



# The Liability Regime For Non-Executive and Independent Directors in India A Case for Reform

Report | September 2019

Debanshu Mukherjee  
Astha Pandey



**This report is  
an independent,  
non-commissioned  
piece of work by  
the Vidhi Centre  
for Legal Policy,  
an independent  
think-tank doing legal  
research to make better  
laws and improve  
governance for public  
good.**

# About the Authors

---

**Debanshu Mukherjee** is one of the founding members of the Vidhi Centre for Legal Policy and leads its corporate law and financial regulation work. He is an alumnus of Harvard Law School, the University of Oxford and Hidayatullah National Law University.

**Astha Pandey** is a Research Fellow at the Vidhi Centre for Legal Policy. She is an alumna of the University of Cambridge and NALSAR University of Law.

# Acknowledgements

---

We would like to thank Prof. Umakanth Varottil, Associate Professor of Law, National University of Singapore, for his comments on an earlier draft of this report. We are also thankful to Vidhi Fellows Param Pandya and Shreya Prakash for their contributions to a chapter titled 'Revisit the Institution of Independent Directors' in Vidhi's most recent Briefing Book, which has been relied upon for our final recommendations.

The views expressed in the report and errors, if any, are the authors' alone.



# Table of Contents

---

Introduction: Setting the Context..... 6

An Overview of Director Liability Frameworks. .... 10

Examining India’s Existing Director Liability Framework..... 21

Challenges in India’s Current Director Liability Framework..... 27

Recommendations for Reform..... 32

Conclusion ..... 36

Annexure I..... 38

Annexure II ..... 39

# Chapter I: Introduction: Setting the Context

---

In the wake of governance failures in companies such as Enron, Adelphia and WorldCom in the early years of the twenty first century, corporate governance reform, specifically with respect to improving corporate conduct and accountability, gained significant prominence worldwide. In India, the financial fraud associated with Satyam Computer Services (often referred to as India's Enron) caused the government and the securities markets regulator to introduce stringent corporate governance standards coupled with a strict liability regime for directors. These requirements are currently reflected across several laws and regulations applicable to Indian companies, including the Companies Act, 2013 ("**Companies Act**"), the Securities and Exchange Board of India Act, 1992 ("**SEBI Act**"), and the rules and regulations thereunder, including the listing agreement with stock exchanges ("**Listing Agreement**").<sup>1</sup>

The aforementioned reforms were undertaken in response to the increasing criticism of the evils attributable to the exercise of unbridled corporate power (and the public narrative around corporate frauds like Satyam). However, the manner in which some of these laws were implemented in the immediate aftermath of such scams created serious problems for many professionally operating directors (especially the non-executive and independent ones) and led to undesirable outcomes. The experience of one of India's leading investment bankers in the aftermath of the Satyam fiasco is a case in point. This individual served as a non-executive director on the board of a finance company from 1998 to 1999. When the government discovered a fraud in the company in 2008, in addition to charging and arresting the founding promoter and other affiliated directors who were known to

be directly involved, it also summoned and charged the banker who had stepped down from the board long ago.<sup>2</sup> Many commentators have deemed Satyam to be a "one-off" blemish with respect to India's corporate governance, and have characterised the episode as being more politically motivated rather than demonstrative of inadequacies in the regulatory framework.<sup>3</sup> However, it is undoubtedly reflective of a broader trend in relation to the government's response to dealing with such issues in India: in the event of non-compliance with statutory obligations by companies, independent and non-executive directors are in a precarious position whereby in addition to substantial reputational harm, they face the risk of criminal liability being attributed to them, even for acts beyond their control.

The Ministry of Corporate Affairs ("**MCA**"), being extremely concerned about the extent of malfeasance in the recent IL&FS Financial Services ("**IL&FS**") scam, expanded the scope of its investigation to independent directors.<sup>4</sup> Further, the MCA also filed a petition in the National Company Law Tribunal seeking to implicate new parties after the Serious Fraud Investigation Office (an agency established under the MCA to investigate corporate frauds) submitted its investigation report which implicated, amongst others, independent directors who were on the company's board during the period in question, for mismanagement.<sup>5</sup> The impleadment application included auditors, chartered accountants as well as independent directors for operational mismanagement.<sup>6</sup> Since prima facie the function of independent directors is to act as gatekeepers and detect irregularities, the MCA enlarged the scope of its investigation in order to understand the role of the former independent

---

<sup>1</sup> Utkarsh Goel, Shailendra Kumar, Kuldeep Singh and Rishi Manrai, 'Corporate Governance: Indian Perspective' (2017), Proceeding of the International Conference on Economics and Development, Vol. 1, 60-61.

<sup>2</sup> Vikramaditya Khanna and Shaun J. Mathew, 'The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidencer' (2010), National Law School of India Review, Vol. 22, No. 1, 40-41.

<sup>3</sup> Ibid 42.

<sup>4</sup> 'MCA Wants to Question erstwhile IL&FS 'independent directors'', Outlook - The News Scroll, May 13, 2019.

<sup>5</sup> 'IL&FS: Auditors Defend Themselves, Question Justification for Ban', LiveMint, June 21, 2019.

<sup>6</sup> Ibid.



directors of IL&FS and the reasons for which they chose to not raise the red flag over various issues related to the corporate misfeasance.<sup>7</sup> While the MCA's concerns may be valid, the expansion of the investigation to include independent directors raises questions related to the extent to which they were in a position to actually exercise their independence and perform their functions effectively and whether these liability and associated risks faced by them are commensurate with their duties. It is therefore not surprising that of the numerous structural changes that have been discussed in the context of corporate governance, internationally and domestically, very few come with such strong support as the need for further strengthening the "outside" or independent" director framework. Conceptually, the standard of skill and care expected of executive directors in relation to a company should not be the same as that for non-executive directors as the former are more directly involved with the day to day management of the company.

Under the Companies Act, an "officer who is in default" is liable to any penalty or punishment by way of imprisonment, fine or otherwise.<sup>8</sup> The scope of the concept of "officer who is in default" is quite broad, and in addition to whole time directors and key managerial personnel, it also covers directors who, in respect of a contravention of the Companies Act, are aware of such contravention, or where such contravention had taken place with their consent or connivance.<sup>9</sup> In practice, investigating authorities and courts often send summoning notices to all directors. However, to address concerns relating to attribution of liability to independent and non-executive directors, section 149(12) of the Companies Act provides that an independent director or a non-executive director can be held liable only for acts of omission or commission by a company that have occurred with the director's knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently. While the Companies Act seeks to limit the liability of independent and non-executive directors to matters relatable to them by the inclusion of these mitigating factors, it does not provide any safeguards at the summoning stage, exposing such directors to reputational harm and protracted legal

proceedings, despite the protections enshrined in section 149(12), which can come to their rescue only at a later stage.

The problem is even more acute in relation to laws which do not recognise the distinction between executive and non-executive directors in their attribution of liability provisions (both, civil and criminal). A few examples of such statutes are the Contract Labour (Regulation and Abolition) Act, 1970, the Environment (Protection) Act, 1986 and the Prevention of Money Laundering Act, 2002. In fact, the Standing Committee on Finance's Report on the Companies Bill, 2011 had remarked that while the Companies Bill, 2011 makes an attempt to mitigate the liability of independent directors, the fact remains that it still treats them equivalent to other directors by holding them responsible through board processes.<sup>10</sup> Amongst the various suggestions made in relation to safeguarding independent and non-executive directors, some of the key recommendations were as follows: (i) the clause limiting the liability of independent and non-executive directors should be modified so as to ensure protection from not just the Companies Act but other laws as well; and (ii) no arrest warrant shall be issued against an independent director without authorisation by a judge of the rank of a district judge who shall give the independent director an opportunity of being heard before issuing such authorisation.<sup>11</sup> The report

**In the event of non-compliance with statutory obligations by companies, independent and non-executive directors are in a precarious position whereby in addition to substantial reputational harm, they face the risk of criminal liability being attributed to them, even for acts beyond their control.**

<sup>7</sup> Outlook - The News Scroll, May 13, 2019 (n. 4).

<sup>8</sup> Section 2(60), Companies Act.

<sup>9</sup> Ibid.

<sup>10</sup> Standing Committee on Finance (2011-12), Fifty-Seventh Report, The Companies Bill, 2011, Ministry of Corporate Affairs (June, 2012), 62-63.

<sup>11</sup> Ibid 63.

also provided that these protections should not be available if such independent director was directly involved in or responsible for such breach or violation or if such breach or violation had been committed with his knowledge or consent or he was guilty of gross or wilful negligence or fraud.<sup>12</sup>

Notwithstanding the differences of opinion amongst scholars and commentators on the definitions of 'independence', the need for active, independent boards has, in fact, become conventional wisdom.<sup>13</sup> Even the current legal and regulatory framework governing independent directors in India is based on the notion that directors should act independently of management and promoters, through a thoughtful and diligent decision-making process. However, the effectiveness of this extant framework requires critical assessment: as of July, 2019, the number of independent directors who have resigned from the boards of companies listed on the National Stock Exchange of India Limited ("NSE") without citing adequate reasons has increased significantly

compared to the number of resignations for the same period in the previous calendar year.<sup>14</sup> A total of six hundred and six independent directors resigned from NSE-listed company boards in the calendar year 2018.<sup>15</sup> In comparison, four hundred and twelve independent directors have already resigned between January 1, 2019 and July 22, 2019, which indicates that the rate of resignations has increased significantly.<sup>16</sup> In fact, the number of independent directors exiting without furnishing reasons other than "personal grounds and preoccupation" has only been growing every year.<sup>17</sup> This situation does not seem to be very different from 2009 i.e. post the Satyam fiasco, when at least six hundred and twenty independent directors resigned from the boards of Indian companies (albeit the number of listed companies in India in 2009 was lower).<sup>18</sup> Annexure I provides an overview of the number of resignations by independent directors from the boards of companies listed on the NSE along with various reasons cited for such resignations during the calendar years 2018 and 2019 (until July 22, 2019).

**The Companies Act seeks to limit the liability of independent and non-executive directors but does not provide any safeguards at the summoning stage. In practice, investigating authorities and courts often send summoning notices to all directors, which results in exposing independent and non-executive directors to protracted legal proceedings and substantial reputational harm.**

The Companies Act defines an 'independent director' as a 'non-executive' director' who, amongst other things, does not have a pecuniary relationship (besides remuneration) with the company, has not been an executive of the company in the preceding three financial years, is not related to its promoters or directors etc.<sup>19</sup> Therefore, in a sense, the Companies Act treats independent directors as a sub-set of non-executive directors, and has assigned additional and specific duties and responsibilities to them under Schedule IV which contains the code of professional conduct for independent directors ("Code of Conduct"). To the extent that both, independent and non-executive directors perform similar functions such as contributing to an 'outsider' perspective in decision-making and ensuring compliance with statutory obligations and corporate governance norms, this report, in examining the issue of outside

<sup>12</sup> Ibid.

<sup>13</sup> Thomas Clarke and Marie dela Rama, 'Beyond "Independent" Directors: A Functional Approach to Board Independence' (2006), Harvard Law Review, Vol. 119, No. 5, 1553-1554.

<sup>14</sup> Jayshree P. Upadhyay, 'Why Independent Directors are Rushing for the Exit Door,' LiveMint, December 19, 2018; Kala Vijayraghavan, Maulik Vyas, Rica Bhattacharyya, "More Independent Directors take the Exit Fearing Legal Scrutiny", The Economic Times, June 21, 2019; Based on information available on nseinfobase.com, developed and powered by Prime Database, a primary market research tracking firm which provides information on the boards of listed companies.

<sup>15</sup> Based on information available on nseinfobase.com, powered and developed by Prime Database (n. 14).

<sup>16</sup> Ibid.

<sup>17</sup> Jayshree P. Upadhyay (n. 14); Kala Vijayraghavan, Maulik Vyas, Rica Bhattacharyya, 'More Independent Directors take the Exit Fearing Legal Scrutiny', The Economic Times, June 21, 2019.

<sup>18</sup> Vikramaditya Khanna and Shaun J. Mathew (n. 2), 36.

<sup>19</sup> Section 149(6), Companies Act.

director liability, considers independent directors and non-executive directors to be on an equal footing (in line with the manner in which Indian courts and the Companies Act deal with their liability).

Against this background, this report argues that when it comes to the liability of independent and non-executive directors for wrongful conduct, the existing legal framework leaves much scope for improvement. It seeks to establish a link between the liability-related risks faced by independent directors and the factors present in the current framework governing them that hamper their ability to exercise their independence effectively. In doing this, it also examines the existing arrangements for appointing and removing directors in promoter-controlled companies which undermine the effectiveness of independent director oversight. This report stresses on the need to formulate effective safeguards for the protection of independent directors, especially on account of the co-relation between director independence and good corporate governance. It argues that the current framework governing the liability of such directors is riddled with incongruity and uncertainty. There is therefore a need to re-evaluate the extant framework in order to address the disconnect between the structural notion of independence and the substantive conduct principles that such directors are expected to abide by.

## This report is structured as follows:

**Chapter II** presents an overview of the legal and regulatory framework governing the liability of independent and non-executive directors in India. It also draws a comparison between India and the director liability frameworks in certain other jurisdictions such as the United States of America (“U.S.”) and the United Kingdom (“U.K.”).

**Chapter III** sets out the provisions relating to director liability across various Indian statutes (including summoning requirements), demonstrating the manner in which different laws deal with offences and contraventions by companies, attribute liability and carve out exceptions in order to limit liability.

**This report argues that when it comes to the liability of independent and non-executive directors for wrongful conduct, the existing legal framework leaves much scope for improvement.**

**Chapter IV** discusses the challenges faced by the present legal and regulatory framework governing the liability of independent and non-executive directors in India and highlights the potential issues posed by the same. Some of the issues discussed include examining the extent to which independent directors actually exercise independence in controlled companies, and limitations of safe harbour provisions and other protective mechanisms such as director and officer insurances and indemnities. This chapter also discusses the limitations of summoning requirements.

**Chapter V** presents certain recommendations in relation to reforming the extant liability framework governing independent and non-executive directors. It also provides a synopsis of the key recommendations proposed.

**Chapter VI** reiterates key learnings and draws attention to the importance of preserving the independent director model, not just notionally but also substantively, especially in the Indian context.

Annexure I provides an overview of the number of resignations by independent directors from the boards of companies listed on the NSE along with various reasons cited for such resignations during the calendar years 2018 and 2019 (until July 22, 2019).

Annexure II provides a synopsis of various Indian statutes along with the accompanying provisions relating to attribution of liability, sanctions/penalties and safe harbours.

