, United States, and Bangladesh were 8.7, 8.6,7.7 and 1.2 out of 10 respectively: Transparency International, "Corruption Perception Index 2002" Berlin, (Aug 2002) *available at* http:// www.transparency.org/cpi/2002/cpi2002.en.html (30 Aug 2002). Those points in 2004 are 8.6, 8.8, 7.5 and 1.5 respectively: Transparency International, "Corruption Perception Index 2004" Berlin, (20 Oct2004) *available at* http://www.transparency. org/pressreleases_archive/2004/2004.10.20.cpi.n.html (30 Dec 2004).

68. *Supra* note 48 at 6.

seen that section147 of the CA'94 as it stands is ambiguous and complex in respect of defences. An ambiguity in law is regarded as an impediment to investor protection.

In addition to the CA'94 as stated above, the Public Issue Rules (PIR'98) contain a penalty provision. Rule 19 of the PIR'98 imposes liability on the issuers and their representatives for furnishing 'false, incorrect, misleading information or suppressing any information' required thereunder.[69]

XI Persons liable under the Public Issue Rule 1998

Although rule 19 of the PIR'98 imposes liability on the 'issuer' of securities and 'its representative', it defines neither of the terms. Moreover, it does not only omit to define these terms, it also fails to adopt their definitions from other law(s) in force.

In contradiction to other legislation discussed so far in this endeavour, rule 19 of the PIR'98 imposes liability on the issuer. Although an explanation of issuer's liability can be found in the Securities and Exchange Ordinance 1969 (SEO'69), the expression 'its representative' (issuer's representative) has not been defined in any of the above laws pertinent to the issuance of securities in Bangladesh. Thus, rule 19 of the PIR'98 is also unclear and suffers from ambiguities in the identification of persons who are liable under this rule for putting out a defective prospectus. The omission of incorporating the definitions of those two terms is regarded as a vital flaw of the PIR'98. A rule cannot be implemented if its applicability remains at best uncertain.

Rule 19 of the PIR'98 refers to the SEO'69 only for the description of penalties that can be imposed by the Securities and Exchange Commission (SEC) under the PIR'98. Presumably, the definition of the term 'issuer' as provided in the SEO'69 should be applicable to impose penalties under rule 19 of the PIR'98. According to section 2(g) of the SEO'69 an 'issuer' is 'any person who has issued or proposes to issue any security'. Under section 2(j) of the SEO'69, a person includes, amongst others, an individual, a company and every other juridical person. From the above description of 'issuers' and 'persons' the term 'issuer' as used in rule 19 of the PIR'98 embraces both individuals and companies that issue securities. As will be discussed later in this paper, section 24 of the SEO'69 will be applied to impose penalties mentioned

69. Rule 19 of the Public Issue Rules 1998 is as follows: 'Penalty - If any issuer or its representative violates any of the provisions of this rule or furnishes false, incorrect, misleading information or suppresses any information, the Securities and Exchange Commission may impose penalty as prescribed under the Securities and Exchange Ordinance 1969'.

in rule 19 of the PIR'98. Section 24(2) of the SEO'69 states that if an issuer is found guilty, then every director, manager or other officer responsible for the conduct of the affairs of the issuer shall be deemed to be guilty unless he or she proves that the offence was committed without his or her knowledge or that he or she exercised all diligence to prevent its commission. The section, thus, imposes liability on directors, managers or other officers of the issuer, but it does not impose any liability on any professionals or intermediaries like auditors, underwriters, lawyers and issue managers. It means that PIR'98 in conjunction with the SEO'69, imposes liability only on the management and the officials of the company. It also implies that the liability is not strict, but is subject to some defences which will be addressed later in this article.

The Indian securities law dealing with the criminal liability for disclosures in a prospectus is different. Section 15A of the Securities and Exchange Board of India 1992 Act (SEBIA'92) imposes penalty on any person who is required under the securities laws to furnish any document, return or report to the Securities and Exchange Board of India (SEBI).[70] A company is required to submit its prospectus to the SEBI for its consent before making any public offer of securities. Therefore, any person as mentioned in the above section 15A may refer to the company and its representative.

The Securities Commission (SC) of Malaysia promulgated the Policies and Guidelines on Issue/Offer of Securities 1999 (Guidelines'99) as guidelines for the issuance of securities. Chapter 6 of the Guidelines'99 deals with the corporate disclosure policy for a public issue.[71] Section 55 of the Securities Commission Act,1993 (SCA'93) imposes criminal liability for a defective prospectus in Malaysia. The section provides that '[n]o person shall authorise or cause the issue of a prospectus' with a false or misleading statement or material omission in its contents. Section 55 does not specify the persons who shall be deemed to have 'authorised or caused the issue of the prospectus'. The absence of the explanation of the expression 'authorised or caused the issue of a prospectus' in the Malaysian law brought about ambiguity in relation to the identification of persons liable for offence under section 55 of the SCA'93 as has been discussed earlier.

