

Article



Umesh K. Modi vs Deputy Directorate of Enforcement - Delhi High Court's Ruling on the Liability of a Non Executive Director

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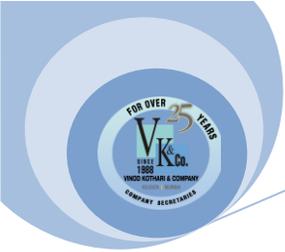
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Article

Introduction

The regime of corporate governance makes a clear distinction between the roles that are required to be performed by the directors of the company distinguishing them as Executive and Non Executive. The nomenclature Non Executive Director (NED) implies that the director is not a part of the executive machinery of the company and his role does not encompass running of the day to day affairs of the company. Listed Public Companies statutorily require that NEDs be placed on the board to oversee the governance process by taking an independent and professional stance.

The extent of liability of a NED has always been a topic of debate¹. The Ministry of Corporate Affairs had vide its circular dated 25th March 2011² clarified that , subject to certain conditions, penal actions can also be taken against directors who are not charged with responsibility. The present article discusses the case of *Umesh K. Modi vs Deputy Directorate of Enforcement*³, 2014 where the Delhi High Court settled the liability of a NED. The decision of the Hon'ble High Court is based on previous decisions of Supreme Court in similar circumstances in the past.

Facts of the Case

Mr. Umesh K. Modi, the plaintiff a NED of Modi Xerox Limited (MXL) challenged the impugned order of the Appellate Tribunal of Foreign Exchange (AT) dated 26th March 2008 upholding the adjudication order (AO) of Deputy Director of the Directorate of Enforcement (ED) dated 31st March 2004.

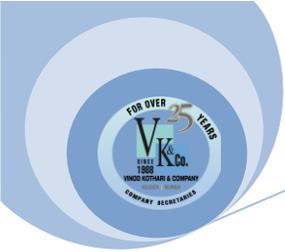
MXL was incorporated in 1983-84 and imported goods/raw materials. It failed to submit to the exchange control copies of customs bills of entry as evidence of import against remittances of foreign exchange made by it. Consequent upon which the ED issued a letter dated 29th April 1991 to MXL enclosing a statement of remittances as forwarded to it by the RBI. In its reply stated that records for the transactions pertaining to the year 1985 could not be traced and bankers could not issue certificates. For eight years no further action in this regard was taken

In the year 2000 MXL amalgamated with Xerox Modicorp Limited (XML). In the same year Foreign Exchange Management Act 1999 replaced Foreign Exchange Regulation Act 1973. Pursuant to FEMA the ED issued show cause notice (SCN) on 19th February 2001 to XML in respect of transactions which were in contravention of the provisions of FERA and had not been proceeded with. XML responded to the same referring to MXL's reply to the letter dated 29th April 1991. In his separate reply the Appellant, Mr. Umesh K. Modi stated that he was not incharge of or responsible for the conduct of the business of the company and hence, not liable

¹ <https://www.india-financing.com/Article-Liability%20of%20independent%20directors-in%20light%20of%20MCA%20circular..pdf>

² http://www.mca.gov.in/Ministry/pdf/Circular_08-2011_25mar2011.pdf

³ <http://indiankanoon.org/doc/123562642/>



Article

under Section 68(1)(2) of FERA 1973. He held that the directors relied on the compliance certificates placed at the board meetings of the company : confirming compliance of statutory requirements during the period under which the contravention took place.

The Deputy Directorate vide its AO dated 31st March 2004 held the Appellant along with other directors liable for violation of Section 8(3) and 8(4) of FERA 1973. However, charges against the nominee directors of the company were dropped. Aggrieved by the AO, the Mr. Umesh K. Modi filed an appeal in the AT which was dismissed by the AO dated 26th March 2008. The AT relied on the Supreme Court decision in the case of *N. Rangachary v. Bharat Sanchar Nigam Limited, 2007*⁴ while deciding the case against the Appellant. Wherein in the absence of specific averment the Managing Director of the company was held responsible for conduct of business and the Court did not absolve him of his responsibility on the ground that there was a technical breach. Further, the AT held that there was nothing on record to show that any restriction had been placed on the powers of the Appellant with reference to subject transaction.

