



**CRIMINAL LIABILITY OF DIRECTORS:
AN IMPORTANT FACET FOR THE
DEVELOPING INDIA**

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ABSTRACT

Company is an artificial person and cannot work on its own. It is the management and the employees who act as an agent and work on behalf of the company. Directors are like the heads of the company who take all the major decisions on behalf of the company. They are also in a position that they have various things under their direct control which can be misused easily. Therefore, it is really important to lay down a proper framework to regulate the working of the directors in order to ensure that the position is not abused and they continue to work towards the welfare of the company.

The new Companies Act, 2013 lay down various duties and responsibilities of the directors of the company. The act has made the penalties for violation of these duties and responsibilities more stringent as compared to the old Companies Act, 1956. The Companies Act contains various provisions that put liability on the director such as the duty to disclose true and correct statements in prospectus, duty to file annual returns of the company, duty to maintain the financial books in the prescribed form, etc. There are provisions that lay down liabilities on the director in other statutes also such as Income Tax Act, Negotiable Instruments Act, etc.

It is important to note that a director cannot be held liable only by the virtue of his

position. It is necessary for the director complained against to be the officer in-charge i.e. he should be the person actually in charge of the affairs of the company and of its day to day functioning, at the time of commitment of the offence. Also, it is not necessary condition that in order to bring any charge against the directors, the company also has to be prosecuted or impeded as a party to the case.

With the increasing modernization and economic growth, India has become home to numerous foreign companies. This has made it even more important for India to take the necessary steps to make sure that the director fulfills his duties and responsibilities and works towards the benefit of the company. Therefore, it the duty of the legislation and the judiciary to ensure that appropriate provisions are set in place and that these provisions are strictly followed by the directors.

INTRODUCTION

The role of a director in a company is very significant. He is the one who has the responsibility to ensure that the business is carried out smoothly also he has the obligations of managing the routine work which the company performs. Appointment of directors are done by the shareholders and hence, owe a fiduciary duty towards them. This makes the directors open to liabilities whether Civil, requiring the director to compensate the victim or Criminal liability resulting in fines and imprisonment.

Like other jurisdictions, India is also accustomed to corporate frauds and scams. Whether it is the Satyam, NSEL or Lilliput, plentiful management or promoters driven



frauds have been exposed in India. Concern regarding the liability of directors became a question of debate after the arrests of Stefan Schlipf, the Managing Director of BMW India Financial Services and William Pickney, managing director and chief executive officer of Amway India, along with other two directors.¹

This increasing concern has led to people becoming more aware and realizing the importance of making a director personally liable. The global issue of corruption and the ever increasing risk of fraud within the company raise serious concern with respect to liability of directors. Therefore, Companies Act, 2013² expressly lays down liabilities which put some amount of restrictions as well as lays down duties of the director, such as exercise of due and reasonable care, skill, diligence, etc., omission of which makes the director liable. The penalties that were insignificant under the 1956 Companies have been amplified under the new Act. Therefore, the new Companies Act by imposing stricter punishments on directors for their wrongful acts.

Three important propositions can be inferred from the Companies Act with respect to the duties and the responsibilities of the directors. They are:

- 1) A director is not expected to exhibit, during the performance of his duties, a greater

degree of skill than may be reasonably expected from a person of his knowledge and experience.

- 2) Director is not duty bound to continuously look over the affairs of his company, his duties being of sporadic nature, it is to be performed periodically at board meetings or committee meetings
- 3) With regard to the duties that under reasonable circumstances can be delegated to someone else and same is not prohibited under the Articles of Association, a director is justified in trusting that official to perform such duties honestly, in the absence of any ground for suspicion.

WHO CAN BE HELD RESPONSIBLE?