# Chapter II: An Overview of Director Liability Frameworks

In order to critically examine the liability landscape of independent and non-executive directors in India, it becomes important to trace the course of its evolution and draw a comparison with governing regimes in other jurisdictions. For instance, in India, wherein most publicly listed companies have controlling shareholders, the need for independence on the board arises on account of the corporate governance concern that such controlling shareholders may be able to expropriate company assets or behave in an opportunistic manner at the cost of other shareholders. On the other hand, in the U.S., where the large majority of publicly traded companies have dispersed ownership, the main concern is that the company management may act in a manner that harms the shareholders in general.<sup>20</sup> This chapter discusses the broad approaches adopted by different jurisdictions, namely, the U.S., the U.K. and India, for dealing with and regulating outside director liability.

## A. A Brief Overview of the Regulatory Framework Governing Director Liability in the U.S.

The collapse of Enron, WorldCom and similar but less catastrophic disclosure failures vividly demonstrated

weaknesses in the board governance system which was a result of the 1990s, and also directed the path towards revised standards of independence and roles for independent directors.<sup>21</sup> These failures marked the origin of the tightened director independence requirements incorporated into the New York Stock Exchange's ("NYSE") listing standards, including compensation committees staffed solely by more stringently qualified independents.<sup>22</sup> Further, the WorldCom scandal of 2002 contributed to the already existing apprehensions with respect to issues in corporate governance and ultimately led to the enactment of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act").<sup>23</sup> These post-Enron reforms laid the groundwork for a revised model of corporate governance. The model operates at many different levels: it escalates the liability for primary wrongdoers, particularly, corporate officers, imposes new duties and liabilities and a revised regulatory structure on certain gatekeepers, including accountants, lawyers and securities analysts. The effect of the reforms on the board's role has been to make the role of the independent director more important than ever - both, the federal securities law and the stock exchange listing requirements imposed stringent standards of director independence.<sup>24</sup>

The NYSE and NASDAQ Stock Market, Inc. ("NASDAQ") listing rules require that independent directors comprise a majority of the board.<sup>25</sup> Controlled companies (i.e.,

<sup>20</sup> B. R. Cheffins, 'Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies', 23 *Oxford J. Leg. Stud.* (2003), 1, 12. As regards a large majority of publicly traded companies in the U.S. having a dispersed ownership pattern, it is important to note that recent research and academic literature indicate that such ownership pattern is undergoing a change, resulting in re-concentration of ownership with institutional investors, on account of various factors. See Ronald J. Gilson & Jeffrey N. Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights', *Columbia Law Review* (2013), Vol. 113:863, 886.

<sup>21</sup> Jeffrey N. Gordon, 'The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices' (2006), *Stanford Law Review*, Vol. 59, No. 6, 1535-1536.

<sup>22</sup> *Ibid.*

<sup>23</sup> Jeffrey N. Gordon (n. 21), 1539.

<sup>24</sup> *Ibid.*

<sup>25</sup> 'Corporate Governance 2018, Getting the Deal Through', Holly J. Gregory (2018), 223.

companies in which more than fifty percent of the voting power is held by an individual, group or another company) and foreign private issuers are exempt from this requirement.<sup>26</sup> Under the NYSE listing rules, for a director to be deemed 'independent', the board must affirmatively determine that he or she has no material relationship with the company.<sup>27</sup> A material relationship includes commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others.<sup>28</sup> Under the NYSE listing rules, directors having any of the following relationships may not be considered independent: a person who is an employee of the listed company or is an immediate family member of an executive officer of the listed company; a person who receives, or is an immediate family member of a person who receives compensation directly from the listed company, other than director compensation or pension or deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), of more than one hundred and twenty thousand U.S. dollars per year; a person who is a partner of, or employed by, or is an immediate family member of a person who is a partner of, or employed (and works on the listed company's audit) by a present or former internal or external auditor of the company; a person, or an immediate family member of a person, who has been part of an interlocking compensation committee arrangement; or a person who is an employee or is an immediate family member of a person who is an executive officer, of a company that makes payments to or receives payments from the listed company for property or services in an amount that in a single fiscal year exceeds the greater of two percent of such other company's consolidated gross revenues or one million U.S. dollars.<sup>29</sup>

In applying the independence criteria, no individual who has had a relationship as described above within the past three years can be considered independent (except in relation to the test set forth in the last point above, which is concerned with current employment relationships only).<sup>30</sup> Only independent directors are allowed to serve on audit, compensation and nominating or governance committees in NYSE and

NASDAQ companies.<sup>31</sup> Section 301 of the Sarbanes-Oxley Act defines an independent director for audit committee purposes as one who has not accepted any compensation from the company other than directors' fees and is not an 'affiliated person' of the company or any subsidiary. Section 301 of the Sarbanes-Oxley Act lays down the criteria for independence and provides that an executive officer of an 'affiliate' would not be considered independent for audit committee purposes. As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, NYSE and NASDAQ developed heightened independence standards for compensation committee members that became effective during 2014.<sup>32</sup> Under these standards, in affirmatively determining the independence of a director for compensation committee purposes, the board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the listed company that is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including the source of compensation received by the director and whether the director is affiliated with the company or any subsidiary.<sup>33</sup>

In general, all board members owe the same fiduciary

**The effect of the post-Enron reforms on the corporate governance landscape in the U.S. has been to make the role of the independent director more important than ever - both, the federal securities law and the stock exchange listing requirements impose stringent standards of director independence.**

<sup>26</sup> Ibid.

<sup>27</sup> Ibid.

<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

**In applying the standard of due care, subjective considerations may be taken into account, such as a director's background, skills, duties.**

duties regardless of their individual skills. However, case law indicates that when applying the standard of due care (i.e., that a director acted with such care as an ordinarily prudent person in a similar position would exercise under similar circumstances), subjective considerations, including a director's background, skills and duties, may be taken into account.<sup>34</sup> For instance, 'inside directors' (usually senior executives or officers) are often held to a higher standard because they participate more actively and have greater knowledge of the corporation's activities, as opposed to directors who are outsiders or independent.<sup>35</sup> Further, outside directors are usually not held liable for their decisions, even if such decisions harm the corporation or its shareholders, if the decisions fall within the judicially developed safe harbour commonly known as the 'business judgment rule'.<sup>36</sup> The judicial presumption underlying this rule is that independent directors make business decisions on an informed basis and with the belief, in good faith, that the decisions will serve the best interests of the corporation.<sup>37</sup> Therefore, in the event that a board's decision is challenged in a lawsuit, the courts usually examine whether the plaintiff has presented evidence to overcome this presumption.<sup>38</sup> In other words, as long as directors act without a conflict of interest, judges review board actions pursuant to the business judgment rule and if

they find that the board was reasonably well-informed, they dismiss suits for breach of duty of care, without delving into the merits of the decision.<sup>39</sup> This safe harbour protects independent directors from liability in instances wherein they have exercised due diligence and acted in an informed manner.<sup>40</sup>

In accordance with the Delaware General Corporation Law ("DGCL") (used herein as the reference point for all state corporate law as Delaware is the most common state of incorporation in the U.S.),<sup>41</sup> companies may and typically do purchase and maintain directors and officers liability insurance to protect directors and officers from the risk of personal liability.<sup>42</sup> Despite such coverage having become substantially more expensive, it is usually available and has not been limited by legislative and regulatory actions.<sup>43</sup> Companies are allowed to pay the premiums for directors and officers liability insurance.<sup>44</sup> With respect to indemnity, a company can indemnify a director for liability incurred if that director acted in good faith, in a manner that he or she reasonably believed was in the best interests of the company, and in case of criminal proceedings, had no reasonable cause to believe that his or her conduct was unlawful.<sup>45</sup>

Further, DGCL allows a corporation to provide additional protection to corporate directors through the adoption of a provision in their certificate of incorporation "*eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of a fiduciary duty as a director*" (known as exculpatory charter clauses).<sup>46</sup> Such a provision, when included in a company's charter, shields directors from personal monetary liability for decisions not otherwise protected by the 'business judgment rule', for example, gross

<sup>34</sup> Rebecca Grapsas, Claire H. Holland and Holly J. Gregory, 'Corporate Governance in the USA', Lexology Newsfeed, Sidley Austin LLP, April 18, 2019.

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

<sup>39</sup> Brian R. Cheffins and Bernard S. Black, 'Outside Director Liability across Countries' (2006), 84 Tex. L. Rev., 1395.

<sup>40</sup> Ibid.

<sup>41</sup> In the U.S., state corporate law (statutory and judicial) governs the formation of privately held and publicly traded corporations and the fiduciary duties of directors.

<sup>42</sup> Section 145(g), DGCL.

<sup>43</sup> Holly J. Gregory (n. 25), 227.

<sup>44</sup> Ibid.

<sup>45</sup> Section 145, DGCL.

<sup>46</sup> Section 102(b)(7), DGCL.



negligence.<sup>47</sup> Specifically with respect to the effect of such exculpatory provisions on independent directors, the Delaware supreme court has confirmed that exculpated claims for damages against independent directors are subject to dismissal, regardless of the underlying standard of review that governs the court's evaluation of the board's conduct or the transaction.<sup>48</sup> In arriving at this result, the court has acknowledged the value of negotiating efforts by independent directors and their ability to secure transactions with controlling stockholders that are favourable to minority stockholders, and expressed concerns that adopting a different standard would create incentives for independent directors to avoid serving as special committee members or reject transactions solely because acceptance would put them at the risk of prolonged litigation.<sup>49</sup> However, such a provision may not protect directors from liability for the following: breaches of duty of loyalty, acts or omissions not in good faith or involving intentional misconduct or a knowing violation of law, unlawful payments of dividends, unlawful stock purchases, or redemptions, or any transaction from which the director derived an improper personal benefit.<sup>50</sup> Further, in cases where companies have formed special committees comprising independent, disinterested and non-management directors to evaluate transactions, corporations themselves can avoid liability if the courts are satisfied as regards the objectivity and impartiality of the members of such committees.<sup>51</sup> Moreover, Delaware law recognizes a "futility" exception and excuses demand if the shareholders allege particularised facts creating a reasonable doubt that the directors are disinterested and independent or that the challenged transaction was otherwise a product of valid business judgment.<sup>52</sup> Under Delaware law, this demand-futility analysis focuses largely on whether the directors of the corporation are sufficiently independent and disinterested to fairly consider the demand. When fiduciary claims are brought, the directors enjoy certain procedural advantages, for instance, the business judgment rule requires courts to presume

that the directors are acting in good faith and in the best interests of the corporation and to overcome that presumption, shareholders have a relatively heavy burden to allege facts without the benefit of demonstrating that directors are not independent.<sup>53</sup>

## B. A Brief Overview of the Regulatory Framework Governing Director Liability in the U.K.

The U.K. Corporate Governance Code ("Code") recommends that a listed company's board should include an appropriate combination of executive and non-executive directors (and in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision-making process.<sup>54</sup> It also recommends that for companies listed

**Outside directors are usually not held liable for their decisions if such decisions fall within the 'business judgment rule'. The underlying presumption of this judicially developed safe harbor is that independent directors make business decisions on an informed basis and with the belief, in good faith, that the decisions will serve the best interests of the corporation.**

<sup>47</sup> Don Tucker, Cliff Brinson and Isaac Linnartz, 'Exculpatory Provisions Provide Powerful Protection for Independent Directors', Corporate and Securities Litigation Alert, Smith Anderson, October, 2015.

<sup>48</sup> *In re Cornerstone Therapeutics, Inc. Stockholder Litigation*, No. 564, 2014 & No. 706, 2014 (Del. May 14, 2015).

<sup>49</sup> Don Tucker, Cliff Brinson and Isaac Linnartz (n. 47).

<sup>50</sup> Holly J. Gregory (n. 25), 227.

<sup>51</sup> Patricia J. Villareal, Scott Fletcher, Jonathan Rosenberg and Evan P. Singer, 'The Importance of Independent and Disinterested Directors for Corporate Litigation in Texas', Jones Day, Commentaries, April 2010; Jonathan Rosenberg and Alexandra Lewis-Reisen, 'Controlling-Shareholder Related-Party Transactions under Delaware Law', Harvard Law School Forum on Corporate Governance and Financial Regulation, August 30, 2017.

<sup>52</sup> Patricia J. Villareal, Scott Fletcher, Jonathan Rosenberg and Evan P. Singer (n. 51).

<sup>53</sup> *Ibid.*

<sup>54</sup> Supporting Principle, B.1.2, Code

**The standard of skill and care owed to a company by its directors and its non-executive directors in the U.K. is likely to be different owing to the subjective test of the level of skill and care owed by a director to their company.**

in the FTSE 350,<sup>55</sup> at least half of the board, excluding the chairman, should be made up of independent non-executive directors.<sup>56</sup> Therefore, in a typical British company, non-executive directors make up about half of the board, compared to the two-thirds (or more) which is prevalent in the U.S. today.<sup>57</sup> Another difference between the U.S. and the U.K. regulatory frameworks is that in the U.K., one of the most crucial principles and provisions that the Code encompasses is that there should be a separation between the roles of the chairman and the chief executive officer of a listed company.<sup>58</sup>

The criteria for assessing the independence of a non-executive director are set out in provision B.1.1 of the Code. The Pension and Lifetime Savings Association (“PLSA”) also publishes guidance on this matter in its ‘Corporate Governance Policy and Voting Guidelines’, and it helps institutional investors in determining whether a director is indeed independent.<sup>59</sup> The PLSA suggests that voting sanctions could be warranted in the event that the appointment of a non-independent non-executive director compromises the composition of key committees or the board itself. Additionally,

provision 15 of the proposed revised Code, published by the Financial Reporting Council (“FRC”) in December 2017, strengthens non-executive independence requiring the chairman to meet the independence requirements throughout his or her tenure, and not only on his or her appointment.<sup>60</sup>

Like U.S. law, U.K. company law, i.e., the Companies Act 2006 (“CA 2006”) does not distinguish between the duties owed to a company by its executive directors and its non-executive directors.<sup>61</sup> However, executive directors owe special duties arising out of their contracts of employment over and above these statutory obligations.<sup>62</sup> These contractual obligations are generally different from the supervisory responsibilities discharged by non-executive directors.<sup>63</sup> Executive directors, for example, are responsible for the day-to-day running of the company, while the role of the non-executive director is to challenge, review and monitor the performance of the board.<sup>64</sup> Recent case law also suggests that English courts have recognised the part-time role that non-executives play in a public company and that they assess their duties accordingly.<sup>65</sup> The FRC’s Guidance on Board Effectiveness states that constructive challenge from non-executive directors is an essential aspect of good corporate governance, and it should be welcomed by the executive directors.<sup>66</sup>

Directors owe their companies duties of care, skill and diligence. This duty is similar to the U.S. duty of care in spirit, but the culpability standard is one of negligence rather than gross negligence, as applied in the U.S.<sup>67</sup> The standard of skill and care owed to the company by its directors and its non-executive directors is also likely to be different owing to the subjective test of the level of skill and care owed by a director to their company.<sup>68</sup> As non-executive directors are less involved with the day-to-day management of the company, they are usually not

<sup>55</sup> The FTSE 350 Index is a market capitalisation weighted stock market index incorporating the largest three hundred and fifty companies by capitalisation which have their primary listing on the London Stock Exchange.