A clear identification of persons who are liable for a particular violation of the law is always crucial for the facilitation of the remedy

70. Details of s.5A of the SEBI'92 as well as criminal liability under the securities law will be provided later in this article

71. In brief, similar to Bangladesh and India, a public company in Malaysia is required to make full disclosure of the affairs of the issuer and the issue. See *Policies and Guidelines on Issue/Offer of Securities 1999* guideline 6.01. S.44 and 46 of the Securities Commission Act , 993 (SCA'93) stipulate the information that needs to be included in a prospectus.

of that wrong. The prevalence of the inexperienced judiciary in adjudicating securities cases and the lack of experience of the regulator in dealing with securities malpractice are additional factors that provoke soliciting for clear laws in Bangladesh.[72] The clarity of the law appears to be more important for the market for IPOs, where public confidence in the operation of the market is essential. Any legal ambiguity or vagueness creates confusion amongst the public. In regard to criminal liability, any scope for doubt protects the offenders at the expense of the legitimate interests of investors.[73]

XII Penalties for defective prospectuses under the securities law

As has been mentioned above, the PIR'98 does not provide any description of the penalties. Instead, its rule 19 states that the SEC may impose a penalty as prescribed under the SEO'69 for the contravention of any of the provisions of the PIR'98. As regards the disclosure requirements, only the disclosure of 'false, incorrect, misleading information or suppression of any information' has been identified as offences under rule 19. The SEO'69 provides for penalties for some of the above mentioned wrongs (discussed below). In addition to these, the SEO'69 makes fraudulent or deceptive inducements in relation to securities trading punishable,[74] but the PIR'98 does not prohibit such conduct. The mentioned exemption from penalty under the PIR'98 has implications for investors in IPOs and appears to be another shortcoming that exists in the PIR'98.[75]

The SEO'69 does not directly refer to the penalty for the violation of the PIR'98. However, the SEO'69 contains two sections (ss. 22 and 24) with regard to the penalties for the violation of securities laws, but neither of the two sections directly relates to the disclosures in a prospectus. Section 22[76] seems to be applicable to the regulation of the

72. The Securities and Exchange Commission (SEC) of Bangladesh is made up of some high profile bureaucrats and university academics. None of them was involved in the activities of the securities market.

73. The offenders get advantage pursuant to the general principle of criminal law that the benefit of doubt goes in favour of the accused

74. Securities and Exchange Commission, 1969 S.17(d).

75. The PIR'98 provides for administrative penalties, whilst the CA'94 refers to judicial remedies. Therefore, they both are in place as complementary to each other.

76. 'Penalty for certain refusal or failure*:* - (1) If any person-(a) refuses or fails to furnish any document, paper or information which is required to furnish by or under this Ordinance; or (b) refuses or fails to comply with any order or direction of the Commission made or issued under this Ordinance; or (c) contravenes or otherwise fails to comply with the provisions of this Ordinance; the Commission may, if it is

secondary market. If any person is penalised under this section, no prosecution can be lodged for the same offence committed against the SEO'69. Section 24 provides for penalties for the contravention of section17 of the SEO'69.

Section 17 basically prohibits fraudulent and some ancillary acts in relation to the sale or purchase of securities. Of these, only the disclosure of untrue statement[77] and suppression of fact[78] fall into the previously mentioned exhaustive description of offences provided in rule 19 of the PIR'98. On the other hand, the disclosure of misleading information has not been listed in section17, although it has been prohibited under rule 19 of the PIR'98.

Therefore, only the disclosure of untrue statement and non-disclosure of known facts regardless of their materiality are punishable under rule 19 of the PIR'98 in conjunction with section17 of the SEO'69. For these two offences, a person may be punished with imprisonment which may extend to five years or with a fine which shall not be less than 0.50 million taka (approximately US$8,772) or with both.[79]

The penalty provisions under the securities law in India are different from those in Bangladesh. Chapter VI of Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000 (SEBI Guidelines 2000) sets out the contents of prospectuses.[80] The SEBI Guidelines 2000 does not include any penalty provision for the violation

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satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such sum no exceeding ten thousand rupees as may be specified in the order and, in the case of a continuing default, a further sum calculated at the rate of one thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues'. The word 'Commission' has been substituted for 'Central Government' in 1993 under s.2 of the *Securities and Exchange (Amendment) Act*1993.Penalties have been increased in 2000 by substituting 'not less than 0.10 million taka' for 'not exceeding 0.10 million taka'. The previous maximum fine 0.10 million taka was fixed under s.8 of the Securities and Exchange (Amendment) Act 1993.