Under the old 1956 Companies Act, certain key managerial personnel like chief executive officer and chief financial officer could not be made personally liable for their fraudulent conduct as they did not fall under the ambit of the term “officer who is in default”. The new 2013 Act has removed this irregularity and has significantly widened the scope of the term “officer in default” so as to include:

1. Any person, who has the right to manage the whole, or substantially the whole, of the goings-on of the company, under the superintendence, control, and direction of the board of directors;
2. Any person, the board of director is accustomed to work under the advice, direction or instructions of, expect any person who is giving the advice under a professional capacity; and
3. Every director who has the knowledge of the wrongdoing by the way of being a part of the Board of directors and does nothing to stop or object it.

¹Resolution of Corporate Disputes Non-Compliances and Remedies, The Institute of Company Secretary of India, https://www.icsi.edu/media/webmodules/FINAL_RESOLUTION_OF_CORPORATE_DISPUTES_BO OK.PDF

² Companies Act, 2013



It is important to understand that no one can not be held responsible merely on the ground of his position in the company. No presumption can be legally made against a person by virtue of the fact that he holds a key managerial position in the company. In order to hold a person liable, it is necessary for that person to fulfil the legal requirements of being a person who is responsible under law to the company for carrying out its operations, at the time of commitment of the offence.³

The Supreme Court of India in the cases *Nat'l Small Indus. Corp. Ltd. v. Harmeet Singh Paintal & Anr*⁴. and *K.K. Ahuja v. V.K. Vora*⁵, has held that a managing director can be held liable for the wrongs committed by the company as is prima facie responsible for the company's business. But only those officers of the company who fall under the ambit of the meaning of the phrase "officer who is in default" will be covered.

VICARIOUS LIABILITY OF DIRECTORS

The concept of vicarious liability of the corporate officials has evolved considerably over the past few years. It is worth noting that it has become a general practice to include senior officials as a party to a case against the company. This is done to exert pressure on the company forcing them to settle. But various judicial decisions have

held that no complaint can be filed against a person until unless a clear case is spelt out against him.⁶

A three judge bench of the Supreme Court in the case of *Sunil Bharti Mittal v. Central Bureau of Investigation and others*,⁷ laid down that a director can only be charged for an offence if it can be proved that he had an active role in the act, coupled with criminal intention. Another important aspect to hold director liable is that there should be an express statutory provision which makes the director vicariously liable for the wrongs committed by a corporate. The Supreme Court categorically laid down that, "When the company is the offender, vicarious liability of the directors cannot be imputed automatically, in the absence of any statutory provision to that effect."⁸ Therefore, in simple words a director can be made vicariously liable only if provision exists in this regard in the statute. Same was reiterated by the Apex Court in the case of *Maksud Saiyed v. State of Gujarat & Ors.*⁹ and *S.K. Alagh v. State of UP & Ors.*¹⁰

³Bishwajit Dubey, *Criminal Liability of Corporate Officials In India*, April 19 2017, India Corporate Law,

<https://corporate.cyrilamarchandblogs.com/2017/04/criminal-liability-corporate-officials-india/>

⁴*Nat'l Small Indus. Corp. Ltd. v. Harmeet Singh Paintal & Anr*, (2010)3 SCC 330

⁵*K.K. Ahuja v. V.K. Vora*, (2009) 10 SCC 48

⁶Siddhant Maken, *Vicarious Liability of Directors and Shareholders*, 19 March 2018, Mondaq, <http://www.mondaq.com/india/x/687872/Shareholders/Note+On+Vicarious+Liability+Of+Directors+And+Shareholders>

⁷*Sunil Bharti Mittal v. Central Bureau of Investigation and others*, Criminal Appeal No. 35 of 2015

⁸Ibid

⁹*Maksud Saiyed v. State of Gujarat & Ors*, Criminal Appeal No. 1248 of 2007

¹⁰*S.K. Alagh v. State of UP & Ors.*, Criminal Appeal No. 317 of 2008



In *N.K. Wahi v. Shekhar Singh &Ors.*¹¹, the Apex court further laid down that it has to be clearly and unambiguously proved before the court as to how the director was in actually in-charge and responsible for the conduct of company. It is although not necessary that precise words from the provisions are reproduced and the court has the liberty to interpret it on a case to case basis. But still, in the absence of any specific evidence, the court will not entertain any complaint.