<sup>56</sup> Provision B.1.2, Code

<sup>57</sup> Brian R. Cheffins and Bernard S. Black (n. 39), 1399.

<sup>58</sup> Holly J. Gregory (n. 25), 193.

<sup>59</sup> Holly J. Gregory (n. 25), 205.

<sup>60</sup> Ibid.

<sup>61</sup> Ibid.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

<sup>64</sup> Ibid.

<sup>65</sup> Brian R. Cheffins and Bernard S. Black (n. 39), 1401.

<sup>66</sup> Holly J. Gregory (n. 25), 205.

<sup>67</sup> Brian R. Cheffins and Bernard S. Black (n. 39), 1401.

<sup>68</sup> Section 174(2)(b), CA 2006.



expected to demonstrate a standard of skill and care that is as high as the standard for executive management.<sup>69</sup> It is accepted that non-executive directors are likely to devote significantly less time to a company's affairs than an executive director and that the detailed knowledge and experience of a company's affairs that could reasonably be expected of a non-executive director will generally be less than that for an executive director.<sup>70</sup> However, if a non-executive director serves on a board committee, he or she will be expected to exercise greater skill and care in relation to matters within the remit of that committee than would directors who are not members of the relevant committee.<sup>71</sup>

The Code advises that the board should appoint one of the independent non-executive directors as senior independent director.<sup>72</sup> The role includes leading a meeting of the non-executive directors to appraise the chairman's performance (without the chairman being present) at least annually and on such other occasions as deemed appropriate.<sup>73</sup> The senior independent director should also hold meetings with the non-executive directors without the executives present.<sup>74</sup> The senior independent director should also be available to shareholders if they have concerns that contact with the company through the normal channels of chairman, chief executive officer or other executive directors has failed to resolve or for which such contact is inappropriate.<sup>75</sup>

Generally, any provision that purports to exempt a company director from liability that would otherwise link him or her with negligence, default, breach of duty or breach of trust in relation to the company, is void.<sup>76</sup> However, there are exceptions to this rule, in the form of provisions for directors and officers liability insurance and indemnification. Moreover, a company may also preclude the liability of a director for a breach of his or her duty to avoid conflicts of interest by including provisions in its articles of association under which a director may

enter into certain arrangements that would otherwise amount to a breach of this duty.<sup>77</sup> Further, the company may pre-authorise a breach of duty by a director in accordance with a relevant rule of law (for example, by the common law rule that a company may authorise a breach of duty if full and frank disclosure is made of all material facts (although, a company may not authorise an unlawful act)).<sup>78</sup> Companies may also relieve their directors of liability for any negligence, default, breach of duty or breach of trust in relation to the company by ratifying such conduct after it has occurred, by way of a shareholder resolution.<sup>79</sup> However, it is unlikely that shareholders will be permitted to ratify unlawful acts.<sup>80</sup>

The CA 2006 permits companies to maintain directors and officers liability insurance but there is no obligation to do so.<sup>81</sup> The Code also recommends that companies should arrange appropriate insurance cover in respect of legal actions against their directors.<sup>82</sup> Directors and officers liability insurance protects directors and officers from financial liability for any claims made against them

**Generally, any provision that purports to exempt a director from liability that would otherwise link him with breach of duty, default etc., is void. However, there are exceptions to this rule, in the form of directors and officers liability insurance, indemnification and inclusion of appropriate provisions in the charter documents of the company.**

<sup>69</sup> Holly J. Gregory (n. 25), 205.

<sup>70</sup> Ibid.

<sup>71</sup> Holly J. Gregory (n. 25), 205.

<sup>72</sup> Ibid.

<sup>73</sup> Ibid.

<sup>74</sup> Ibid.

<sup>75</sup> Provisions A.4.1 and A.4.2, Code.

<sup>76</sup> Section 232(1), CA 2006.

<sup>77</sup> Section 180(4)(b), CA 2006.

<sup>78</sup> Section 180(4)(a), CA 2006.

<sup>79</sup> Sections 239(1) and 239(2), CA 2006.

<sup>80</sup> Section 239(7), CA 2006.

<sup>81</sup> Section 233, CA 2006.

<sup>82</sup> Provision A.1.3, Code.

**The reports of various committees on corporate governance have recognized the unique challenges faced by the Indian market and as a result, their recommendations have consistently focused on the independence of directors, and affiliated principles, such as transparency, fairness, accountability, verifiability and enforceability.**

regarding the performance of their duties.<sup>83</sup> A typical liability insurance policy provides cover for directors, officers, managerial and supervisory employees and the company itself, to the extent that it has indemnified such persons.<sup>84</sup> These policies generally cover losses as court costs and damages in respect of claims brought for the wrongful acts of the insured.<sup>85</sup> However, certain types of claims are not covered by such policies, such as those in respect of fraud, dishonesty, property damage or personal injury.<sup>86</sup>

With respect to indemnities, a company generally may not exempt a director from liability for any negligence, default, breach of duty or breach of trust in relation to the company, nor indemnify him or her in respect of such behaviour.<sup>87</sup> However, as stated above, a company may maintain insurance for a director in respect of such liability and provide directors with an indemnity in respect of such liability by way of a qualifying third-party indemnity provision (“QTPIP”) or a qualifying pension scheme indemnity provision (“QPSIP”).<sup>88</sup> A QTPIP indemnifies

a director in respect of liability incurred to a third party (that is, a liability that is not incurred by the director to the company itself or to an associated company).<sup>89</sup> However, a QTPIP must not indemnify a director in respect of fines imposed in criminal proceedings, regulatory penalties, the liabilities incurred in defending the director against criminal proceedings in which he or she is convicted, the liabilities incurred in defending civil proceedings brought by the company in which judgment is given against him or her or certain applications for relief in which the court refuses to grant him or her relief.<sup>90</sup> A QPSIP indemnifies a director of a company that is a trustee of an occupational pension scheme against liability incurred in connection with the company’s activities as trustee of the scheme.<sup>91</sup> A QPSIP must not indemnify a director in respect of fines imposed in criminal proceedings, regulatory penalties or liability incurred by the director in defending criminal proceedings in which he or she is convicted.<sup>92</sup> The existence of either a QTPIP indemnity or a QPSIP indemnity must be disclosed in the directors’ report.<sup>93</sup> A company may also provide directors with funds to pay for their expenses in defending any civil or criminal proceedings in connection with any alleged negligence, default, breach of duty or breach of trust in relation to the company or an associated company, or for making applications for relief under various provisions of the CA 2006.<sup>94</sup> Moreover, a company may also advance funds to a director to meet the costs of defending any regulatory investigation or action concerning him or her.<sup>95</sup>

## **C. Legal and Regulatory Framework Governing Director Liability in India**

In India, the Companies Act and the SEBI (Listing

<sup>83</sup> Holly J. Gregory (n. 25), 210.

<sup>84</sup> Ibid.

<sup>85</sup> Ibid.

<sup>86</sup> Ibid.

<sup>87</sup> Sections 232(1) and (2), CA 2006.

<sup>88</sup> Section 232(2), CA 2006.

<sup>89</sup> Section 234(2), CA 2006.

<sup>90</sup> Section 234(3), CA 2006.

<sup>91</sup> Section 235(2), CA 2006.

<sup>92</sup> Section 235(3), CA 2006.

<sup>93</sup> Section 236(1), CA 2006.

<sup>94</sup> Sections 661, 1157, 205(1) and 205(5), CA 2006.

<sup>95</sup> Holly J. Gregory (n. 25), 211.

Obligations and Disclosure Requirements) Regulations, 2015 (“**LODR Regulations**”) govern the framework for corporate governance. The regulatory response in India to international corporate scandals such as Enron, WorldCom and Tyco, and their domestic counterparts, such as Satyam and 2G, was to improve corporate governance standards and practices in both, letter and spirit. Since 1998, corporate governance guidelines, both mandatory and voluntary, have and continue to evolve, as a result of the recommendations of various committees appointed by the MCA, SEBI and the Confederation of Indian Industry (“**CII**”).<sup>96</sup> The SEBI report on corporate governance chaired by Mr. N. R. Narayana Murthy (2003), the CII Task Force report on corporate governance chaired by Mr. Naresh Chandra (2009) and more recently, the SEBI report on corporate governance chaired by Mr. Uday Kotak (2017), have all recognised the inherently unique challenges (and the accompanying risks) faced by India. One such challenge is in relation to the fact that promoter-led companies constitute a sizeable portion of the Indian market, which in certain situations might lead to the possibility of promoter interests taking precedence over those of other stakeholders and cause governance concerns.<sup>97</sup> In fact, cases like IL&FS indicate that such risks are relevant for other (non-promoter-run) companies as well. As a result, the reports of these committees have consistently focused on, amongst other things, the independence of directors, and affiliated principles, such as transparency, fairness, accountability, verifiability and enforceability.<sup>98</sup> The recommendations made by these reports with respect to independent and non-executive directors are reflected in various provisions of the Companies Act and the LODR Regulations (discussed below). Clause 49 of the Listing Agreement which lays down the standards for corporate governance was amended in 2014 to ensure conformity with the Companies Act.<sup>99</sup>

The Companies Act defines an ‘independent director’ as a non-executive director, who, amongst other factors: does not have any pecuniary relationship, other than remuneration, or having transactions not exceeding ten percent of his or her total income or other prescribed amount, with the company, its

promoters, its directors, its senior management or its holding company, its subsidiaries and associates during the two immediately preceding financial years, which may affect the independence of the director; is not related to the promoters or directors of the company or its holding subsidiary or associate company; has not been an executive of the company in the immediately preceding three financial years; is not a partner or executive or was not a partner or executive, during the preceding three years of: (i) the statutory audit firm or the internal audit firm that is associated with the company; or (ii) legal firms and consulting firms that have a material association with the company; and is not a substantial shareholder of the company, owning two percent or more of the voting shares along with his or her relatives.<sup>100</sup> The Companies Act does not define a ‘non-executive director’ as such, but the term is commonly used to refer to directors who are directors simpliciter, and do not hold any managerial positions, besides being a member of the board of directors.<sup>101</sup> Unlike executive directors, independent directors are not responsible for the day to day management of the company. They instill an external and wider perspective, bring independence to the decision-making process and ensure compliance by the company with corporate governance norms. They are also expected to act as whistle blowers and act in the shareholders’ and public interest, for the implementation of corporate

**Supreme court in Pooja Ravinder Devidasani v State of Maharashtra & Ors:**  
**“a non-executive director is no doubt a custodian of the governance of the company but simply because a person is a director of a company, he does not become liable for all the actions of the company.”**

<sup>96</sup> Utkarsh Goel, Shailendra Kumar, Kuldeep Singh and Rishi Manrai (n. 1), 63.

<sup>97</sup> Report of the SEBI Committee on Corporate Governance (2003); Corporate Governance: Recommendations for Voluntary Adoption - Report of the CII Task Force on Corporate Governance (2009); and SEBI Report of the Committee on Corporate Governance (2017).

<sup>98</sup> Ibid.

<sup>99</sup> CIR/CFD/POLICY CELL/2/2014 - Corporate Governance in Listed Entities - Amendments to Clauses 35B and 49 of the Equity Listing Agreement, April 17, 2014.

<sup>100</sup> Section 149(6), Companies Act.

<sup>101</sup> Holly J. Gregory (n. 25), 60.

governance principles.<sup>102</sup> Moreover, they are also required to hold and attend at least one meeting in a year without the attendance of non-independent directors and members of management to review the performance of non-independent directors, the chairman, and the board in its entirety, and also assess the quality, quantity, and timelines of flow of information between the management of the company and the board.<sup>103</sup>

The Companies Act requires listed companies to have at least one-third of their boards made up of independent directors.<sup>104</sup> In addition to the fiduciary duties owed by the directors to companies, and other duties of directors such as the duty to act in accordance with the articles of association of the company, to act in good faith to promote the objects of the company, the duty of care, skill and diligence and to exercise independent judgment, and to not obtain any undue gain or advantage either for themselves, their relatives, partners or associates<sup>105</sup>, the Companies Act lays down specific provisions in relation to independent directors in the Code of Conduct prescribed under Schedule IV. It also provides stringent qualifications for independent directors, including detailed guidelines for their appointment, roles, responsibilities, removal and resignation, to ensure that they work in an objective manner. Some of the key functions under the Code of Conduct include: help in bringing independent judgment to the board, scrutinise the performance of the management in meeting goals, safeguarding the interests of all stakeholders, particularly, minority shareholders, balancing the conflicting interests of stakeholders, in cases where they have concerns about the running of the company or a proposed action, ensuring that those issues are addressed by the board, and to the extent they are unresolved, insisting on such concerns being recorded in the minutes of board meetings, report concerns of unethical behaviour, fraud or violations of the code of conduct or the ethics policy of the company. The Companies Act also mandates the compulsory presence of independent directors in the corporate social responsibility committee, nomination

and remuneration committee and the audit committee of companies.<sup>106</sup>

The LODR Regulations make it mandatory for listed companies to have at least half of their board made up of independent directors if the chairman of the board is an executive director, or a non-executive director who is a promoter or is related to the promoters or holds a managerial position at the board level or a level below that.<sup>107</sup> In cases where the chairman of the board is a non-executive director not falling in any of the categories aforementioned, listed companies must have at least one-third of their directors made up of independent directors.<sup>108</sup> Further, the LODR Regulations state that independent directors must be provided suitable training to familiarise them with the company, nature of the industry in which the company operates, their role, rights, responsibilities, the business model of the company, and the details of such training must be disclosed by the company in its annual report.<sup>109</sup>

Under the Companies Act, being fiduciaries, directors are exposed to liabilities as a consequence of a breach of their duties. Such liabilities can broadly be classified into two categories: the first set of liabilities is statutory in nature, and it could be either civil liability, requiring directors to make payments to the state or victims, or criminal liability, resulting in fines or imprisonment; the second set of liabilities arise from claims made against directors, either by the company, or the shareholders, for breaches of directors' duties.<sup>110</sup> The severity of the liability provisions has been addressed through certain relief or safe harbour provisions which operate in favour of directors. For instance, in any proceedings, a director can seek relief on the ground that he or she acted honestly and reasonably, and that having regard to all the circumstances of the case, such director ought to be excused.<sup>111</sup>

In the case of independent directors and non-executive directors, the Companies Act creates specific safe harbour provisions, in an attempt to balance the

---

<sup>102</sup> Ibid.

<sup>103</sup> Schedule IV, Companies Act.

<sup>104</sup> Section 149(4), Companies Act.

<sup>105</sup> Section 166, Companies Act.

<sup>106</sup> Sections 135, 177 and 178, Companies Act.

<sup>107</sup> Regulation 17, LODR Regulations.

<sup>108</sup> Ibid.

<sup>109</sup> Regulation 25, LODR Regulations.

<sup>110</sup> Umakanth Varottil, 'Director Liability Under the New Regime', IndiaCorp Law, June 16, 2014.