Mr. Umesh K. Modi filed a further appeal in the High Court of Delhi against the order of the Appellate Tribunal (AT) where the case was decided in his favor vide order dated 31st July 2014.

Provisions of Law Considered by Delhi High Court

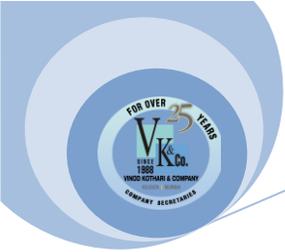
Section 8 of Foreign Exchange Regulation Act 1973

Restrictions on dealing in foreign exchange —

(3) Where any foreign exchange is acquired by any person, other than an authorised dealer or a money-changer, for any particular purpose, or where any person has been permitted conditionally to acquire foreign exchange, the said person shall not use the foreign exchange so acquired otherwise than for that purpose or, as the case may be, fail to comply with any condition to which the permission granted to him is subject, and where any foreign exchange so acquired cannot be so used or the conditions cannot be complied with the said person shall, within a period of thirty days from the date on which he comes to know that such foreign exchange cannot be so used or the conditions cannot be complied with, sell the foreign exchange to an authorised dealer or to a money-changer.

(4) For the avoidance of doubt, it is hereby declared that where a person acquires foreign exchange for sending or bringing into India any goods but sends or brings no such goods or does not send or bring goods of a value representing the foreign exchange acquired, within a reasonable time or sends or brings any goods of a kind, quality or quantity different from that specified by him at the time of acquisition of the foreign exchange, such person shall, unless the

⁴ <http://indiankanoon.org/doc/272267/>



Article

contrary is proved, be presumed not to have been able to use the foreign exchange for the purpose for which he acquired it or, as the case may be, to have used the foreign exchange so acquired otherwise than for the purposes for which it was acquired.

Section 68 of Foreign Exchange Regulation Act 1973

Offences by companies-

(1) Where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time of the contravention 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, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Provided that nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention.

(2) Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Explanation-For the purposes of this section

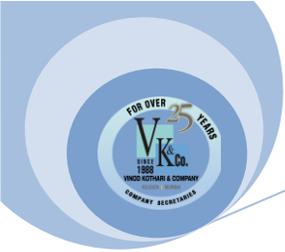
- (i) "company" means any body corporate and includes a firm or other association of individuals; and*
- (ii) "director", in relation to a firm, means a partner in the firm.*

Section 141 of Negotiable Instruments Act 1881

Offences by companies-

(1) If the person committing an offence under section 138 is a company, 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

Provided that nothing contained in this sub-section shall render any person liable to punishment if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence.



Article

Provided further that where a person is nominated as a Director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government, as the case may be, he shall not be liable for prosecution under this Chapter.

(2) Notwithstanding anything contained in sub-section (1), where any offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation-For the purposes of this section

(a) “company” means any body corporate and includes a firm or other association of individuals; and

(b) “director” in relation to a firm, means a partner in the firm.

Judgment

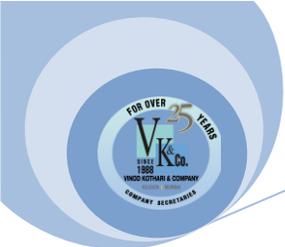
The Hon’ble Delhi High Court held that to determine the liability under Section 68 of Foreign Exchange Regulation Act 1973, several Supreme Court decisions on Section 141 of the Negotiable Instruments Act 1881 could be taken as precedent. Since there is no distinction in the wordings of the two sections, both dealing with Offences by Companies and making liable every person who at the time of contravention was in charge of the conduct of business of the company. The judge referred to the following case laws:

In *SMS Pharmaceuticals Limited (I) v. Neeta Bhalla, 2005⁵*, the Hon’ble Supreme Court settled that by merely being a director of the company a person cannot be deemed to be in charge of the conduct of the business. The allegation must be based on facts and that there is no deemed liability for a director in the absence of specific allegations.

Similarly, in the case of *Saroj Kumar Poddar v. State (NCT of Delhi), 2007⁶* the Supreme Court held that in order for a director to be vicarious liability for offenses committed by the company, he must be responsible for and in control of the conduct of business of the company or negligent in carrying out that responsibility or exercising that control at the time of commission of offense. A specific case as to how the director is responsible for /in control of the conduct of the business or negligent is doing so is required to be made in this regard.