Additionally, some previous division bench judgments of the Apex Court of India such as *J.K Industries Limited and Others v. Chief Inspector of Factories and Boilers and Others*¹² and *P.C Agarwala v. Payment of Wages Inspector, M.P and Others*¹³ have held that, the responsibility for that activities of the company would be deemed to be of the person to is in actual charge of it, in case of vicarious liability under the strict liability statutes.

Another question of debate under the Companies Act, 2013 with respect to director's liability is whether a director or officer of a company can be prosecuted without arraigning the company itself as an accused and can company and the director be simultaneously prosecuted? Over the period of time, Indian judiciary has had divergent view point on the issue.

Hon'ble Supreme Court in *State of Madras v. CV Parekh*,¹⁴ dealt with a similar issue under the Essential Commodities Act, 1955 and held that person in charge can only be held liable only when a wrong is committed by the company and if the company is not prosecuted, the person in charge could not be fastened with any liability. Subsequently, in the case of *Sheoratan Agarwal v. State of Madhya Pradesh*,¹⁵ Supreme Court had a contracting view to the earlier decision and held that the company alone or the person in charge alone can be prosecuted alone for the wrongs committed by the company as there is no statutory provision that mandates that an individual can be prosecuted without the company being arraigned as an accused alongside him. Thereafter, in the case of *Aneeta Hada v. Godfather Travels and Tours (P) Ltd.*,¹⁶ Supreme Court adjudicated the same issue under the Negotiable Instruments Act, 1881 ruled that it is a necessary condition for person in charge or person responsible for the conduct of its business to be held liable that the company is also prosecuted alongside.

This issue was finally settled by the Competition Commission of India (CCI) in a recent judgment of *Ministry of Agriculture v. Mayhco Monsanto Biotech (India) Limited*,¹⁷ in which the CCI dealt with same issue under Section 48 of the Competition Act, 2002. The commission held that a company and person in charge can be

¹¹*N.K. Wahi v. Shekhar Singh &Ors.*, (2007) 9 SCC 481

¹²*J.K Industries Limited and Others v. Chief Inspector of Factories and Boilers and Others*, (1996) 6 SCC 665

¹³*P.C Agarwala v. Payment of Wages Inspector, M.P and Others*, (2005) 8 SCC 104

¹⁴*State of Madras v. CV Parekh*, (1970) 3 SCC 491

¹⁵*Sheoratan Agarwal v. State of Madhya Pradesh*, (1984) 4 SCC 352

¹⁶*Aneeta Hada v. Godfather Travel and Tours*, (2008) 85 SCL 56

¹⁷*Ministry of Agriculture v. Mayhco Monsanto Biotech (India) Limited*, (2016) 137 SCL 373



simultaneously prosecuted and further, it is not necessary to first record a conviction against the company in order to make the director liable. Also, it laid down that vicarious liability can be put on a person in-charge by fiction of law even if he may or may not be directly responsible for the commission of the fraudulent act.

Under Indian Law, there are various provisions that put vicarious liability of directors or key managerial personnel. But in order to protect these key managerial personnel of a company from any kind of malicious prosecution and to protect the interest of the managers, these provisions come with an exception which states that no director shall be held vicariously liable for the acts of the company if he can prove that the given act was committed without his knowledge and negligence and that he exercised due diligence to do everything to prevent the commission of the offence. Therefore, a balance is maintained to make directors liable when they commit an offence and protects them from malicious charges.¹⁸

STATUTORY LIABILITIES OF DIRECTORS UNDER COMPANIES ACT

The new Company Act, 2013 lays down various liabilities on the directors which can not be deviated from under any circumstances. The penal provisions under the new act have been made more stringent

¹⁸Nigam Nuggehali, *Vicarious Criminal Liabilities for Corporate Officers in India: Problems and Prospects*, AzimPremji University, <https://azimpremjiuniversity.edu.in/SitePages/pdf/Vicarious-Corporate-Criminal-Liability%20.pdf>

and provide for higher penalties as compared to the old 1956 Act.¹⁹

Directors owe a duty towards the company which is laid under Section 166²⁰ of the new Companies Act. It lays down the fiduciary duties of a director towards his company such as the duty to act in good faith, the duty to act in the best interest of the company, its employees, its shareholders and the community. The Delhi High Court in the case of *Rajeev Saumitra v. Neetu Singh*²¹ held that the director was liable to the company for any undue gains made by him by virtue of his position in the company. Section 166(5) expressly prohibits such activities and make the director liable.