<sup>111</sup> Section 463, Companies Act.

extensive nature of their duties and the liabilities imposed on them. The supreme court, in *Pooja Ravinder Devidasani v State of Maharashtra & Ors*<sup>112</sup> held that “...although a non-executive director is no doubt a custodian of the governance of the company and is not usually involved in the day-to-day affairs of the running of its business, if it is proved that at the time the specific decision was taken, the director was at the helm of affairs of the company, he may be made liable, but simply because a person is a director of a company, he does not become liable for all the actions of the company.” The rationale behind insulating independent and non-executive directors from potential liability is to limit their liability only to matters that they are connected with. In other words, the mitigating factors for independent and non-executive directors have been specifically designed to protect and prevent them from being held liable for acts of the company which are beyond their control or not within their mandate, in their capacity as outside directors who are not involved in the everyday affairs of the company. Section 149(12) of the Companies Act provides that an independent director and a non-executive director can only be held liable in respect of such acts of omission or commission by a company which had occurred with: (i) his knowledge; (ii) attributable through board processes; and (iii) with his consent or connivance; or (iv) where he had not acted diligently.

The Companies Act permits companies to obtain insurance on behalf of its key managerial personnel to indemnify them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust.<sup>113</sup> In the event that a director or officer is found guilty, the premium paid on any such insurance is to be treated as a part of his or her remuneration.<sup>114</sup> The LODR Regulations mandate that the top five hundred listed entities by market capitalisation should undertake directors and liability insurance for all their independent directors of such quantum and for such risks as may be determined by the board.<sup>115</sup>

With respect to indemnities, Indian companies can indemnify directors for liabilities related to negligence,

default, misfeasance, breach of duty or breach of trust, as regards the company. As provided under the model articles of association to the Companies Act, companies are required to indemnify every director or officer of the company against any liability incurred by him in defending any proceeding (civil or criminal) in which judgment is given in his favour or in which he is acquitted or discharged, at its own cost.<sup>116</sup> These liabilities are different from those incurred by directors in the ordinary course of managing the company's affairs, in good faith and within their authority.<sup>117</sup> While dealing on behalf of a company in good faith, directors have been treated as the company's agents and have accordingly been provided with safeguards available to agents, generally, under the Indian Contract Act, 1872 (including the right to seek indemnity from the principal, the company).<sup>118</sup> Companies ordinarily include specific provisions in their articles of association for directors' indemnities, to the extent that such indemnities are in line with the provisions of the Companies Act.<sup>119</sup>

Further, directors may face both, civil and criminal liability, under various other laws which govern a broad spectrum of issues, including but not limited to protection of the environment, labour and employment, anti-trust practices and data protection. A significant number of these statutes have a provision titled “offences by companies”, which make the

**Directors may face both, civil and criminal liability, under various laws which govern a broad spectrum of issues, and make the person in charge of and responsible at the time of commission of the offence, as well as other officers liable for that offence.**

<sup>112</sup> Criminal Appeal Nos. 2604-2610 of 2014 arising out of Special Leave Petition (CRL) Nos. 9133-9139 of 2010.

<sup>113</sup> Section 197(13), Companies Act.

<sup>114</sup> Section 197, Companies Act.

<sup>115</sup> Regulation 25(10), LODR Regulations.

<sup>116</sup> Holly J. Gregory (n. 25), 64.

<sup>117</sup> Ibid.

<sup>118</sup> Section 124, Indian Contract Act, 1872.

<sup>119</sup> Holly J. Gregory (n. 25), 64.

person in-charge of and responsible at the time of commission of the offence, as well as other officers (on the satisfaction of certain conditions) liable for that offence. While these statutes do not differentiate between executive directors and non-executive directors, they generally contain limitations on liability in the form of mitigating factors such as knowledge,

exercise of due diligence, and consent or connivance. The range of offences (and provisions imposing civil liability) and their accompanying sanctions/penalties, across various statutes, under which independent and non-executive directors can be held liable, have been discussed in more detail in the next chapter.





# Chapter III: Examining India's Existing Director Liability Framework

---

While chapter II of this report discussed the regulatory framework governing director liability in a broad comparative context, this chapter provides a detailed overview of various Indian statutes which impose liability on directors, along with the accompanying sanctions/penalties, summoning requirements and carve-outs for limiting liability. It also briefly discusses case law and analyses the manner in which courts in India have dealt with the issue of imposing liability on independent and non-executive directors.

In India, statutes governing various offences, such as tax evasion, securities frauds, money laundering and environmental degradation, impose liability on corporate officers for the company's wrongful actions. These statutes typically contain a provision titled "offences by companies" which impose liability on directors as follows: (i) every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the specific statute is deemed guilty of the offence and is liable to be proceeded against and punished; and (ii) where an offence has been committed by a company and it is proved that the offence: (a) has been committed with the consent or connivance of; or (b) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary or other officer is deemed guilty of the offence and is liable to be proceeded against and punished accordingly. For persons falling within the scope of (i), the carve out limiting liability is that such persons shall not be liable to any punishment under the specific statute if he proves that the offence was committed without his knowledge or that he had exercised due diligence to prevent the commission of such offence. For persons covered under (ii), it has

to be proved that the offence had been committed either with the consent or connivance of, or that it was attributable to neglect on part of such persons, for them to be held liable and punished.

A careful reading of such provisions demonstrates that Indian statutes impose liability on directors in primarily two ways: (i) vicarious liability on those officers who are in charge of and responsible to the company for the conduct of its business - this imposition of liability is based on the powers and responsibilities assigned to the directors, and the actual commission of any particular wrong by a director is not a prerequisite to be held liable; and (ii) vicarious liability on those officers who have contributed to the contravention or the offence by consenting, conniving or not acting diligently, thereby allowing the offence to take place - this imposition of liability requires some wrong doing on part of the directors, through means such as consent or connivance.<sup>120</sup> In this regard, the supreme court in *SEBI v Gaurav Varshney*<sup>121</sup> held as follows: "...a company being a juristic person, all its deeds and functions are the result of acts of others. Therefore, officers of a company who are responsible for acts done in the name of the company are sought to be made personally liable for acts which result in criminal action being taken against the company. It makes every person who, at the time the offence was committed, was in charge of, and was responsible to the company for the conduct of business of the company, as well as the company, liable for the offence. The liability arises from being in charge of and responsible for the conduct of business of the company at the relevant time when the offence was committed and not on the basis of merely holding a designation or office in a company. Conversely, a person not holding any office or designation in a company may be liable if he

---

<sup>120</sup> Umakanth Varottil, 'Supreme Court on Vicarious Liability of Corporate Officers', *IndiaCorp Law*, April 3, 2017.

<sup>121</sup> (2016) 14 SCC 430.

**Indian statutes impose liability on directors in primarily two ways: (i) vicarious liability on those officers who are in charge of and responsible to the company for the conduct of its business; and (ii) vicarious liability on those officers who have contributed to the contravention or the offence by consenting, conniving or not acting diligently, thereby allowing the offence to take place.**

satisfies the main requirement of being in charge of and responsible for the conduct of business of a company at the relevant time. Liability depends on the role one plays in the affairs of a company and not on designation or status.” Further, in *National Small Industries v Harmeet Singh Paintal*<sup>122</sup>, the supreme court has stated that for making a director of a company liable for offences committed by the company, there must be specific averments against the director showing as to how and in what manner the director was responsible for the conduct of the business of the company. Moreover, if the person responsible to the company for the conduct of the business of the company, was not in charge of the conduct of the business of the company, then he can be made liable only if the offence was committed with his consent or connivance or as a result of his negligence.<sup>123</sup>

The sanctions and penalties for offences by companies under these laws range from imprisonment for three months and/or fine of one thousand rupees<sup>124</sup>, to imprisonment for ten years, and/or fine upto twenty five crore rupees.<sup>125</sup> Examples of such laws include the Black Money (Undisclosed Foreign Income and Assets) and

Imposition of Tax Act, 2015, the Prevention of Money Laundering Act, 2002, the Information Technology Act, 2000, the Foreign Exchange Management Act, 1999, the SEBI Act, the Environment (Protection) Act, 1986, the Income Tax Act, 1961 and the Employees’ Provident Fund and Miscellaneous Provisions Act, 1952. In *Sunil Bharti Mittal v CBI*<sup>126</sup>, the supreme court addressed the question of when directors and other officials of a company can be held vicariously liable for the actions of the company, and held that an individual can be held liable for an offence by the company: (i) if there is sufficient evidence of the individual’s active role coupled with criminal intent; and (ii) where the statute itself stipulates the liability of directors and other officials.<sup>127</sup> Recently, in *Shiv Kumar Jatia v State of NCT of Delhi*<sup>128</sup>, the supreme court has reiterated the principles laid down by it in the *Sunil Bharti Mittal* case and stated the following: “...while considering the circumstances when a director/person in charge of the affairs of the company can also be prosecuted, when the company is an accused person, this court has held, a corporate entity is an artificial person which acts through its officers, directors, managing director, chairman etc. If such a company commits an offence involving mens rea, it would normally be the intent and action of that individual who would act on behalf of the company. At the same time, it is observed that it is the cardinal principle of criminal jurisprudence that there is no vicarious liability unless the statute specifically provides for it. ...it is clear that an individual either as a director or a managing director or chairman of the company can be made an accused, along with the company, only if there is sufficient material to prove his active role coupled with criminal intent. Further, the criminal intent alleged must have direct nexus with the accused.”

Certain statutes such as the Competition Act, 2002 and the Foreign Exchange Management Act, 1999 impose civil liability on directors for contraventions by companies. The penalties are usually contingent on the amount involved in the contravention (where the amount is quantifiable) and range from a fine of two lakh rupees to one crore rupees. The manner in which liability is attributed and limited is similar to other statutes that impose criminal liability on directors for

<sup>122</sup> Criminal Appeal No. 320-336 of 2010 (arising out of Special Leave Petition (CRL) Nos. 445-461 of 2010)).

<sup>123</sup> *K.K. Ahuja v V.K. Vora and Another* [(2009) 10 SCC 48].

<sup>124</sup> Section 23, Contract Labour (Regulation and Abolition) Act, 1970.

<sup>125</sup> Section 24, SEBI Act, 1992.

<sup>126</sup> Criminal Appeal No. 34 of 2015 (arising out of Special Leave Petition (CRL) No. 2961 of 2013)).

<sup>127</sup> *Ibid.*

<sup>128</sup> Criminal Appeal No. 1263 of 2019 (arising out of Special Leave Petition (CRL) No. 8008 of 2018)).



offences by companies (as discussed above). Annexure II sets out various Indian statutes along with the accompanying liability provisions, sanctions/penalties, as well as safe harbours in more detail.

The Companies Act approaches the issue of director liability differently, as compared to the aforementioned statutes. The Companies Act has codified directors' duties under section 166, the provisions of which apply to all categories of directors, including independent and non-executive directors. Some of these duties include acting in good faith in order to promote the objects of the company, acting in accordance with the articles of the company and exercising due and reasonable care, skill, diligence and independent judgment.<sup>129</sup> The duties set out under section 166 of the Companies Act are essentially reflective of common law principles of fiduciary duties of directors. Contravention of the provisions of section 166 results in civil liability with directors being punishable for a fine of not less than one lakh rupees, which may extend to five lakh rupees.<sup>130</sup> Similarly, there are other provisions in the Companies Act which impose civil liability on directors for various contraventions, such as mis-statements in prospectus, according to which every person who is a director of the company at the time of the issue of the prospectus is liable to pay compensation to every person who has sustained loss or damage as a result of such mis-statement.<sup>131</sup>

For offences committed by companies, the Companies Act imposes vicarious liability on officers who are in default. The scope of the concept of "officer who is in default" is broad, comprising five main categories: (i) whole time directors and key managerial personnel; (ii) personnel who, while reporting to the key managerial personnel, are responsible for maintaining, filing or distributing accounts and records, and actively participate in, knowingly permit or knowingly fail to take active steps to prevent any default; (iii) persons who advise the board in a professional capacity; (iv) directors who were aware of the contraventions that led to or constituted the offence committed by the company, either because they participated in the board proceedings or were in receipt of such board proceedings that led to such contraventions

(without objecting), even if it is the case that they were not present during these board proceedings; and (v) persons associated with the issue or transfer of a company's shares, such as share transfer agents, registrars and merchant bankers.<sup>132</sup> Since whole time directors are covered under the first category, the fourth category can be construed as applying to independent directors and non-executive directors, who are not in charge of the day to day affairs of a company, but serve on the board to ensure compliance with principles such as transparency, objectivity and accountability by the company.

Therefore, in terms of their duties and functions, the potential liability of these directors appears to be disproportionate, and the Companies Act seeks to address this concern by mitigating such liability through the safe harbours provided for in section 149(12). In order to insulate potential liability for independent and non-executive directors for acts of the company that cannot be attributed to them, and to limit their liability to matters relatable only to them, section 149(12) of the Companies Act provides that independent directors and non-executive directors are liable only in respect of such acts of omission or commission by a company which occurred with their knowledge, attributable through board processes, and

### Supreme court in *Sunil Bharti Mittal v CBI*:

**"Directors and other officials of a company can be held vicariously liable for the actions of the company: (i) if there is sufficient evidence of the individual's active role coupled with criminal intent; and (ii) where the statute itself stipulates the liability of directors and other officials."**

<sup>129</sup> Section 166, Companies Act.

<sup>130</sup> Section 166(7), Companies Act. The Companies Act also imposes criminal liability for certain breaches of directors' duties, for example, any director who contravenes the provisions of section 184 (disclosure of interest by directors) can be punished with imprisonment for a term which may extend to one year, or with a fine not less than fifty thousand rupees, which may extend to one lakh rupees, or both.

<sup>131</sup> Section 35, Companies Act.

<sup>132</sup> Section 2(60), Companies Act.

**Section 149(12) of the Companies Act seeks to limit the liability of independent and non-executive directors by providing that they are liable only in respect of such acts of omission or commission by a company which occurred with their knowledge, attributable through board processes, and with their consent or connivance or where they had not acted diligently.**

with their consent or connivance or where they had not acted diligently. The scope of the provision can be understood by analysing each of the components in more detail.