⁵ <http://indiankanoon.org/doc/775638/>

⁶ <http://indiankanoon.org/doc/672341/>



Article

In the case of *National Small Industries Corporation Limited v. Harmeet Singh Paintal*, 2010⁷ the Supreme Court noted that the decision in the case of *N. Rangachari v. Bharat Sanchar Nigam Limited* supra was distinguishable on the basis of facts. The question whether a person is incharge of and responsible for the conduct of the business of the Company, is to be adjudged during the trial on the basis of the materials to be placed on record by the parties.

In the present case the Delhi High Court in particular considered the observations made in the case of *Kavita Dogra v. Director of Enforcement, 2014*⁸ that many of the SCN issued by the ED contained a standard cyclostyled paragraph for the purpose of Section 68(1) of FERA, not taking into account the context of the stand taken by the concerned director to whom notice had been issued.

The Hon'ble High Court of Delhi considered that the Appellant relied on the compliance certificates confirming statutory compliances and that this explanation was plausible. In the considered view the High Court set aside the impugned order of the AT and AO.

Analysis

Since a company is an artificial person it cannot act by itself, it is the directors of the company who are considered to act on behalf of the company. However this role of running a company is not assumed by NEDs. They do not act on behalf of the company. Most recently in the case of *Kartikey Sarabhai vs. TVS Net Technologies*⁹ the Hon'ble High Court of Madras held that the liability of a director is determined by the role he plays in the company and the NED are not a part of the day-to-day administration of the company.

However, this does not absolve NEDs of the liabilities that they can incur¹⁰. For example *Re. Union Carbide of India* Mr. Keshub Mahindra, a NED was booked by the Central Bureau of Investigation (CBI) under the same sections as the managing director, executive director, works manager and others directly involved in the day-to-day running of the company. He was also the only NED to be singled out. This accusation was circumstantial as it was shown by the learned solicitor general relying upon various documents of the company that Mr. Mahindra shared criminal knowledge of the mishap.

The Ministry of Corporate Affairs in its Circular dated 25th March 2011¹¹ requires penal actions to be taken against NEDs only after when the Registrar Of Companies, after taking due care, has come to the conclusion that such directors are the officers in default and have not acted diligently in the board process. The non-executive directors cannot be prosecuted if the violation of the law or any omission is on the part of the company or by any other officers of the company and which

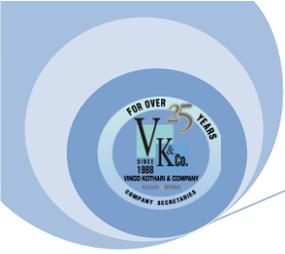
⁷ <http://indiankanoon.org/doc/832836/>

⁸ <http://indiankanoon.org/doc/114607625/>

⁹ <http://indiankanoon.org/doc/38209629/>

¹⁰ <http://indiacorplaw.blogspot.in/2013/12/guest-post-corporate-governance.html>

¹¹ Circular no. 8/2011 No.2/13/2003/CL- V



Article

have occurred without his knowledge and consent. The Circular provided relief to NEDs in the sense that the culpability is to be confirmed and verified by the ROC before issuing any notice to NEDs as officer in default. The Circular imposed greater obligations on the ROC to verify relevant information and records before initiating prosecution against independent or nominee directors. Wordings of the circular have also been incorporated under Section 149(12)(ii) of the Companies Act 2013 which provides that liability of a NEDs arises only with respect to such acts of 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.

Courts have time and again taken the view that a specific case as to how a director is at the helm of affairs of the company has to be made to make him liable for offense committed by companies. A person at the helm of the affairs of the company could be an ED, a NED or may not be a director at all. This upholds the understanding that only by virtue of holding the office of a director, a person cannot be vicariously made liable for offences committed by companies. It has to be proved how he was responsible for, or in control of, or negligent in conducting the affairs of the company. In the absence of specific averments, a director cannot be deemed to be liable. Hence, in the present case the Hon'ble Delhi High Court concluded that Mr. Umesh K. Modi could not be held liable.

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