77. Securities and Exchange Ordinance 1969 S.17(b).

78. Securities and Exchange Ordinance 1969 S.17 (c).

79. The penalty was increased from three years' imprisonment to five years and a fine from 10 thousand rupees to 0.50 million taka in 2000 under s.9 of the Securities and Exchange Act 1993. Rupee is the currency of Pakistan and the SEO'69 was promulgated by the then President of Pakistan when Bangladesh was the eastern province of the federal Pakistan. It was amended again under s.6 of the Securities and Exchange (Amendment) Act 2000 which provides that the fine shall not be less than 0.50 million taka.

80, Chapter VI of the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000 provides contents for offer documents. In respect of a public issue, an offer document means prospectus: Guideline 1.2(xx).

of prospectus requirements. However, the penalty for any violation of disclosure requirements has been provided in section15A of the Securities and Exchange Board of India Act 1992 (SEBIA'92).[81] Section 15A of the SEBIA'92 provides that:

> If any person, who is required under this Act or any rules or regulations made hereunder,-(a) to furnish any document, return or report to the Board [Securities and Exchange Board of India], fails to furnish the same, he[or she] shall be liable to a penalty not exceeding one lakh and fifty thousand rupees [0.15 million rupees/approximately 3,108 US dollar] for each such failure.

The SEBI Guidelines 2000 has been issued by the SEBI itself under the authority of section 11 of the SEBIA'92.[82] The above penal provisions are therefore applicable to penalise the violators of the disclosure requirements under the SEBI Guidelines 2000.[83]

In Malaysia, section 55(3) of the SCA'93 seems to be the equivalent of the above-mentioned provisions of Bangladesh and India.[84] Penalties for the contravention of prohibitions as set forth in section 55(3) are fines not exceeding 3 million ringgit or imprisonment for a term not exceeding 10 years or both.[85]

As has been seen in respect of penalties under company law, the penalty under the PIR'98 in conjunction with the SEO'69 in Bangladesh is also very low as compared with that of Malaysia.[86] However, the actual penalty greatly depends on the honesty and dignity of the court having wide discretion in this regard.

XIII Defences against criminal liability for defective prospectuses under the securities law

Rule 19 of the PIR'98 does not mention any defence against offences

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81. S. 15A of the SEBIA'93 has been inserted by Securities Laws (Amendment) Act 1995.

82. Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000 Guideline 1.

83. This applicability is understood on the basis of the fact that companies willing to go public are required to submit their prospectuses to the SEBI for its consent before the issuance of their prospectuses as has been mentioned earlier.

84. S. 55 of the Securities Commission Act 1993 has created criminal liability for a defective prospectus.

85. Securities Commission Act 1993 S.55 (3).

86. In Bangladesh, the maximum term of imprisonment for issuing a defective prospectus is five years, but is 10 years in Malaysia. Courts have been given discretion in both jurisdictions to fix the pecuniary penalties depending on the merits of each case. In Bangladesh, the penalty is not less than 0.50 million taka (approximately US$8,772), and in Malaysia it should not exceed 3 million ringgit (approximately US$789,785).

concerning disclosures in a prospectus. However, two clear defences are available in section 24(2) of the SEO'98. Those defences are: commission of the offence without the knowledge of the accused, and exercising all diligence to prevent the commission of the offence. Simply, the defences are 'ignorance' and 'due diligence'. The chancery division in *Broome* v. *Speak*[87] held that ignorance of the law can never be pleaded as a defence and knowledge always refers to the knowledge of the facts. In *Tait* v. *Macleay*[88] it was said that in respect of a company prospectus that the defendants need to conduct inquiries before they include any information in a prospectus. The chancery division in *Watts* v. *Bucknall* observed that without further inquiry about the facts included in the prospectus, the defendant cannot claim the ignorance defence and here (without inquiry) the defendant is said to have prepared the prospectus with knowledge of the facts.[89] In *Tait* v. *Macleay*, the English Court of Appeal held that a person cannot properly claim ignorance of a fact to which he or she has not directed his or her attention.[90] The above judicial observations imply that ignorance defence cannot be relied upon without reasonable care. This defence has thus become a part of the due diligence defence in practice.

