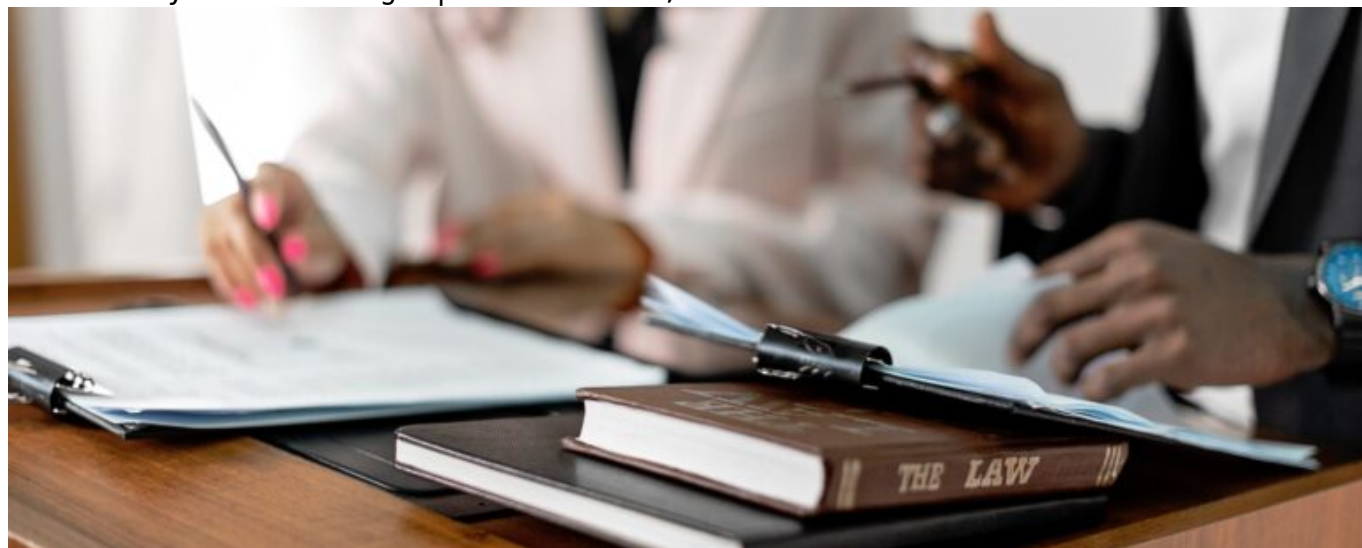


The Companies Act 2013: Criminal Liability Of Directors And Key Managerial Persons

written by Sameer Singh | November 20, 2021



While registered companies are considered separate legal entities, they rely on various officers to The Companies Act 2013 and take necessary decisions on their behalf to function in a manner that is efficient and compliant with legal obligations. This fiduciary responsibility is assigned to its directors and key managerial persons (collectively referred to as “officers”). Such officers are required to discharge their duties with the utmost care, diligence, and skill and it is naturally expected that they must not take any undue advantage of their fiduciary capacity. However, the stark reality is that the corporate sector of India is no stranger to scams and frauds and so, it is common to find officers abusing the powers of their position for personal gain, monetary or otherwise.

To deter companies and officers from engaging in flagrant abuse of power, the provisions of the Companies Act 2013 and rules (“Companies Act & Rules”) have been amended so as to strengthen the Companies Act, 1956, which was deemed ineffective. The Companies Act & Rules have prescribed various penalties for companies and fines for *officers who are in default*^[1], further, certain provisions also impose mandatory imprisonment for officers in the event of non-adherence and/or contravention. The period for imprisonment under such provisions ranges from six (6) months up to seven (7) years and includes fines. While the imposition of imprisonment and fines would seem an ideal deterrent, company officials do still manage to crawl through legal loopholes.

In a recent survey conducted by Deloitte Touche Tohmatsu India LLP in association with the Institute of Directors, several independent directors surveyed were of the opinion that corporate fraud is bound to rise in the next two years due to COVID-19 related pressures on businesses, the lack of awareness and inadequate fraud risk management policies.^[2]

In light of the above, it would be worthwhile to take a close look at the offences listed under the Companies Act & Rules. While the Companies Act & Rules have prescribed criminal liability on officers who are in default, in most instances (wherein imprisonment is not mandatory), only penalties are imposed on the company and/or fines for the officers or such other person in default. This is the result of Section 441 of the Companies Act & Rules, which provides an option for compounding offences wherein imprisonment is not

mandatory.