While the issue of 'knowledge' arises in various areas of contract, corporate and commercial law, the response to the question of when a matter can be considered to be within the knowledge of an independent or a non-executive director, would require an inquiry into both, actual knowledge as well as constructive knowledge.<sup>133</sup> Actual knowledge would refer to something the director in fact knew. Constructive knowledge, on the other hand, would refer to something the director 'ought to know', which would impose an obligation on the director to conduct due enquiry.<sup>134</sup> Moreover, any analysis of knowledge has to be done keeping in mind the overall role and function of independent and non-executive directors, and the fact that they are primarily involved in company matters in a strategic and advisory capacity, rather than on a regular or day to day basis. The linking of knowledge with 'attributable through board processes' makes the concept wider, implying that a director is deemed to have knowledge of all matters that have been taken up at the board level or discussed in board meetings.<sup>135</sup> Therefore, in

order to invoke the safe harbour provision, directors may be required to take additional practical steps, such as ensuring that any questions raised or dissent expressed by them in a board meeting is properly recorded in the minutes of the meeting so as to provide prima facie evidence of proceedings before the board in case the role of the director were to be called into question in a liability suit.<sup>136</sup> 'Consent' or 'connivance', in addition to presupposing knowledge, requires a higher level of mental state on part of the directors who are involved more directly in the act or omission.<sup>137</sup> Lastly, 'not acted diligently' is linked to the duty of care, skill and diligence which directors are expected to comply with.<sup>138</sup> While the standard for independent and non-executive directors will be different compared to executive directors, they are subject to a minimum standard that must be met. Failure to attend board meetings, not raising the right questions or concerns and ignoring developments within the company are some such matters that will be considered while determining whether directors have complied with the requirement to act diligently.<sup>139</sup>

In including carve outs specifically for independent directors and non-executive directors, section 149(12) of the Companies Act recognises that such directors face substantial risk in terms of liability, without having influence over the daily management of the company. This risk is even more pertinent in the context of various other statutes, which do not distinguish between executive and non-executive directors in imposing liability. An illustrative example of the inordinate liability risk faced by independent and non-executive directors is the Negotiable Instruments Act, 1881 ("**NI Act**"). Section 138 of the NI Act relates to dishonour of cheques issued by companies and where a company commits such an offence, the concept of vicarious liability is triggered under section 141 of the NI Act which provides that "*every person who, at the time the offence was committed, was in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly*". However, there are carve outs for limiting liability and if the director can

<sup>133</sup> Umakanth Varottil (n. 110).

<sup>134</sup> Ibid.

<sup>135</sup> Ibid.

<sup>136</sup> Ibid.

<sup>137</sup> Ibid.

<sup>138</sup> Ibid.

<sup>139</sup> Ibid.

prove that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence, he can escape liability. Nonetheless, it is important to note that it is quite customary in complaints under section 138 of the NI Act to incriminate all directors of a company whose cheque has been dishonoured. Though courts have generally been cautious in interpreting section 141 of the NI Act to ensure that prosecution can continue only against directors who were in charge of the day to day affairs of the company or those who had in fact signed the cheque that was dishonoured<sup>140</sup>, the significant inconvenience to non-executive directors and, in particular, independent directors, caused by the issuance of summons by investigating and adjudicating authorities, irrespective of the outcome of such legal suits, is problematic and needs to be addressed.

A recent example of such cautious interpretation mentioned above is *Bhardwaj Thirvenkata Venkatavaraghavan v PVR Ltd*<sup>141</sup>, where the Delhi High court was concerned with a non-executive nominee director of a company that had issued a cheque. The court reiterated the position that in order to be prosecuted under section 141 of the NI Act, the person must be in charge of the day to day activities and responsible for the conduct of business of the company.<sup>142</sup> The court also cautioned that it is insufficient for a complainant to arraign directors merely on the basis of a statement that they are responsible for the conduct of the company without anything more.<sup>143</sup> Consequently, the court found it appropriate to quash the complaint against the director in this case.<sup>144</sup> In contrast, in *Somendra Khosla v State*<sup>145</sup>, the Delhi High Court was concerned with a complaint against an independent director of a company. Despite the director in question being an independent director, the complainant argued that he was responsible for the day to day functioning of the business, which was accepted by the court. Consequently, it refused to quash the complaint against the independent director.

In arriving at its conclusion, the Delhi High court relied on the supreme court's decision in *Standard Chartered Bank v State of Maharashtra*.<sup>146</sup> In that case, the supreme court had permitted summoning directors who are in charge of the day to day business of the company.<sup>147</sup> However, that case involved the chairman, managing director, executive director, whole-time director and authorised signatories of the accused company.<sup>148</sup> Similarly, in *Chitra Sharma and Ors v Union of India and Ors*<sup>149</sup>, the supreme court, while issuing orders in relation to protecting the interests of home buyers in projects floated by Jaypre Infratech Limited ("JIL")<sup>150</sup>, did not distinguish between the executive directors and non-executive directors of JIL in placing restrictions on them as regards leaving the country without the permission of the court, and on the alienation of the properties and assets of the directors and their families.

**It is quite customary in complaints under the Negotiable Instruments Act, 1881 to incriminate all directors of a company (irrespective of the category that they belong to) whose cheque has been dishonoured. The significant inconvenience caused to independent and non-executive directors (due to issuance of summons by investigating authorities and courts) is problematic and needs to be addressed.**

<sup>140</sup> Umakanth Varottil, 'Actions against Independent Directors for Dishonour of Cheques', IndiaCorp Law, February 16, 2019.

<sup>141</sup> 2019 SCC Online Del 6774.

<sup>142</sup> Ibid.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

<sup>145</sup> CRI.MC. 3982/2017 & connected matters.

<sup>146</sup> (2016) 6 SCC 62.

<sup>147</sup> Ibid.

<sup>148</sup> Ibid.

<sup>149</sup> Writ Petition (Civil) No. 744 of 2017.

<sup>150</sup> JIL went into insolvency in August, 2017, after the National Company Law Tribunal admitted an application filed by an IDBI Bank-led consortium seeking the initiation of the corporate insolvency resolution process against it under section 7 of the IBC.

**The Somendra Khosla and JIL cases completely disregard the role, responsibilities and status of independent directors - by their very nature and definition, independent directors ought not to be involved in the management of the company or in any executive capacity.**

While provisions for limiting the liability of independent and non-executive directors such as section 149(12) of the Companies Act are useful, the contrasting outcomes in the cases discussed above highlight that the effectiveness of insulating potential liability for such directors is heavily dependent on the manner in which courts interpret it, based on the specific facts and circumstances of individual cases. The *Somendra Khosla* and *JIL* cases completely disregard the role, responsibilities and status of independent directors. By their very nature and definition, independent directors ought not to be involved in the management of the company or in any executive capacity. In fact, section 149(6)(e)(i) of the Companies Act clarifies that

a person who holds the position of a key managerial personnel cannot be treated as an independent director. The courts arrived at their conclusions and issued orders based on the submission of the parties without considering the position of independent directors. The decision in the *Somendra Khosla* case is inconsistent with the well-established precept on the issue that the prosecution of such a complaint against a director cannot be continued merely upon the statement of the complainant.<sup>151</sup> Even if these cases are seen as anomalies in terms of the manner in which courts usually adjudge such matters, they demonstrate the fact that when it comes to the liability of independent and non-executive directors, they are in a significantly vulnerable situation, and can be prosecuted for offences that they are not concerned with, such as, dishonour of cheques. The risks and harassment associated with being summoned, investigated, probed and even prosecuted for corporate misfeasance or non-compliances that independent and non-executive directors cannot be ultimately linked with, place an onerous and unfair burden on them, especially taking into account the critical functions that they are expected to perform in the context of corporate governance. The next chapter discusses the challenges faced by the present legal and regulatory framework governing the liability of independent and non-executive directors in India in further detail.

<sup>151</sup> Umakanth Varottil (n. 140).

# Chapter IV: Challenges in India's Current Director Liability Framework

---

Having examined the existing regulatory framework governing director liability in India in the previous chapter, this chapter takes the discussion forward by examining some challenges attributable to the current regime. Some such challenges discussed include examining the extent to which independent directors actually exercise independence in controlled companies, limitations of safe harbour provisions and other protective mechanisms (such as directors' and officers' insurances and indemnities) and the problems associated with summoning provisions.

The provisions of the Companies Act and the LODR Regulations governing independent directors are reflective of the legislature's attempt at strengthening governance norms, in order to prevent corporate frauds like Satyam. Section 149(4) of the Companies Act which mandates every listed public company to have at least one-third of the total number of directors as independent directors was included as a result of the recognition of the necessity to have independent directors on boards of companies in order to serve the purpose of maintaining checks and balances, and questioning the decisions of the board as independent authorities in an impartial manner. The value of independent directors has been widely acknowledged by regulators, policy makers, institutional shareholders and other stakeholders.<sup>152</sup> Proponents of the independent director model share the belief that independent directors play a cardinal role in ensuring the proper performance of the following functions: accountability, informational transparency, managerial efficiency, strategic advisory and protection of minority shareholders' interests.<sup>153</sup> Given the pivotal and distinctive nature of the functions

performed by independent directors, their role is even more crucial in the context of India wherein companies are primarily controlled by promoters, who usually oversee managerial behaviour, and are therefore less concerned with governance issues like entrenchment and wealth expropriation.

Despite the well-intentioned aims of the legislative measures, there exist serious issues with the implementation of the functioning of independent directors, and one of these issues is that of their liability. The preliminary examination of the extant framework governing the liability of independent directors in India, as undertaken in the previous chapter, reveals that the duties that they are expected to perform are incommensurate with the attendant liability risks. While the Companies Act, under section 149(12), includes safe harbours limiting the liability of independent directors and non-executive directors specifically, there is a plethora of statutes that not only do not contain carve outs for independent and non-executive directors, but also impose both, civil and criminal liability for non-compliance with their provisions by companies, on their directors and officers, without distinguishing between executives and non-executives. This invariably leads to significant risks for independent and non-executive directors, primarily in relation to action or inaction with respect to violations ranging from technical mishaps to corporate frauds committed by accountants, auditors or members of management. These risks include both, real risks as well as perceived nuisance risks of being summoned, investigated, served arrest warrants and harassed by investigating and adjudicating authorities, often resulting in encouraging director resignations

---

<sup>152</sup> Simon Witney, 'Corporate Opportunities Law and the Non-Executive Director' (2016), *Journal of Corporate Law Studies*, Vol. 16, No. 1, 145-146.

<sup>153</sup> Thomas Clarke and Marie dela Rama, (n. 13), 1561-1564.

**While the Companies Act includes safe harbours limiting the liability of independent directors and non-executive directors specifically, there is a plethora of statutes that not only do not contain such safe harbours, but also impose both, civil and criminal liability for non-compliance with their provisions by companies, on their directors and officers, without distinguishing between executives and non-executives.**

and discouraging many potentially well-qualified candidates from joining boards of companies.<sup>154</sup>

Another issue closely linked to the issue discussed above is whether independent directors are truly independent and the extent to which they actually exercise their independence. Keeping the functional justifications for director independence in mind, it is submitted that there are various factors in India's current regulatory regime governing independent directors which contribute to compromising the structural notion of 'independence', as a consequence of which independent directors are not in a position to discharge their duties effectively. Some such factors are as follows: (i) the selection of independent directors is done by the board and their appointment for a term of five years has to be approved at a general meeting of shareholders after which they can be re-appointed for another five year term only after passing a special resolution at a general meeting<sup>155</sup>; (ii) the sitting fees for

participation in board meetings or committee meetings and profit related commission that independent directors may receive, are decided and approved by the board<sup>156</sup>, and the LODR Regulations provide that the board must recommend all fees or compensation paid to non-executive directors, including independent directors, and it must require approval of shareholders in a general meeting<sup>157</sup>; and (iii) independent directors can be removed by a company by passing an ordinary resolution at a general meeting.<sup>158</sup> Instead of ensuring independence on the board, which is particularly important in the context of companies with controlled ownership patterns, these factors supplement and aid its weakening. In light of the fact that the controlling or majority shareholders have a significant influence on the appointment as well as the continuance of independent directors on boards, the burden to effectively carry out duties such as monitoring self-dealing transactions and managerial overreach, bringing in an element of impartiality to boardroom decision-making, and overseeing compliance with corporate governance norms with an informed objectivity, is inordinately unfair and unreasonable.

While academic literature has focused on the impact director independence can have on the board's advisory role and company performance, little attention has been given to the impact of the current independent board structure on the board's ability to effectively carry out its monitoring role, which is the primary objective for which director independence was sought.<sup>159</sup> As part-time employees who often sit on multiple boards, independent directors lack the time, adequate resources and industry-specific knowledge to obtain, comprehend and analyse the extensive and complex information that modern boards are tasked with evaluating.<sup>160</sup> Consequently, such directors are heavily dependent on the information which management chooses to provide or conceal, as well as on the manner in which management presents it to them.<sup>161</sup> Addressing the issue at its core, therefore, requires a re-thinking of the current board structure, and processes of appointment

<sup>154</sup> Vikramaditya Khanna and Shaun J. Mathew (n. 2), 63.

<sup>155</sup> Sections 149, 150 and 152, Companies Act; Schedule IV, Companies Act.

<sup>156</sup> Sections 149 and 197, Companies Act.

<sup>157</sup> Regulation 17, LODR Regulations - the requirement to obtain shareholder approval in a general meeting is not applicable to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, for payment of sitting fees without the approval of the central government.

<sup>158</sup> Section 169, Companies Act; Schedule IV, Companies Act.

<sup>159</sup> Kobi Kastiel and Aaron Nili, "Captured Boards": The Rise of "Superior Directors" and the Case for a Board Suite", Harvard Law School Forum on Corporate Governance and Financial Regulation, June 28, 2017.

<sup>160</sup> Ibid.

<sup>161</sup> Ibid.



and removal and how these factors co-relate with the board's role as a monitor.<sup>162</sup> Though the examination of the adequacy of the independent director model in India is beyond the scope of this report, with regard to the framework governing their liability, it is crucial to examine its shortcomings holistically, and therefore, to take into account these aforementioned factors that influence their performance, and consequently impact the risks connected with their liability.<sup>163</sup>

The discussion above demonstrates that the inadequacies in the extant director liability regulatory regime in India expose non-executive directors, especially independent directors, to potentially significant liability risks, which are disproportionate to their onerous duties and functions. Concerns related to loss of reputation, financial ruin and being part of prolonged legal proceedings may, and often does, lead to capable people declining directorships, and boardroom decision-making becoming counterproductively cautious.<sup>164</sup> Therefore, the inclusion of statutory protections limiting the liability of independent and non-executive directors in the form of safe harbour provisions is extremely critical. In the Indian context, as stated earlier, section 149(12) of the Companies Act provides that independent directors and non-executive directors can only be held liable in respect of such acts of omission or commission by a company which occurred with their knowledge, attributable through board processes, and with their consent or connivance or where they did not act diligently. However, as highlighted earlier in chapter III of this report, while section 149(12) of the Companies Act undoubtedly seeks to limit the liability of independent and non-executive directors to matters relatable only to them, the carve outs have a very high degree of subjectivity embedded in them, which consequently results in problematic judicial decisions such as the *Somendra Khosla* case.