In India, section 15A of the SEBIA'92 provides for a penalty for the contravention of, *inter alia*, the disclosure requirements in a prospectus as alluded to earlier. The section offers no defences in respect of disclosures.[91]

In Malaysia, the criminal liability for disclosures as set forth in section 55 of the Securities Commission Act 1993 (SCA'93) is subject to the three standard defences. These defences are: withdrawal of consent (s.63) due diligence (s.59), expertisation (s.60), but not ignorance.

The foregoing demonstrates that the 'ignorance defence' is available only in Bangladesh. The impact of that defence greatly depends on the honesty of the defendants and the way the courts deal with the pleading of ignorance by the defendants.[92] If the courts allow the defendants to rely on the ignorance defence only after proving due care, such a defence can be used in respect of criminal liability. It is submitted that in Bangladesh, the requirement of reasonable care should be placed in the statute so that the non-availability of case law would not imply that

87. [1903] 1 Ch 586 at 613-14.

88. [1904] 2 Ch 631 at para 2 (per Cozens-Hardy LJ).

89. [1902] 2 Ch 628 at para 3(per Byrne J).

90. *Supra* note 88.

91. For details, see the text of s.15A of the SEBIA'92.

92 The honesty and dignity of the courts in dealing with such ignorance defense have been emphasized.

there is no necessity for such a requirement.[93]

XIV Criminal liability of professionals and intermediaries for defective prospectuses

As can be seen from the above discussion, the laws of Bangladesh creating criminal liability for a defective prospectus are unclear about the identification of persons on whom criminal liability is imposed. The provisions of company law and securities laws impose liability on 'every person who authorised the issue of the prospectus' and on 'the issuer or its representative' respectively without defining these imprecise expressions. However, the criminal liability of directors and promoters is certain in view of judicial interpretations referred to earlier.[94] Thus ambiguities exist in respect of the liability of other members of an IPO coalition.

In Australia, to provide for criminal liability for a defective prospectus, the expression 'authorise or cause the issue' was used in section 996 of the Corporations Act 1989 (Cth). Taking the ambiguity of the meaning of this expression into account, the prospectus law reforms sub-committee of the companies and the securities advisory committee recommended specific mentions of the persons who are criminally liable for a defective prospectus.[95] Section 996 was repealed in the 2000 legislation and the expression 'authorise or cause the issue' has been dropped in the relevant present provisions in the Corporation Act 2001.[96] Likewise, the Securities Act 1933 of the United Sates (US) has deleted a similar expression because of its ambiguity.[97]

In support of the imposition of criminal liability on the persons involved in the preparation of a prospectus, it has been said that '[i]n the interest of effective deterrence and fairness, … a parallel set of criminal sanctions against individuals, including jail sentences, should remain as a supplement to the set of civil fines'.[98]

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93. The reasons for such apprehension are that both the bar and bench are inexperienced in dealing with securities cases and the judiciary significantly relies on the case law of the Indian sub-continent. It would be very hard to find case law in relation to the above references in the sub-continent.

94. See *Adams* v. *Thrift,* [1915] 2 Ch 21; *Henderson* v. *Lacon,* [1867 L R 5 Eq 249; *Barrow* v. *De Garis,* (1926) 29 WALR 4; *Flavel* v. *Giorgio,* (1990) 2 ACSR 568; *Stewart* v. *Montgomery,* (1967) 116 CLR 220.

95. *Companies and Securities Advisory Committee Prospectus Law Reforms Sub-Committee Report,* Canberra, (March 1992) para 229.

96. The provisions of the Corporations Act 2001 concerning prospectus liability will be discussed later in this section.

97. See M P Dooley, "The Effects of Civil Liability on Investment Banking and the New Issue Market" (1972) 58 *Virginia Law Review* 776 at 793.

98. "Developments in the Law - Corporate Crime" *supra* note 11 at 1374.