Certain provision under the act imposes only monetary fines on the defaulter whereas some impose an additional provision for imprisonment. Some provisions attract penalties which are over 1 crore and more such as:

- a) Section 8²² - Violation of provision relating to Not for-profit organizations
- b) Section 42²³ - Violation of provisions relating to subscription of securities on private placement
- c) Section 46(5)²⁴ - Issue of duplicate share certificates with an intent to defraud

¹⁹ Bharat Anand and Satish Padhai, *Director's Liability: Revisiting the Principles of Vicarious Liability*, 30 Jan 2017, Mondaq, <http://www.mondaq.com/india/x/563958/Directors+Officers/DIRECTORS+LIABILITY+REVISITING+THE+PRINCIPLES+OF+VICARIOUS+LIABILITY>

²⁰Supra Note No. 2, Section 166

²¹*Rajeev Saumitra v. Neetu Singh*, I.A No. 17545/2015 in CS (OS) No. 2528/2015

²²Supra Note no. 2, Section 8

²³Supra Note no. 2, Section 42



- d) Section 74 (3)²⁵- Failure to repay deposits within specified time
- e) Section 195 (2) ²⁶ - Contravention of provisions relating to insider trading
Most of the provisions that lays down the penalty of imprisonment are non-cognizable offences i.e. the person against whom the complaint has been file can not be arrested without an arrest warrant issued by a competent court. But there are certain grave offences that are cognizable in nature and no arrest warrant would be required. Some of these offences are:

1) Section 34 ²⁷ - Untrue or misleading statements in Prospectus

Every person who authorizes untrue or misleading statements to be published in the prospectus, so as to induce any person to invest in the company in good faith. Such person can be subjected to imprisonment for a minimum period of 6 months which can go up to 10 years.

2) Section 53²⁸- Issue of shares at a discount by a Company

This section bars any company to issue shares at a price lower than the par value i.e. at a discount. If a company violates this provision, it will be liable for a fine which could vary between 1 lakh to 5 Lakh and the person in-charge can be criminally held liable for imprisonment up to 6 months or fine of 1 Lakh to 5 Lakhs.

3) Section 68²⁹- Purchase of its own Shares by the company (Buyback)

The section lays down some rules and regulations that to kept in mind by the company during the process of buying back its own shares. Section 68(11) states the penalty for non-compliance with the section or with the guidelines laid down by SEBI, which is, imprisonment that can go up to 3 months or fine of at least 1 Lakh rupees or both for the person in-charge.

4) Section 71³⁰- Issue of Debentures

This provision lays down regulations to be followed by the company when issuing debentures. As per the provisions of the Companies Act, the company is required to appoint a debenture trustee to look over the rights of debenture holders. In case the company is not able to redeem the debentures when the debentures have matured, the debenture holder or its trustee has a right to file a petition before the Company Law Tribunal, praying for an order to the company asking them to repay the principle amount along with the interest. Petition can also be filed by a debenture trustee in case he has reasons to believe that the company is not in a state to return the principle amount when required, requesting for an order to bar the company from incurring any more liabilities. Failure to comply with such an order by the tribunal would make the person in-charge liable for an imprisonment up to 3 year or a fine of 2 Lakhs to 5 Lakhs or both.