Some limitations of section 149(12) of the Companies Act are as follows: (i) independent and non-executive directors can be implicated not only for errors of omission and commission, but also for passive negligence, for instance, in cases where such directors

have attended board meetings or merely received minutes of such meetings but have failed to record their concerns or objections, they cannot escape prosecution claiming that the decision was not taken with their knowledge or consent; (ii) the safe harbour provisions help in alleviating concerns relating to liability only after investigative or legal proceedings have been initiated, and not at the stage where these directors are served with summoning notices; and (iii) this limited immunity is specific to proceedings under the Companies Act and does not protect these directors from the provisions of various other statutes which attribute civil and criminal liability to them for contraventions and offences by companies. The fact that independent directors typically resign without citing adequate reasons behind their decisions is a manifestation of the shortcomings of the safe harbour provisions.<sup>165</sup>

Other forms of safeguards against liability include directors and officers insurance and indemnities. As discussed earlier in chapter II, the Companies Act, under section 197(13) permits companies to obtain insurance on behalf of their managing director, whole-time director, manager, chief executive officer, chief financial officer or company secretary to indemnify them against any liability in respect of any negligence,

**The safe harbours in section 149(12) of the Companies Act have certain limitations such as high degree of subjectivity and limitation of applicability to offences under the Companies Act (i.e., the protections available to independent and non-executive directors under the Companies Act do not extend to offences by companies under other statutes).**

<sup>162</sup> Ibid.

<sup>163</sup> Amongst the various reforms that have been discussed with respect to the institution of independent directors in India, the appointment process and the need for providing non-controlling shareholders a significant role in the process, has been a recurring theme. In this regard, please see 'Towards the Rule of Law, 25 Legal Reforms for India', Vidhi Centre for Legal Policy (June, 2019), 22-23, for a more detailed discussion, available at <https://static1.squarespace.com/static/551ea026e4b0adba21a8f9df/t/5d0c7e9f5bdee0000131de1d/1561099940899/Vidhi+Briefing+Book+2019+%281%29.pdf>.

<sup>164</sup> Brian R. Cheffins and Bernard S. Black (n. 39), 1389.

<sup>165</sup> Jayshree P. Upadhyay (n. 14).

**There have been instances where directors have been summoned as accused by trial courts despite them not having been named in the first information report or where the investigating agency itself had recorded in the charge sheet that it did not find any material to implicate them. This is especially problematic in the context of independent and non-executive directors.**

default, misfeasance, breach of duty or breach of trust.<sup>166</sup> Section 197(13) does not include non-executive and independent directors. Schedule IV which prescribes the Code of Conduct provides that the appointment of independent directors must be formalised through a letter of appointment which shall set out, among other things, a provision for directors and officers insurance, if any. Therefore, not only are non-executive and independent directors excluded from the provision specifically permitting companies to take insurance on behalf of their officials, there is no mandatory requirement to obtain insurance by companies, for both, executive directors as well as non-executive directors. The LODR Regulations, however, have made it mandatory for the top five hundred listed entities by market capitalisation to undertake directors and officers insurance for all their independent directors of such quantum and for such risks as may be determined by the board, with effect from October 1, 2018.<sup>167</sup>

Further, as highlighted in chapter II, Indian companies can indemnify directors for liabilities related to negligence, default, misfeasance, breach of duty or breach of trust, as regards the company. As provided

under the model articles of association to the Companies Act, companies are required to indemnify every director or officer against any liability incurred by him in defending any proceeding (civil or criminal) in which judgment is given in his favour or in which he is acquitted or discharged, at its own cost.<sup>168</sup> Companies ordinarily include specific provisions in their articles of association for directors' indemnities, to the extent that such indemnities are in line with the provisions of the Companies Act.<sup>169</sup> Moreover, with respect to the contractual right of directors to seek indemnity from their companies, it is important to bear in mind that contractual indemnities are heavily dependent on negotiations, owing to the fact that they usually focus on what directors 'can' be indemnified for, rather than what they 'should' be indemnified for.<sup>170</sup> Even where such policies are obtained by companies, or where specific provisions or directors' indemnities are included in the constitutive documents of companies, or are agreed upon contractually, these insurances and indemnities typically do not provide protection against liability arising out of fraudulent or criminal conduct, which is a substantial risk that outside directors are exposed to, especially in the Indian context.

Another issue is that at in the course of an inquiry into, or a trial of an offence, all directors, irrespective of the category that they belong to, are issued summons. Thereafter, the burden of proof lies on them to prove that they were diligent in the discharge of their duties and had acted in a bona fide manner. Even recently, there have been instances in high profile scams involving public money wherein directors have been arraigned as accused in criminal prosecutions without any evidence on record of their involvement.<sup>171</sup> Courts are empowered to summon any person as an accused at any stage of an inquiry, trial or other proceeding, only when there is sufficient ground for initiating criminal proceedings against such a person based on the material and evidence on record.<sup>172</sup> However, this judicial precedent, though well-settled in terms of this legal position, is rarely observed in practice.<sup>173</sup> In fact, there have been instances where directors have been summoned as accused by trial courts despite

<sup>166</sup> Section 197(13), Companies Act.

<sup>167</sup> Regulation 25(10), LODR Regulations.

<sup>168</sup> Holly J. Gregory (n. 25), 64.

<sup>169</sup> Ibid.

<sup>170</sup> Directors' Liability, D&O: Blurring the Lines, Allen & Overy and Willis, September 2014.

<sup>171</sup> Bharat Vasani and Umang Pathak, Corporate Criminal Liability - # DirectorToo, India Corporate Law, July 10, 2019, available at <https://corporate.cyrilamarchandblogs.com/2019/07/corporate-criminal-liability-directortoo/>.

<sup>172</sup> Ibid; Sections 190 and 319, Code of Criminal Procedure Code, 1973.

<sup>173</sup> Bharat Vasani and Umang Pathak (n. 171).



them not having been named in the first information report or where the investigating agency itself had recorded in the charge sheet that it did not find any material to implicate them.<sup>174</sup> This is especially problematic in the context of independent and non-executive directors who are not involved in the day to day affairs of companies and primarily perform the role of overseeing and monitoring. Till the time any conclusion is drawn in relation to their conduct, they face significant inconvenience, harassment and embarrassment.

A related concern is with respect to the responsibility of investigation of economic offences being fragmented into various governmental agencies, sectoral regulators and the economic offences wing of the police, which often leads to multiple investigations by different agencies.<sup>175</sup> Further, in cases where offences are a result of common facts and consequently fall within the scope of different regulators, lack of experience and non-compliance with due process by investigating officers may result in: (i) courts invalidating investigations or parts thereof; and (ii) the quality of investigations being compromised as a result of failure by multiple investigating authorities to provide a clear picture of incriminating events.<sup>176</sup> For instance, in cases involving

corporate frauds, the company and its officers may be investigated by the Serious Fraud Investigation Office (as per the Companies Act) as well as the Enforcement Directorate (as per the Prevention of Money Laundering Act, 2002, since handling of proceeds from corporate frauds is a money laundering offence). The mandates and consequently the powers vested in both the investigating agencies differ and as a result, there is no uniformity when it comes to following procedures for investigations and prosecutions by them. One of the many repercussions of this fragmented approach is that in the event a fraud is discovered, parties such as independent and non-executive directors who are connected with the affairs of the company(ies) under scrutiny are questioned and harassed and also face potential risks such as their assets being seized before any assessment of the nature and degree of their involvement has been done. Such risks are even more severe when the offence is within the ambit of certain statutes such as the Prevention of Money Laundering Act, 2002, under which every offence punishable under the statute is cognizable and non-bailable.<sup>177</sup>

The next chapter suggests certain recommendations focused at addressing the challenges faced by India's extant director liability framework, as underscored above.



---

<sup>174</sup> Ibid.

<sup>175</sup> 'Towards the Rule of Law, 25 Legal Reforms for India', Vidhi Centre for Legal Policy (n. 163), 24. The Serious Fraud Investigation Office, Enforcement Directorate, Central Bureau of Investigation, SEBI, Reserve Bank of India, Pension Fund Regulatory and Development Authority India, Insurance Regulatory and Development Authority of India etc., all have jurisdiction to investigate various economic offences.

<sup>176</sup> Ibid.

<sup>177</sup> Section 45, Prevention of Money Laundering Act, 2002.

# Chapter V:

# Recommendations for Reform

---

The challenges faced by the current regulatory framework governing director liability in India, and the potential issues arising therefrom, as discussed in the previous chapter, indicate that there is a need to re-assess the extant framework. In this regard, certain measures may be contemplated in order to address the liability-related risks faced by independent and non-executive directors, and to consequently strengthen corporate governance standards in India.

As mentioned earlier, a majority of Indian listed entities are promoter-driven with significant shareholding being held by the promoter/promoter group.<sup>178</sup> Therefore, protection of minority shareholders' interests, creating checks and balances, monitoring managerial efficiency and enhancing transparency and accountability, are particularly critical in the Indian context. The role played by independent directors, in being the custodians of these functions, is crucial. However, the analysis of the regulatory framework governing their liability in this report demonstrates that there is a glaring disconnect between their responsibilities and liabilities. Evidently, the current framework merits serious consideration. Set out below are certain broad recommendations aimed at reforming the current liability framework governing independent and non-executive directors, and ultimately ensuring better compliance with corporate governance standards in India.

The previous chapter underlined certain factors which contribute to debilitating the 'independent' or 'outside' director model, which in turn results in hampering the exercise of 'independence' by non-executive directors,

especially independent directors, ultimately leading to increasing the risks that they face in terms of liability. In this regard, it is submitted that the processes in relation to their appointment, removal and resignation be made more stringent in that the degree of controlling shareholders' influence in these matters be reduced. In addressing this issue, making the appointment and removal of independent directors subject to confirmation by non-controlling or minority shareholders should be considered.<sup>179</sup> **It is crucial to ensure that non-controlling shareholders play a significant role in the appointment and removal processes of independent directors in order to keep a check on the controlling shareholders' influence in the processes.**<sup>180</sup> For example, in the U.K., the listing rules require that appointment of an independent director to the board of a premium listed company having one or more controlling shareholders (who holds more than thirty percent of voting rights, subject to certain exceptions) must be approved by all shareholders and the non-controlling shareholders separately.<sup>181</sup> Further, if non-controlling shareholders disapprove the appointment of an independent director, such independent director can only be re-considered for appointment after a cooling period of ninety days, by the general body of shareholders as a whole.<sup>182</sup> As regards the process for resignation of independent directors, the provisions of the Companies Act should be aligned with the LODR Regulations, which mandate the filing of copies of resignations by independent directors with the stock exchanges within seven days from the date of such resignation, along with detailed reasons for such resignations as well as a confirmation that there are no other material reasons other than those provided.<sup>183</sup>

---

<sup>178</sup> SEBI Report of the Committee on Corporate Governance (2017) (n. 97), 7-8.

<sup>179</sup> Balasubramanian, Bala N., and Jaideep Singh Panwar, 'The Spirit of Independence Remains Unaddressed', LiveMint, October 10, 2017; 'Towards the Rule of Law, 25 Legal Reforms for India', Vidhi Centre for Legal Policy (n. 163), 23.

<sup>180</sup> 'Towards the Rule of Law, 25 Legal Reforms for India', Vidhi Centre for Legal Policy (n. 163), 23.

<sup>181</sup> Ibid.

<sup>182</sup> Ibid.

<sup>183</sup> Regulation 30 and Schedule III, LODR Regulations.

Currently, the Companies Act requires directors to forward copies of their resignations with detailed reasons to the registrar of companies within thirty days of resignation, without the requirement to file a declaration confirming that there are no other material reasons for such resignation.<sup>184</sup> In fact, recently, the MCA has, amongst other proposals for reform with respect to the Companies Act, recommended that **independent directors must file copies of their resignations with detailed reasons with the registrar of companies within seven days of such resignations.**<sup>185</sup> This will ensure transparency, accountability and protection of minority shareholders' interests and enable independent directors to effectively perform their oversight role. Enhancing independence is therefore inter-linked with enabling independent and non-executive directors to perform their functions effectively. A connected recommendation in this regard is the consideration of instituting a mechanism for time-bound investigations to be conducted when serious governance issues are raised by independent or non-executive directors.<sup>186</sup>

The examination of the regulatory framework governing director liability in India in the preceding chapters is demonstrative of its fragmented nature. While the Companies Act and LODR Regulations acknowledge the distinction between executive directors and non-executive directors in attributing liability by creating safe harbours limiting liability, a significant number of other statutes impose liability without making this distinction. In this regard, it is recommended that the government should consider rectifying this discrepancy by aligning the attribution of liability provisions in these statutes with the Companies Act, so that independent and non-executive directors can avail the carve-outs limiting their liability. The Insolvency and Bankruptcy Code, 2016 ("IBC") is a good example of the manner in which the director liability framework can be harmonised: chapter VII of the IBC in dealing with 'offences and penalties' attributes liability for offences such as concealment of property and defaulting creditors to

"officers" who are in turn defined as "officers who are in default" as per the Companies Act, thereby making it possible for independent and non-executive directors to claim the protections designed specifically for them under section 149(12) of the Companies Act.

With respect to arraigning directors as accused in criminal prosecutions irrespective of their category and without any evidence on record of their involvement, it is suggested that there must be mechanisms in place to ensure that the procedure laid down in the Code of Criminal Procedure, 1973 is adhered to, in practice. In *Sunil Bharti Mittal v CBI*<sup>187</sup>, the supreme court has underlined the seriousness of the process of summoning as highlighted in *In Pepsi Foods Ltd. v Special Judicial Magistrate*<sup>188</sup> and stated the following: "**Summoning of an accused in a criminal case is a serious matter. Criminal law cannot be set into motion as a matter of course. It is not that the complainant has to bring only two witnesses to support his allegations in the complaint to have the criminal law set into motion. The order of the magistrate summoning the accused must reflect that he has applied his mind to the facts of the case and the law applicable thereto. He has to examine the nature of allegations made in the complaint and the evidence both oral and documentary in support thereof. It is not that the magistrate is a silent spectator at the time of recording of preliminary evidence before summoning of the accused. The Magistrate has to carefully scrutinise the evidence brought on record and may even himself put questions to the complainant and his witnesses to elicit answers to find out the truthfulness of the allegations or otherwise and then examine if any offence is prima facie committed by all or any of the accused.**" This underlying principle and the importance of following the procedure for issuing summons prescribed under law at every stage, including investigations and inquiries, has been further stressed upon by the supreme court in *Rajesh & Ors v State of Haryana*<sup>189</sup>, by stating the following: "**To answer the questions and to resolve the impediment that is being faced by the trial courts in exercising of powers under Section 319 Cr.PC**<sup>190</sup>, the issue has to be investigated by examining the circumstances which give rise to a situation

<sup>184</sup> Section 168, Companies Act.

<sup>185</sup> Ministry of Corporate Affairs, Amendments in the Companies Act, 2013 (2018), available at [http://www.mca.gov.in/Ministry/pdf/NoticeAmendmentsCA2013\\_05112018.pdf](http://www.mca.gov.in/Ministry/pdf/NoticeAmendmentsCA2013_05112018.pdf).

<sup>186</sup> N. Sundaresha Subramanian, 'How Independent are Independent Directors?', Business Standard, March 17, 2017.