Under the disclosure-based regulation (DBR) the members of the IPO coalition are required to meet in preparing disclosures in a prospectus.[99] This requirement implies the regulatory objective that the participants not only compile but also verify the disclosure materials.[100] The standard of corporate disclosure for IPOs will not be raised adequately unless the participants in that process have effective incentive to disclose the required information. From that point of view, it has been argued that all major participants should face penalties for the non-compliance with the disclosure requirements.[101]

Laws governing prospectus criminal liabilities appear to be flawed in one way or the other in all of the three jurisdictions, Bangladesh, India and Malaysia. A critical lack of either judicial activism or scope of judicial interpretation of those provisions owing to the paucity of litigation helps the wrongdoers escape liability. But the case is different in developed jurisdictions. For example, the US and Australia do not specifically mention by any name who should be held criminally liable for a defective prospectus. Instead, the Securities Act 1933 (US) and the Corporations Act 2001 (Australia) impose criminal liability on every person who is involved in the violation of disclosure requirements.[102] These two Acts have used two different terms which are 'any person'[103] and 'a person'[104]. The expression 'any person' or 'a person' seems to be much wider in ambit than 'who authorised the issue of prospectus' as used in section146 of the CA'94 in Bangladesh.[105] This is because, the expression 'any person' or 'a person' emphasises the involvement or participation of a person in the preparation of the disclosure documents, whereas the term 'who authorised the issue of the prospectus' underscores the involvement in the authorisation of the prospectus. Due to a lack of statutory as well as judicial exposition of the latter expression, the imposition of liability has become uncertain. On the other hand, criminal liability under rule 19 of the PIR'98 has been confined to only the issuer and its representative.

In respect of criminal liability for dealing with securities, the US courts took the issue of involvement in the preparation of a prospectus

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99. N L Wong, "Easing Down the Merit-Disclosure Continuum: A Case Study of Malaysia and Taiwan" (1996) 28 *Law and Policy in International Business* 49 at 85.

100. *Ibid*.

101. *Id.* at 119.

102. See Securities Act, 1933(US) S.24 & Corporations Act, 2001 Ss.726-36.

103. This term has been used in s.24 of the Securities Act, 1933 (US).

104. The expression ' a person' has been used in ss.726-36 of the Corporations Act, 2001 (Australia).

105. S. 146 of the CA'94 provides penalty for untrue statement in a prospectus.

into account as a crucial consideration.[106] For example, in the US Court of Appeal for the Ninth Circuit underscored the need for participation in the alleged offence in order to establish a *prima facie* case against the accused.[107] A similar view was taken in *Christoffel* v. *Hutton & Company*.[108] It is a recognised fact that the underwriters, issue managers, auditors and lawyers are very much involved in the preparation of a prospectus. It is said that civil liability of these persons 'supplemented with criminal enforcement is probably the superior rule'.[109] What this means is that the above mentioned persons involved in the preparation of a prospectus should also be liable criminally. However, the issuers' liability is strict having no defence, but the above-mentioned persons have a defence to act in good faith, i.e., the violation in question was not 'wilful'. In construing the term 'wilful' in the present context,[110] the court in *United States* v. *Schwartz*[111] said that a violation is wilful even if there is no 'bad purpose' or no 'specific intent to violate the law'. In a similar context, the court of appeals of Arizona in *State* v. *Tarzian* construed the term 'wilfully' by saying that: [112]

> [W]hen applied to the intent with which an act is done or omitted, implies simply a purpose or willingness to commit the act, or make the omission referred to. It does not require any intent to violate law, or injure another or to acquire any advantage.

The requirement for 'wilful violation' had been omitted in 1998 from the Securities Act of Arizona 1951 although the requirement still persists in the Securities Act 1933 (the US federal law). Thus, the criminal liability has been made strict without any defence in Arizona since 1998 providing better protection to the investors. The rationale for the criminal liability of the professionals and intermediaries is further amplified from the following judicial pronouncements.

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106. N C Staudt, '"Controlling" Securities Fraud: Proposed Liability Standards for Controlling Persons under the 1993 and 1994 Securities Acts' (1988) 72 *Minnesota Law Review* 930 at 941.

107. *Kersh* v. *General Council of the Assemblies of God*, 804 F 2d 546 (1986) at 449.

108. 588 F 2d 665 (1978) at 668.

109. J. H. Arlen & W.J. Carney, "Vicarious Liability for Fraud on Securities Markets: Theory and Evidence" (1992) 1992 *University of Illinois Law Review* 691 at 695.

110. Court interpreted the term 'wilfully' under s.32 (a) of the Securities Exchange Act 1934 (US) and *criminal liability provisions are analogous to s.24 of the Securities Act 1933 (US).*

111. 464 F 2d 499 (1972) at 509-10. Cert. Denied 409 US 1009 (1972).

112. 665 P 2d 582 (1983) at 585.

In respect of lawyers, it was said in *Mercer* v. *Jaffee*[113] that a lawyer is a primary participant in the offering of corporate securities. In *SEC* v. *Spectrum Ltd*[114] Irving R Kaufman CJ in considering the liability of lawyers observed that:

> The securities laws provide a myriad of safeguards designed to protect the interests of the investing public. Effective implementation of these safeguards, however, depends in large measure on the members of the bar who serve in an advisory capacity to those engaged in securities transactions.