5) Section 92³¹- Failure to file Annual Returns

Every Company is mandated to file his annual returns before 60 days have elapsed from the date of Annual General Meeting

²⁴Supra Note no. 2, Section 46(5)

²⁵Supra Note no. 2, Section 74 (3)

²⁶Supra Note no. 2, Section 195(2)

²⁷Supra Note no. 2, Section 34

²⁸Supra Note no. 2, Section 53

²⁹Supra Note no. 2, Section 68

³⁰Supra Note no. 2, Section 71

³¹Supra Note no. 2, Section 92



(AGM). This section lays down the format of the report and prescribes all the information that has to be included in it. Failure to file the report or any deviation from the set format will make the company liable for a fine of 50 thousand and will make the officer in default criminal liable in the form of imprisonment up to 6 months or fine of 50 thousand to 5 Lakhs or both.

6) Section 129³² - Preparing of Financial Books in the prescribed form

It mandates the company to prepare its financial statements in the form prescribed which gives a true image of the monetary condition of the company and also ensure that it adheres to the accounting standards present. In case of any violation the MD or the CFO or officer in-charge would be held liable for imprisonment for one year or fine of not less than 50 thousand and which may go up to 5 lakhs or both.

7) Section 185³³- Advancement of Loans to directors by the Company

This section prohibits the company from giving any amount to the director as loan represented by a book debt or to any person for whom the director is the guarantor or any security for any loan of the director, except as provided otherwise in the act. If any director or other person contravenes the section, he shall be criminally liable for imprisonment up to 6 months or a fine of 5 Lakhs which may extend to 25 Lakhs or both.

8) Section 447³⁴- Fraud

This section put liability on an any person of the company who does any act which causes unlawful loss to the shareholders or unlawful gains for himself. Such officer would be liable for fraud and for an imprisonment for the period of 6 months up to 10 years or fine not less than the amount of the fraud, which can go up to 3 times that amount.

9) Section 449³⁵- Providing false evidence to Authorities

This section lays down the liability for providing false evidence to authorities. If any person provides false evidence in the course of the examination upon oath or in the form of deposition, affidavit or winding up process of the company, then the person can be criminally held liable for imprisonment for at least 3 years up to 10 years or fine which may go up to 10 Lakh rupees.

These are the numerous provisions of the Companies Act, 2013 under which a officer of the company or a director can be criminally held responsible for his wrongful acts. Apart from these provisions, Companies Act, 2013 under section 245, has introduced the concept of “class action suits”. Under this concept, a group of shareholder (minimum 100 shareholders or a percentage as prescribed from time to time) can bring in action against the company and/or the director on behalf of all the affected parties for the wrongful or fraudulent act on their part.³⁶

³²Supra Note no. 2, Section 129

³³Supra Note no. 2, Section 185

³⁴Supra Note no. 2, Section 447

³⁵Supra Note no. 2, Section 449

³⁶ Animesh Tiwary, *Criminal Liability of Directors Under Companies Act, 2013*, July 2 2018, iPleaders, <https://blog.ipleaders.in/criminal-liability-directors/>



LIABILITY OF DIRECTORS UNDER OTHER ACTS

- Liability under Income Tax Act, 1961³⁷
Section 179³⁸ lays down that in a situation of winding up of a private company, if the tax assessed can not be recovered from the company, then each individual who held the position of the director of the company would be severally and jointly liable to pay the tax amount. In the case of *GurudasHazra v. P.K. Chowdhury*³⁹, the bank account of the director of a private company was frozen in order to recover the tax amount of the company. The court held that the only defense available to the director is to show that the default committed by the company was in no way attributed to an act of breach of trust by him. In of *Peter J. R.Prabhu v. Asstt Commissioner of Commercial Taxes*⁴⁰, the court laid down that arrears of the tax amount can not be recovered from the directors of the company from their personal assets, unless a provision of a taxing statue provides for it.
- Liability under Indian Penal Code (IPC)⁴¹
Supreme Court of India in the case of *HDFC Securities Ltd &Ors. v. State of Maharashtra &Anr.*⁴², relying on the judgment of S.K. Alagh⁴³ and

MaksudSaiyed⁴⁴ held that there is provision for vicarious liability of directors under IPC. To make the director liable express provision is required fixing such liability, as no such provision in present in IPC, hence, a director can not be held liable for the companies act under IPC.