<sup>187</sup> Criminal Appeal No. 34 of 2015 (arising out of Special Leave Petition (Crl.) No. 2961 of 2013)).

<sup>188</sup> (1998) 5 SCC 749.

<sup>189</sup> Criminal Appeal No. 813 of 2019 (Arising out of SLP (Crl.) No. 1189 of 2019)).

<sup>190</sup> Section 319 of the Code of Criminal Procedure, 1973 relates to the power of the court to proceed against persons appearing to be guilty of an offence. It provides that where in the course of any inquiry into, or trial of, an offence, it appears from the evidence that any person not being the accused has committed any offence for which such person could be tried together with the accused, the court may proceed against such person for the offence which he appears to have committed. Further, if such person is not attending the court, he may be arrested or summoned, as the case may require.

for the court to invoke such powers. The circumstances that lead to such inference being drawn up by the court for summoning a person arise out of the availability of the facts and material that come up before the court and are made the basis for summoning such a person as an accomplice to the offence alleged to have been committed. **The material should disclose the complicity of the person in the commission of the offence which has to be the material that appears from the evidence during the course of any inquiry into or trial**

that the material has to be “where ... it appears from the evidence” before the court.”

Following the procedure laid out in law is especially crucial in the context of independent and non-executive directors who are particularly vulnerable to the risks, harassment and inconvenience accompanying the procedure for initiating criminal proceedings. It is therefore suggested that **summons should be issued to independent and non-executive directors only on arriving at the conclusion that there is a prima face case against them.** Additionally, such conclusion must be arrived at only after due application of mind and proper examination of the evidence available on record. This recommendation is closely linked to the issue of non-uniformity in procedures followed by multiple investigating agencies and the negative implications of the same (as discussed in the previous chapter of this report). It is recommended that **in order to effectively safeguard independent and non-execute directors, formulation of specific guidelines to be followed by all investigating agencies concerned must be considered. A permanent co-ordination committee (with representatives from all major investigation and prosecution agencies) (“Co-ordination Committee”) should be set up for overseeing the implementation of such guidelines.** The guidelines must provide clear-cut directions on the manner in which investigating agencies must conduct investigations with respect to offences by companies. Particularly with respect to issuance of summons, these directions must, amongst other things, place emphasis on the following: (i) difference between issuing notices and summons - while notices may be sent to all directors once it has been established that an offence by a company has been committed, summons for enforcing the attendance of independent and non-executive directors and examining them should only be issued after properly reviewing the facts and material on record (both, oral and documentary, and which may be collected based on the notices issued to all

directors); and (ii) ensuring the maintenance of a count of all summons issued with recorded justifications to ensure transparency and accountability. **Further, for a specified category of independent directors (for instance, directors who have a limited role in core governance matters), a requirement may be imposed that they should not be summoned without prior authorization from the Co-ordination Committee or a court of appropriate jurisdiction.**

In so far as civil liability is concerned, the government should examine the viability of introducing shareholder sanctioned safe harbours such as exculpatory clauses and statutorily recognise the business judgment rule as a defence, at least for independent directors.

The primary objective of the aforementioned recommendations is to strike an appropriate balance between the liability risks faced by independent and non-executive directors and the safeguards available to them. To that extent, it is important to highlight that for independent directors who are members of audit committees of their companies, the applicability of these safeguards will be heavily dependent on the facts and circumstances of each individual case. This is because of the following reasons: (i) by virtue of being members of audit committees, independent directors are responsible for the examination of financial statements and auditors’ reports, approval or subsequent modification of transactions of the company with related parties, scrutiny of inter-corporate loans and investments, valuation of undertakings or assets of the company, evaluation of internal financial controls and risk management systems and monitoring the end use of funds raised through public offers and related matters; and (ii) the audit committee has the authority to investigate into any matter in relation to its functions specified in (i) or matters referred to it by the board and have full access to information contained in the records of the company.<sup>191</sup> In other words, independent directors who are part of audit committees are privy to extensive information in relation to the company, and therefore, the applicability of the safeguards will be limited depending on case-specific facts and material available. On the other hand, non-executive directors who are nominees of banks and financial institutions on the boards of companies in which such institutions have an interest, may find themselves in a particularly difficult position when their companies commit offences. This is because: (i) such non-executive

---

<sup>191</sup> Section 177, Companies Act.

directors are typically nominated in good faith, and one of the main purposes of their appointment is to safeguard the interests of the entity that nominates them (without conflicting with their fiduciary duties as directors); and (ii) usually, their participation in the affairs of the company and the information that they are privy to, are both, very limited. Accordingly, the safeguards recommended above must be applicable to such non-executive nominee directors as well.

A synopsis of the key recommendations discussed in this chapter is set out below.

■ **Recommendations for enabling a more ‘independent’ outside director model:**

- The appointment process for independent directors should be made more stringent by limiting controlling shareholders’ influence in the process and making the appointment subject to approval by non-controlling shareholders.
- Provisions relating to resignations by independent directors in the Companies Act should be aligned with the LODR Regulations thereby making it mandatory for such directors to file a declaration with the registrar of companies confirming that there are no other material reasons besides the reasons provided for such resignations.

■ **The liability framework for directors across all statutes recognizing corporate offences should be harmonized with the Companies Act by providing for the concept of ‘officer who is in default’ and enabling non-executive and independent directors to claim the protections designed specifically for them under section 149(12) of the Companies Act.**

■ **The procedures followed by investigating agencies/ authorities for conducting investigations in relation to offences by companies must recognize the**

**importance of creating safeguards for independent and non-executive directors. To this end, the formulation of guidelines (in line with the provisions for investigations and inquiries prescribed under the Code of Criminal Procedure, 1973) to be followed by all investigating agencies/authorities specifically with respect to investigating offences by companies must be ensured. More specifically:**

- A permanent co-ordination committee (with representatives from all major investigation and prosecution agencies) should be set up for overseeing the implementation of such guidelines.
- Summons should be issued to independent and non-executive directors only on arriving at the conclusion that there is a prima face case against them.
- For a specified category of independent directors, a requirement may be imposed that they should not be summoned without prior authorization from the Co-ordination Committee or a court of appropriate jurisdiction.

■ **Where civil liability is concerned, the government should examine the viability of introducing shareholder sanctioned safe harbours such as exculpatory clauses and statutorily recognise the business judgment rule as a defence, at least for independent directors.**

Needless to say, while corporate governance may comprise both legal and behavioral norms, no written set of rules or laws can contemplate every situation that independent and non-executive directors may find themselves in. Nonetheless, given the nature of responsibilities of such directors, which can broadly be categorised as that of overseeing and monitoring, it is imperative that the regulatory framework governing them consist of adequate protections especially for the risks associated with their liability.





# Chapter VI: Conclusion

---

The importance of having outside directors is being increasingly viewed as essential to protecting public investors, especially in controlled companies, all over the world.<sup>192</sup> Accordingly, several countries have adopted one or more of the following arrangements: (i) public company boards are expected to include some fraction of independent directors; (ii) independent directors must serve on committees that play an active role in monitoring management and controlling shareholders; and (iii) many countries specifically require that independent directors play an active role in scrutinising self-dealing transactions.<sup>193</sup> In Europe, independent directors are often expected to serve on the corporation's audit committee, and they often constitute a significant fraction of the audit committee's members.<sup>194</sup> Japan, Korea and Russia have adopted similar requirements.<sup>195</sup> In Brazil, Japan and some European countries, independent directors play an important role in nomination and remuneration committees.<sup>196</sup> Their presence on the audit, compensation and nomination committees provides them with better access to information and the means to monitor value diversion by controlling shareholders.<sup>197</sup> Further, some countries specifically require that independent directors play an active role in the vetting of related-party transactions in controlled companies.<sup>198</sup> For instance, in Italy, significant related-party transactions require the approval of an independent committee of the board.<sup>199</sup> In the Indian context, independent directors are essentially non-executive directors who are not supposed to have any material pecuniary relationships which may affect their independence, and whose functions include balancing conflicts of interest,

protecting the interests of minority shareholders and exercising independent judgment.<sup>200</sup> The importance of the institution of independent directors has been aptly captured by the SEBI report on corporate governance chaired by Mr. Uday Kotak (2017) as follows: *"The institution of independent directors forms the backbone of the corporate governance framework worldwide and in India. Independent directors are expected to bring objectivity into the functioning of the board and improve its effectiveness. Independent directors are required to safeguard the interests of all stakeholders, particularly minority shareholders, balance the conflicting interest of the stakeholders and bring an objective view to the evaluation of the performance of the board and management."*<sup>201</sup>

In light of the critical and distinctive nature of their role, it is imperative to ensure that the conception of independence links these various functions to the normative goals of independence-based reforms.<sup>202</sup> The analysis of the regulatory framework governing the liability of independent and non-executive directors in India demonstrates that while the current framework rests on procedures and technicalities, its implementation is lacking in certain respects. The overarching issue is that of the disparity between the onerous duties placed on independent directors and their liability risks, which emanates from various shortcomings and inconsistencies within the extant framework, such as the fragmented liability regime, the limitations of the independent director model and the inadequacies of protective mechanisms such as safe harbours, directors and officers liability insurances and indemnities. It is hoped that the analysis and

---

<sup>192</sup> Lucian A. Bebchuk & Assaf Hamdani, 'Independent Directors and Controlling Shareholders' (2017), University of Pennsylvania Law Review, Vol. 165, No. 6, 1280.

<sup>193</sup> Ibid 1282-1283.

<sup>194</sup> Ibid 1283.

<sup>195</sup> Ibid.

<sup>196</sup> Ibid.

<sup>197</sup> Ibid.

<sup>198</sup> Ibid 1283-84.

<sup>199</sup> Ibid.

<sup>200</sup> Report of the Committee to Review Offences under the Companies Act, 2013, Ministry of Corporate Affairs, Government of India (August, 2018), 55.

<sup>201</sup> Ibid; SEBI Report of the Committee on Corporate Governance (2017) (n. 97), 24.

<sup>202</sup> Thomas Clarke and Marie dela Rama (n. 13), 1565.

**SEBI Report on Corporate Governance (2017):**

**“The institution of independent directors forms the backbone of the corporate governance framework worldwide and in India. Independent directors are expected to bring objectivity into the functioning of the board and improve its effectiveness. Independent directors are required to safeguard the interests of all stakeholders, particularly minority shareholders, balance the conflicting interest of the stakeholders and bring an objective view to the evaluation of the performance of the board and management.”**

recommendations presented in this report will contribute to the discussion on re-assessing the director liability framework and urge the government to consider formulating corporate governance reforms

based on enhancing the independence of directors, and safeguarding their interests, in order to strengthen their functioning and efficiency.



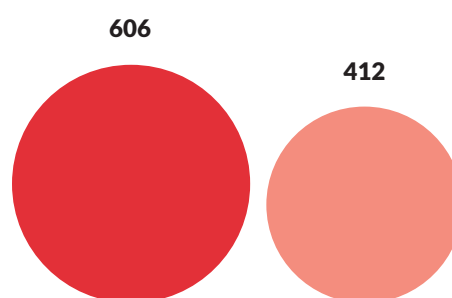
# Annexure I

*Resignations by independent directors from the boards of companies listed on the NSE in calendar years 2018 and 2019 (until July 22, 2019)<sup>203</sup>*

## Total Resignations

Resignations by independent directors

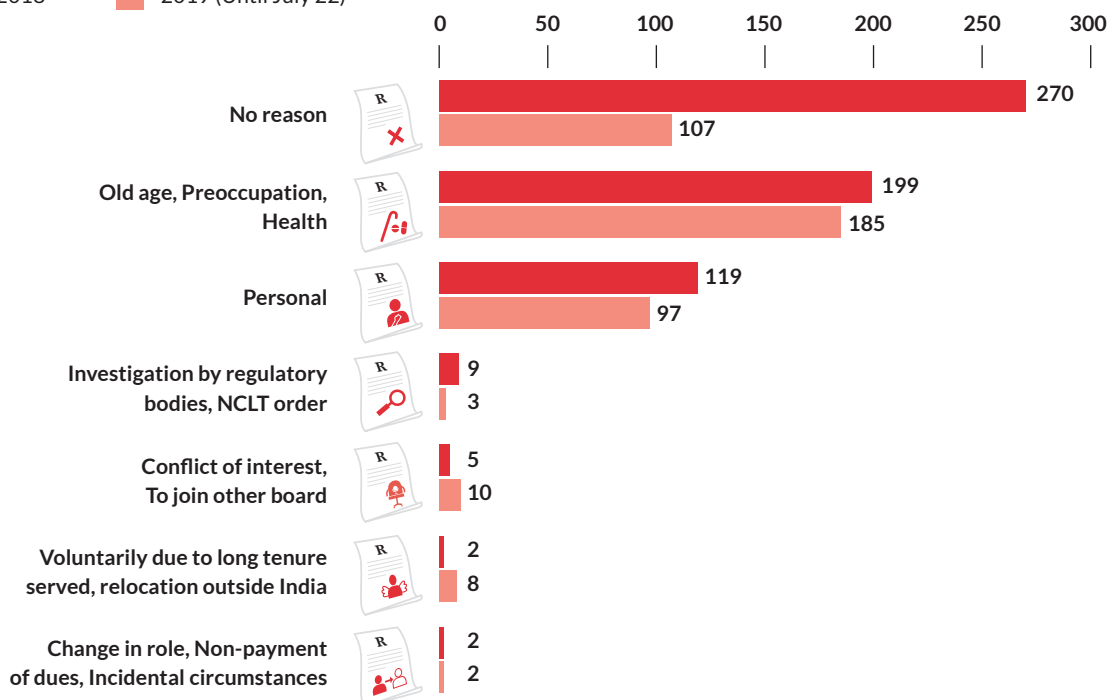
■ 2018 ■ 2019 (Until July 22)



Source: nseinfobase.com, developed and powered by Prime Database.

## Reasons for Resignations

■ 2018 ■ 2019 (Until July 22)



Source: nseinfobase.com, developed and powered by Prime Database.

<sup>203</sup> Based on information available on nseinfobase.com, developed and powered by Prime Database (n. 14). Errors in interpreting the data, if any, are ours.