It was further stated that 'the legal profession plays a unique and pivotal role in the effective implementation of the securities laws'. The smooth functioning of those laws will be seriously interrupted if the public cannot trust in the expertise proffered by the attorneys when they render opinions in relation to the compliance with securities laws.[115]

The most influential judicial decision on the liability of lawyers was made perhaps in *Escott* v. *BarChris Construction Corp*[116] in which the US District Court for the Southern District of New York pointed out that a lawyer is obliged to make reasonable investigation about the information included in the prospectus. The court went on to say that the failure of such investigations exposed lawyers to liability because they hold the 'unique position' for assuring the accuracy of the disclosures. In *United States* v. *Benjamin*,[117] the US Court of Appeal Second Circuit rejected the defence of ignorance claimed by the lawyer involved in the offering process of securities. The US District Court for the District of Oregon in *Blakely* v. *Lisac*[118] made an attorney liable for drafting the prospectus and other disclosure documents that contained misleading financial information. In that case it was also said that the attorney should have investigated the truth of the information set forth in the prospectus.[119] In another case the US Court of Appeal for the Second Circuit clearly concluded that lawyers preparing disclosure documents for securities offerings owe 'a duty of disclosure to investors'.[120] Another court imposed primary liability on the lawyers for false and misleading information in the securities offering document and suggested that a lawyer who prepares a misleading disclosure document is a primary participant in the offering of securities by a

113. 713 F Supp 1019 (1989) at 1025.
114 489 F 2d 535 (1973) at 536.
115. *SEC* v. *Spectrum Ltd,* 489 F 2d 535 (1973) at 541-42.
116. 283 F Supp 643 (1968) at 690,692.
117. 328 F 2d 854 (1964) at 856.
118. 357 F Supp 255 (1972) at 266.
119. *Ibid*.
120. *Breard* v. *Sachnoff & Weaver Ltd.,* 941 F 2d 142 (1991) at 143.

company.[121]

The US Securities and Exchange Commission (SEC) emphasised several times that the task of enforcing the securities laws overwhelmingly rests on the lawyers.[122] The SEC further added that when a lawyer has a significant role in fulfilling the disclosure requirements and the issuer fails to provide adequate information, then the lawyers' continued involvement in the preparation of the prospectus constitutes 'unethical or improper professional conduct'.[123] The US Court of Appeal for the Second Circuit in *SEC* v. *Frank* rejected the lawyer's claim-'I am only a scrivener'- by stating that: [124]

> A lawyer has no privilege to assist in circulating a statement with regard to securities which he [or she] knows to be false simply because his [or her] client has furnished it to him…. [A] lawyer, no more than others, can escape liability from fraud by closing his [or her] eyes to what he [or she] saw and could readily understand.

The above case law vividly establishes the criminal liability of lawyers in respect of a defective prospectus.

As regards accountants, the Court of Appeal of Arizona in *State* v. *Tarzian* [125] affirmed the criminal conviction of the accountant who audited the accounts of the company for filing misleading information with the securities regulator. Emphasising the investigation by the accountants, the US Court of Appeals Second Circuit in *United States* v. *Benjamin*, observed that the certificates of accountants in relation to corporate disclosures 'can be instruments for inflicting pecuniary loss' on investors and rejected the plea of ignorance.[126]

Further, it is generally argued that the profession of auditors plays a crucial role in presenting a distorted financial position of the issuer.[127] Similar to the position of lawyers aforementioned, the accountants and auditors have been held primarily liable by several courts for a defective prospectus.[128]

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121. *Mercer* v. *Jaffee PC,* 713 F Supp 1019 (1989) at 1025.

122. M G Warren, "The Primary Liability of Securities Lawyers" (1996) 50 *SMU Law Review* 383 at 396.

123. Federal Securities Law Report (CCH) (18 Feb 1981) at 84,172 quoted in *id.* at 397.

124. 388 F 2d (1968) at 489.

125. 665 P 2d 582 (1983) at 583.

126. 328 F 2d 854 (1964) at 863.

127. M Markovic, 'Auditors' Criminal Liability: Another Approach' (1995) 6 *Australian Journal of Corporate Law* 1 at 65.

128. For example, see *SEC* v. *Seaboard Corp,* 677 F 2d 1301 (1982); *Bradford White Corp* v. *Ernst & Whinney,* 872 F 2d 1153 (1989); *Adam* v. *Silicon Valley Bancshares,* 884 F Supp 1398 (1995).