Compounding the offence allows the company or the officer or such other person in default to settle the offence by payment of such amount as prescribed by the authorities in lieu of prosecution. Even the provisions that prescribe mandatory imprisonment under the Companies Act & Rules are only applied in a few cases. In general, officers are prosecuted for offences under other laws wherein the fines and/or imprisonment implications are much stricter.

However, there is a stark difference in the criminal liability under other laws and that of the Companies Act & Rules. For instance, criminal liability under the Criminal Procedure Code specifically states who will be an accused under a particular provision and there is limited scope for vicarious liability, however, the Companies Act & Rules have broadly defined an officer who is in default, thereby extending the definition to cover officers as well as individuals present at the time of the non-compliance or contravention. This implies that all officers present in the company at the time of the offence can be held liable and can be subjected [3].

While vicarious liability implications are present in certain other laws such as Negotiable Instruments Act, 1881, it is rare to have blanket liability on all officers. For instance, in 2015, the Calcutta High Court in the case of *Davinder Kaur vs The State of West Bengal and Ors.*, reiterated the position held in several other cases that any person in charge of the affairs of the company during the period of the non-compliance or contravention shall also be prosecuted by the trial courts as one of the offenders.

In the case mentioned above, the cheques issued by the company were dishonoured on presentation to the bank due to the acts of the directors, however, the officer in charge of signing the cheques was also considered as an accused and was required to prove innocence. The High Court rejected the plea to quash proceedings against the officer, as he was directly connected with the transaction as a signatory to the cheques.

The need for having the broad definition of an officer who is in default is primarily because quite often, the offences are committed by a group of individuals acting through the company and so, it is imperative to identify those who are responsible. However, whether such blanket liability on a group of individuals can be upheld has been clarified by the Supreme Court of India in 2019 in the case of [4] *Shiv Kumar Jatia vs. State of NCT of Delhi*.

The Court held that in the absence of any specific vicarious liability provisions, an individual who commits an act on behalf of the company can be made an accused only if there is sufficient evidence that indicates their active role coupled with criminal intent. Therefore, to hold an officer of a company liable, it is imperative that the officer must be in-charge of the business in the company and substantial evidence is produced to establish the *actus reus* (the action which is the constituent element of the crime) and *mens reus* (the criminal intent behind the crime).

While the *actus reus* of crimes are identifiable in most instances, the difficulty is in establishing the *mens reus*. To determine the *mens reus* behind a crime, the Supreme Court of India, in 2011, proposed an acid test of 'doctrine of attribution' to determine the *mens reus* of the officials responsible for the affairs of the company. The Doctrine of Attribution explains that the liability of the 'alter ego' of the company i.e., the officials/group of people that are involved in the affairs of the company is

determined by establishing their criminal intention and understanding the basis of why the action(s) were carried out.

Therefore, while the imposition of criminal liability under the Companies Act & Rules generally is compounded under Section 441 (where applicable), most officers of a company are held liable under other laws such as the Indian Penal Code, Negotiable Instruments Act, various Foreign Exchange Management Regulations, etc. It is not uncommon in India for the top management of companies to indulge in such acts that are detrimental to the interests of the company as well as its shareholders for their personal benefit.

The Indian corporate sector has seen a multitude of scams and frauds valued at thousands of crores and as stated hereinbefore, there may be a rise in such cases given the difficult scenario presented by COVID-19. A possible solution would be to ensure that officers who are in charge of the affairs of the company and play a key role in its management are required to subscribe to a certain portion of the share capital of the company, thereby ensuring that their interests are tied and aligned with that of the company.

The Companies Act 2013

[1] *officer who is in default* means any of the following officers of a company, namely:—

- whole-time director;
- key managerial personnel;
- where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;
- any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;
- any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to the companies act 2013, other than a person who advises the Board in a professional capacity;
- every director, in respect of a contravention of any of the provisions of the companies act 2013 who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;
- in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer;
- [2] Corporate Fraud and Misconduct: Role of Independent Directors
- The Companies Act 2013
- [3] CRR 1341 of 2015 - Calcutta High Court
- [4] Criminal Appeal No. 1263 of 2019

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