# Annexure II

*A Summary of Director Liability Provisions Across Various Statutes in India. Note: The statutes covered under this Annexure II include a range of offences and sanctions/penalties, some of which have been listed out below.*

## Companies Act, 2013

### 1. Particulars: Related party transactions (S. 188(5))

**Attribution of Liability:** Related party transactions - any director or employee who entered into or authorised the contract or arrangement in violation of S. 188 which deals with related party transactions (S. 188)

**Offences and Sanctions:** Entering into or authorising the contract or arrangement in violation of S.188 - for a listed company, imprisonment which may extend to 1 year, or fine not less than Rs. 25,000, which may extend to Rs. 5 lakhs, or both (S. 188(5))

### 2. Particulars: Fraud (S. 447)

**Attribution of Liability:** Fraud - any person found guilty of fraud (S. 447)

**Offences and Sanctions:** Fraud - imprisonment for not less than 6 months, which may extend to 10 years, and fine not less than the amount involved in the fraud, which may extend to three times the amount involved in the fraud (S. 447)

### 3. Particulars: False statement (S. 448)

**Attribution of Liability:** False statement - any person making a false statement in any return, report, certificate, financial statement, prospectus or other document required by the Companies Act (S. 448)

**Offences and Sanctions:** False statement - same punishment as that for fraud (S. 448)

### 4. Particulars: False evidence (S. 449)

**Attribution of Liability:** False evidence - any person who intentionally gives false evidence (S. 449)

**Offences and Sanctions:** False evidence - imprisonment for not less than 3 years, which may extend to 7 years, and fine which may extend to Rs. 10 lakhs (S. 449)

### 5. Particulars: Duties of directors (S. 166)

**Attribution of Liability:** Duties of directors (S. 166) - all categories of directors

**Penalty:** Duties of directors - fine not less than Rs. 1 lakh, which may extend to Rs. 5 lakhs (S. 166(7))

### 6. Particulars: Mis-statement in Prospectus (S. 35)

**Attribution of Liability:** Mis-statement in prospectus (S. 35)- every person who is a director at the time of issuance of the prospectus

**Penalty:** Mis-statement in prospectus - compensation to every person who has suffered loss/damage (S. 35)

**Safe Harbours:** Officer who is in default - with respect to a contravention of the provisions of the statute, every director who is aware of such contravention, or if such contravention took place with his or her connivance, then he is liable to any penalty or punishment by way of imprisonment, fine or otherwise (S. 2(60)(vi))

An independent director and a non-executive director are liable only in respect of such acts or omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently (S. 149(12))

Person not liable if he proves withdrawal of consent before issuance of prospectus, or that it was issued without his knowledge or consent (S. 35)

# Insolvency and Bankruptcy Code, 2016

**1. Particulars:** Fraudulent trading or wrongful trading (S. 66)

**Attribution of Liability:** Director of the corporate debtor is liable to make contributions to the assets of the corporate debtor as it may deem fit (S. 66(2))

**Penalty:** Fraudulent trading or wrongful trading - any persons who were knowingly parties to carrying on the business of the corporate debtor with the intent to defraud creditors or for any fraudulent purpose - liable to make contributions to the assets of the corporate debtor as it may deem fit (S. 66(1)), and the adjudicating authority may direct that a director of the corporate debtor is liable to make contributions to the assets of the corporate debtor as it may deem fit (S. 66(2))

**Safe Harbours:** Director of the corporate debtor is liable if: (i) such director knew or ought to have known that there was no reasonable prospect of avoiding the commencement of a corporate insolvency resolution process in respect of the corporate debtor (before the insolvency commencement date) (S. 66(2)(a)); and (ii) such director did not exercise due diligence in minimising the potential loss to the creditors of the corporate debtor (S. 66(2)(b))

**2. Particulars:** Concealment of property (S. 68)

**Attribution of Liability:** Concealment of property - any officer of the corporate debtor (S. 68). (Note: Chapter VII deals with 'Offences and Penalties' - 'officer' of the corporate debtor is defined as an officer who is in default as defined under S. 2(60) of the Companies Act, 2013)

**Offences and Sanctions:** Concealment of property - imprisonment not less than 3 years, which may extend to 5 years, or fine not less than Rs. 1 lakh, which may extend to Rs. 1 crore (S. 68)

**Safe Harbours:** Person is not liable if he proves that he had no intent to defraud or conceal the state of affairs of the corporate debtor (S. 68)

**3. Particulars:** Transactions defrauding creditors (S. 69)

**Attribution of Liability:** Transactions defrauding creditors - any officer of the corporate debtor (S. 69)

**Offences and Sanctions:** Transactions defrauding

creditors - imprisonment not less than 1 year, which may extend to 5 years, or fine not less than Rs. 1 lakh, which may extend to Rs. 1 crore, or both (S. 69)

**Safe Harbours:** Person is not liable if he proves that at the time of commission of the acts, he had no intent to defraud the creditors of the corporate debtor (S. 69)

# Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

**Particulars:** Offences by companies (S. 56)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 56(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 56(2))

**Offences and Sanctions:** False statement in verification under the statute or delivery of an account or statement that is false knowingly - rigorous imprisonment of not less than 6 months, which may extend to 7 years, with fine (S. 52)

Abetting or inducing another person to make and deliver a false account or statement or declaration relating to tax, knowingly - rigorous imprisonment of not less than 6 months, which may extend to 7 years, with fine (S. 53)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 56(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 56(2))

# Foreign Contribution Act, 2010

**Particulars:** Offences by companies (S. 39)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 39(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 39(2))

**Offences and Sanctions:** Making false statements or declaring or delivering false accounts - imprisonment which may extend to 6 months, or fine, or both

Contravention of provisions of the statute - imprisonment which may extend to 5 years, or fine, or both

Offences where no separate punishment has been provided - imprisonment which may extend to 1 year, or fine, or both

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 39(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 39(2))

# Prevention of Money-Laundering Act, 2002

**Particulars:** Offences by companies (S. 70)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 70(1))

Where an offence under the statute has been

committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 70(2))

**Offences and Sanctions:** Wilfully and maliciously giving false information - imprisonment which may extend to 2 years, or fine which may extend to Rs. 50,000, or both (S. 63)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 70(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 70(2))

# Competition Act, 2002

**Particulars:** Contravention by companies (S. 48)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the contravention under the statute is deemed guilty of the contravention and is liable to be proceeded against and punished (S. 48(1))

Where a contravention under the statute has been committed by a company and it is proved that it has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the contravention and is liable to be proceeded against and punished (S. 48(2))

**Penalty:** Making a false statement or omission to furnish material information - penalty not less than Rs. 50 lakhs, which may extend to Rs. 1 crore (S. 44)

**Safe Harbours:** Person is not liable if he proves that the contravention was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 48(1))

Person is liable only if it is proved that the contravention was committed with his connivance or was attributable to neglect on part of such person (S. 48(2))

# Information Technology Act, 2000

**Particulars:** Offences by companies (S. 25)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 25(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, managing agent or other officer, such director, manager, managing agent, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 25(2))

**Offences and Sanctions:** Computer related offences- imprisonment which may extend to 3 years, or fine which may extend to Rs. 5 lakhs, or both (S. 66)

Violation of privacy- imprisonment which may extend to 3 years, or fine not exceeding Rs. 2 lakhs, or both (S. 66E)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 85(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 85(2))

# Foreign Exchange Management Act, 1999

**Particulars:** Contravention by companies (S. 42)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the contravention under the statute is deemed guilty of the contravention and is liable to be proceeded against and punished (S. 42(1))

Where a contravention under the statute has been committed by a company and it is proved that it has been: (i) committed with the consent or connivance of;

or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the contravention and is liable to be proceeded against and punished (S. 42(2))

**Penalty:** Contravention of provisions of the statute - penalty up to thrice the sum involved in such contravention (where the amount is quantifiable), or up to Rs. 2 lakhs (where the amount is not quantifiable), and for a continuing contravention, further penalty which may extend to Rs. 5,000 for every day after the first day during which the contravention continues. (S. 13(1))

**Safe Harbours:** Person is not liable if he proves that the contravention was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 42(1))

Person is liable only if it is proved that the contravention was committed with his connivance or was attributable to neglect on part of such person (S. 42(2))

# Securities and Exchange Board of India Act, 1992

**Particulars:** Offences by companies (S. 27)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 27(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, managing agent or other officer, such director, manager, managing agent, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 27(2))

**Offences and Sanctions:** Contravention of the provisions of the statute - imprisonment which may extend to 10 years, or fine which may extend to Rs. 25 crores, or both (S. 24(1))

Failure to pay penalty imposed by the adjudicating officer or failure to comply with his orders or directions-

imprisonment for not less than 1 month, which may extend to 10 years, or fine which may extend to Rs. 25 crores, or both (S. 24(2))

Penalty for contravention of the statute where no separate penalty has been provided - penalty not less than Rs. 1 lakh which may extend to Rs. 1 crore. (S. 15HB)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 27(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 27(2))

## ‘Prohibition of Benami Property Transactions Act, 1988

**Particulars:** Offences by companies (S. 62)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 62(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, managing agent or other officer, such director, manager, managing agent, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 62(3))

**Offences and Sanctions:** Giving false information or furnishing a false document - rigorous imprisonment for not less than 6 months, which may extend to 5 years, and fine which may extend to 10% of the market value of the property (S. 54)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge (S. 62(2))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 62(3))

## Environment (Protection) Act, 1986

**Particulars:** Offences by companies (S. 16)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 16(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 16(2))

**Offences and Sanctions:** Penalty for contravention of provisions of the statute - imprisonment which may extend to 5 years with fine which may extend to Rs. 1 lakh, or both (S. 15)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge (S. 16(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 16(2))

## Air (Prevention and Control of Pollution) Act, 1981

**Particulars:** Offences by companies (S. 40)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 40(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, managing agent or other officer, such director, manager, managing agent, other officer is deemed guilty of the offence and is liable to



be proceeded against and punished (S. 40(2))

**Offences and Sanctions:** Making a statement which is false in any material particular, failure to furnish, failure any information required under the statute - imprisonment which may extend to 3 months, or fine which may extend to Rs, 10,000, or both (S. 38)

Other offences - imprisonment which may extend to 3 months, or fine which may extend to Rs. 10,000, or both (S. 39)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 40(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 40(2))

## Water (Prevention and Control of Pollution) Act, 1974

**Particulars:** Offences by companies (S. 74)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 47(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, managing agent or other officer, such director, manager, managing agent, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 47(2))

**Offences and Sanctions:** In giving information required to be given under the statute, knowingly or wilfully making a statement which is false in material particular, failure to furnish information required under the statute - imprisonment for a term which may extend to 3 months, or fine which may extend to Rs. 10,000, or both. (S. 42)

**Safe Harbours:** Person is not liable if he proves that the

offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 47(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 47(2))

## Contract Labour (Regulation and Abolition) Act, 1970

**Particulars:** Offences by companies (S. 25)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 25(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, managing agent or other officer, such director, manager, managing agent, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 25(2))

**Offences and Sanctions:** Contravention of provisions regarding employment of contract labour- imprisonment which may extend to 3 months, or fine which may extend to Rs. 1000, or both (S. 23)

Other offences - imprisonment which may extend to 3 months, or fine which may extend to Rs. 1000, or both (S. 24)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 25(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 25(2))

## Income-tax Act, 1961

**Particulars:** Offences by companies (S. 278B)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 278B(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 278B(2))

**Offences and Sanctions:** Making false statement in verification or delivering a false statement or account knowingly - in case the amount of tax which would have been evaded if the statement or account were accepted as true exceeds Rs. 25,000, rigorous imprisonment not less than 6 months, which may extend to 7 years, and in other cases, rigorous imprisonment for not less than 3 months, which may extend to 2 years, with fine (S. 277)

Falsification of books of account or document - rigorous imprisonment for not less than 3 months, which may extend to 2 years, with fine (S. 277A)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 278B(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 278B(2))

## Securities Contracts (Regulation) Act, 1956

**Particulars:** Contravention by companies (S. 24)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 24(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of

any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 24(2))

**Offences and Sanctions:** Contravention or abetment of contravention of provisions of the statute for which no punishment is provided elsewhere - imprisonment which may extend to 10 years, or fine which may extend to Rs. 25 crores, or both

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 24(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 24(2))

## Employees' Provident Funds and Miscellaneous Provisions Act, 1952

**Particulars:** Offences by companies (S. 14A)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 14A(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 14A(2))

**Offences and Sanctions:** Failure to make any payment required to be made under the statute, enabling another person to avoid such payment, or knowingly making a false statement or false representation - imprisonment which may extend to 1 year, or fine of Rs. 5000, or both (S. 14)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that



he exercised due diligence to prevent its commission (S. 14A(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 14A(2))

## Negotiable Instruments Act, 1881

**Particulars:** Offences by companies (S. 141)

**Attribution of Liability:** Every person in charge of, and responsible to the company for the conduct of its business at the time of the commission of the offence under the statute is deemed guilty of the offence and is liable to be proceeded against and punished (S. 141(1))

Where an offence under the statute has been committed by a company and it is proved that the offence has been: (i) committed with the consent or connivance of; or (ii) is attributable to neglect on part of any director, manager, secretary or other officer, such director, manager, secretary, other officer is deemed guilty of the offence and is liable to be proceeded against and punished (S. 141(2))

**Offences and Sanctions:** Dishonour of cheque for insufficiency etc. of funds in account - imprisonment which may extend to 2 years, or fine which may extend to twice the amount of the cheque, or both (S. 138)

**Safe Harbours:** Person is not liable if he proves that the offence was committed without his knowledge or that he exercised due diligence to prevent its commission (S. 141(1))

Person is liable only if it is proved that the offence was committed with his connivance or was attributable to neglect on part of such person (S. 141(2))

## Indian Penal Code, 1860 and Code of Criminal Procedure, 1973 (Cr.PC)

**1. Particulars:** Criminal conspiracy (S. 120A and S. 120B)

**Attribution of Liability:** Any two persons who agree

to do or cause to be done an illegal act or an act not illegal by illegal means (S. 120A)

**Offences and Sanctions:** Criminal conspiracy to (i) commit an offence - punishment in the same manner as if the person had abetted the offence; (ii) other than to commit an offence - imprisonment for a term not exceeding 6 months, or fine, or both (S. 120B)

**2. Particulars:** Cheating (S. 420)

**Attribution of Liability:** Whoever cheats and thereby dishonestly induces the person deceived to deliver any property to any person or destroys valuable security or anything capable of being converted to valuable security (S. 420)

**Offences and Sanctions:** Cheating - imprisonment which may extend to 7 years, and fine (S. 420)

**3. Particulars:** Criminal breach of trust (S. 405 and S. 406)

**Attribution of Liability:** Whoever dishonestly misappropriates property that he is entrusted with (S. 405)

**Offences and Sanctions:** Criminal breach of trust - imprisonment which may extend to 3 years, or fine, or both (S. 406)

**4. Particulars:** Falsification of accounts (S. 477A)

**Attribution of Liability:** Whoever being an officer wilfully and with intent to defraud, destroys/alters/mutilates/falsifies any book/paper/writing/valuable security/account which belongs to his employer (S. 477A)

**Offences and Sanctions:** Falsification of accounts - imprisonment which may extend to 7 years, or fine, or both (S. 477A)



## **Vidhi Centre for Legal Policy**

For any queries and clarifications regarding this report,  
please contact [astha.pandey@vidhilegalpolicy.in](mailto:astha.pandey@vidhilegalpolicy.in).

D-359, Defence Colony

New Delhi – 110024

Phone: 011-43102767/43831699

Website: [www.vidhilegalpolicy.in](http://www.vidhilegalpolicy.in)