Because of the critical role played by the underwriters in the corporate fundraising process, they should incur criminal liability for issuing a defective prospectus.[129] As regards the criminal liability of issue managers, the central reason for their liability is their responsibility for assuring of the accuracy of a prospectus. This proposition has been reinforced in the landmark case, *Escott* v. *BarChris Constr Corp*,[130] which held that the lead underwriter or issue manager is ultimately responsible for the truth of disclosures in a prospectus.

Having regard to the reasons and arguments stated above, all major participants in the preparation of a prospectus should be held criminally liable for a defective prospectus. A clear set of provisions concerning criminal liability of prompters, directors, auditors, lawyers, underwriters and issue managers for a defective prospectus can contribute significantly to the improvement of investor protection in the IPO market in Bangladesh.

XV Conclusion

The foregoing discussions support the proposition that the present legal provisions dealing with criminal liability for a defective prospectus are flawed on several counts. First of all, the expression 'who authorised the issue of the prospectus' appears to be one of the major impediments towards the identification of persons liable for a defective prospectus. So far as it is understood from the analysis, no members of an IPO coalition except for directors and promoters fall within the ambit of such an expression in respect of criminal liability for a defective prospectus. Because of a considerable ambiguity and uncertainty about the applicability of such an expression, it has been omitted from the relevant statutes of some other jurisdictions. The legislation in Bangladesh should be amended by inserting clear provisions of criminal liability of all persons involved in the preparation of a defective prospectus.

Low penalties and the wide discretion given to judges to soften the penalties further in most cases are considered to be contrary to the need for investor protection. The penalties prescribed by the various laws in Bangladesh are significantly lower and less stringent than those of other jurisdictions such as of India and Malaysia. The stringency has been measured in respect of both the terms of imprisonment and the fines imposed. Leaving an extensive discretion with the judges to choose the minimal extent of imprisonment and fines or selecting either of the two seems to be unsuitable for the Bangladesh IPO market.

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129. Golding, *supra* note 14 at 404.
130. *Supra* note 116 at 696-97.

The prevalence of a broad range of defences to escape liability is another concern for law enforcement mechanism as they 'encourage' the violation of disclosure requirements. Such defences have made the criminal liability provisions 'weaker' to bring the offenders to book. Amongst the defences, the requirement of wilful violation of disclosure provisions by the defendants has been omitted from the Securities Act of Arizona in 1998 considering its negative impact on the prevention of corporate crimes. Other defences, such as due diligence, ignorance and acting in good faith have been made conditional in some jurisdictions. Pursuant to those conditions, reliance on any defence can be justified by the exercise of reasonable care concerning the truth of the information included in a prospectus. The boundaries of the defences have been narrowed down in some selected jurisdictions for the sake of investor protection. This is not the case in Bangladesh. At the same time, the defences are not only more in number; they are wider in the scope of their application.

Investor protection in the IPO market requires stringent liability provisions. For the regulation of the business community, the 'need for so-called 'draconian sanctions' is generally recognised.[131] Lack of investor protection keeps the investors away from the market resulting in the impairment of the ability of firms to raise equity capital from the market.[132] To make the criminal liability regime effective in deterring wrongdoers, criminal sanctions against them should be in place together with a civil remedies regime.[133] In a disclosure regime, the disclosure of accurate information is essential, because investors cannot make informed judgments based on untrue, misleading and fraudulent disclosures. To bring about investment confidence amongst the investors, an effective liability regime and its proper enforcement are *sine qua non*, and will assure the investors that there are effective remedies against the contravention of disclosure requirements.

A stringent liability regime for the malfeasance of the other players (except investors) of the IPO market is considered to be important for investor protection. The stringency of the liability regime has become more crucial in view of the adoption of the DBR in Bangladesh. Criminal liability provided in the CA'94 was included to protect the investors in the paternalistic merit regulation. The DBR entails more stringent

131. R Tomasic, 'Sanctioning Corporate Crime and Misconduct: Beyond Draconian and Decriminalisation Solutions' (1992) 2 *Australian Journal of Corporate Law* 82 at 106.

132. F Modigliani & E Perotti, 'Security Versus Bank Finance: TheImportance of a Proper Enforcement of Legal Rules' (2000) *available at* 2 <http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=26945> visited on 31 Aug 2002.