- Liability under Negotiable Instruments Act, 1881⁴⁵
Section 138⁴⁶ of the Act lays down the offence of Cheque bounce. Section 141⁴⁷ further, lays down the liability of the director or the person in-charge of the affairs of the company liable in a case of Cheque bounce. In the case of *SMS Pharmaceuticals v. Neeta Bhalla&Anr.*⁴⁸ the court held that in order to make a director liable, it is mandatory to prove that the director was indeed in-charge of the company when the Cheque was issued and furthermore, only the person who signed the Cheque i.e. the signatory is responsible and can be held liable.

CONCLUSION

More than 27 years have passed from the time when India ushered into a fresh phase of liberalization and globalization. This gradual opening of the economy by India has led to a great influx of foreign capital into India. But this economic growth has brought with it various problems like corporate frauds and scams. With India now being a global country and having

³⁷ Income Tax Act, 1961

³⁸ Ibid, Section 179

³⁹ *GurudasHazra v. P.K. Chowdhury*, 2002 109 CompCas 530 Cal

⁴⁰ *Peter J R Prabhu v. Asstt Commissioner of Commercial Taxes*, 2001 105 CompCas 247 Kar, ILR 2001 KAR 1045

⁴¹ Indian Penal Code, 1860

⁴² *HDFC Securities Ltd &Ors. v. State of Maharashtra &Anr.*, Criminal Appeal No. 1213 of 2016

⁴³ Supra Note no. 10

⁴⁴ Supra Note no. 9

⁴⁵ Negotiable Instruments Act, 1881

⁴⁶ Ibid, Section 138

⁴⁷ Ibid, Section 141

⁴⁸ *SMS Pharmaceuticals v. Neeta Bhalla&Anr.*, 2005 8 SCC 89



large number of foreign companies making place in the Indian market alongside millions of Indian companies, it is of utmost importance to have a clearly laid down duties and responsibilities of the director.

Company is an artificial person with no mind of its own. It is run through its agents namely, the management and employees. It is the management who takes all the decisions in a Company and hence, it is very important that the directors fulfill his duties and obligations to ensure prosperity of the company. Also, directors being agents of the company, are in fiduciary relationship and hence, obligated to work towards the best interest of the company.

Thus, this shows that director occupies a very significant position in a company and has the power to make or break it. One wrong act of the director can have a huge impact on the company, which might take the company years to recover from. Therefore, accountability is an important element in the working of the company.

The current legislation framework confers a lot of duties and liabilities on the directors. Enhanced punishment under the new Companies Act shows how important regulating the functions of a director are. The legislation framework is set right and it is the continues duty of the court now to ensure that these provisions are applied in a way so as to reduce and eventually stop the malpractices undertaken by the directors.

In applying the general equitable principles to company directors four separate rules have emerged. They are (1) director must

act in good faith and do what they believe to be in the best interest of the company (2) they should refrain from using the powers conferred on them for any purpose other than for which they were conferred (3) that they should not place themselves in such a position where there are changes of a conflict between their personal interest and their duties towards the company, without the express consent of the company.⁴⁹

With the increasing global interest in Indian Companies, new players will enter the market on regular basis unaware of the possible consequences. In the light of which, Director indemnification clause which is a part of the agreement between the shareholder and the director should be vigilantly and meticulously read and negotiated. Additionally, Director's and Officer's liability insurance is also a mechanism that is becoming immensely prevalent in India. Rapidly modernizing on director liability requires full attention not only by lawyers and corporate directors but by the masses.⁵⁰

⁴⁹Soma Dhawal, *Director's Liability in India, Legal Services India*,
<http://www.legalservicesindia.com/artic les/dl.htm>

⁵⁰ *Criminal Liability of Directors under the Companies Act, 2013*, Novo Juris,
<https://novojuris.com/2014/04/16/criminal-liabilities-of-directors-under-the-companies-act-2013/>