133. "Developments in the Law - Corporate Crime" *supra* note 11 at 1374.

penalties for the wrongdoer for whom many countries like India and Malaysia have amended their respective penalty provisions.[134] Bangladesh has adopted the DBR without changing the provisions concerning liability for the prospectus. A strong legal liability regime can reduce violation of the law by creating 'stringent standards' of liability for persons who are involved in IPOs.[135] By virtue of the DBR, companies have acquired freedom to raise funds from the public without extra risk of incurring liability. Following the adoption of the DBR, investors in Bangladesh do not have advantage of a paternalistic merit assessment, which should have been provided by the regulator. The current prospectus liability provisions do not seem to have the incentive to demand justice and seem 'helpless' in view of the fact that they are going to remain unchanged.

'Good legal rules' are widely regarded as of paramount importance in all successful examples of the development of securities markets.[136] A group of writers, namely, La Porta, Lopez-De-Silanes, Shleifer and Vishny (LLSV) have presented perhaps the most cited recent literature in connection with investor protection. Their empirical studies conducted by various teams covering numerous states of different legal systems all over the world demonstrate that investor protection is very crucial for the development of securities markets.[137] Apart from their efforts, there

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134. Malaysia has done so even before the adoption of the full disclosure philosophy as a part of its move towards the complete disclosure regulation.

135. See *Herman & MacLean* v. *Huddleston,* 459 U S (1983) 375 at 381-82. See also the US legislation, Sarbanes-Oxley Act 2002 enacted following some recent high profile collapses such an Enron and WorldCom.

136. S. Johnson, "Coase and the Reforms of Securities Market"(2002) 16 *International Economic Journal* 1 at 2.

137. See, for some of those studies, R. La Porta, F. Lopez-De-Silanes & A Shleifer, 'What Works in Securities Law' (2006) *Journal of Finance*(forthcoming) *available at* <http://post.economics.harvard.edu/faculty/shleifer/papers.html> visited on 27 Nov 2005; R. La Porta, F. Lopez-De-Silanes, A. Shleifer & R. Vishny, "Investor Protection and Corporate Valuation" (2002) 57 *Journal of Finance* 1147; A Shleifer & D Wolfenzon, "Investor Protection and Equity Markets" (2002) 66 *Journal of Financial Economics* 3; F. Lopez-De-Silanes, "The Politics of Legal Reforms" (2002) 2 *Economia* 91; R. La Porta, F Lopez-De-Silanes, A. Shleifer & R. Vishny, "Investor Protection and Corporate Governance" (2000) 58 *Journal of Financial Economics* 3; R. La Porta, F. Lopez-De-Silanes, A. Shleifer & R. Vishny, "Agency Problems and Dividend Policies Around the World" (2000) 55 *Journal of Finance* 1; R. La Porta, F. Lopez-De-Silanes, "Corporate Ownership Around the World" (1999) 54 *Journal of Finance* 471; R. La Porta, F. Lopez-De-Silanes, A. Shleifer, "Law and Finance" (1998) 106 *Journal of Political Economy* 1113; R. La Porta, F. Lopez-De-Silanes, A. Shleifer & R.W. Vishny, "LegalDeterminants of External Finance" (1997) 52 *Journal of Finance* 1131; A. Shleifer & R. W. Vishny, "A Survey of Corporate Governance" (1997) 52 *Journal of Finance* 737.

have been a good number of studies that concur with LLSV.[138]

The availability of legal remedies against the violation of any law primarily depends on the quality of liability provisions as well as the effective enforcement thereof. The preceding discussions exposed the shortcomings and drawbacks of the criminal liability provisions for a prospectus in Bangladesh. These flaws demonstrate quite clearly that the whole regime for prospectus criminal liability is in need of reform, as it is inadequate for the protection of investors in the current disclosure regime.

In addition to the flaws in the liability provisions, weaknesses exist in their enforcement mechanisms as well.[139] One of the major weaknesses in the present enforcement regime is that the securities regulator and the courts are not sufficiently trained and experienced in dealing with prospectus liability provisions. This reinforces the need for clear and unambiguous liability regime for prospectuses in Bangladesh.

138. For example, E. Glaeser, S. Johnson & A. Shleifer, "Coase Versus The Coasians" (2001) 116 *QuarterlyJournal of Economics* 853 at 897.

139. S.M. Solaiman,'Investor Protection Through Administrative Enforcement of Disclosure Requirements in Prospectuses: Bangladeshi Laws Compared with Their Equivalents in India and Malaysia' (2005) 12 *Journal of Financial Crimes* 360; S.M. Solaiman, 'Investor Protection and Judicial Enforcement of Disclosure Regime in Bangladesh: A Critique' (2005) 34 *Common Law World Review* 229.