

Director's liability has a nexus with his role and not the position

-SAT & Bombay High Court upholds the view once again!

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Background

While there has been a lot of rulings on the liability of directors, the question that mostly cropped up for examination was with respect to their involvement in the day-to-day operations. The liability of non-executive directors has mostly been scanned to evaluate their role in the subject matter of default. Courts in India as well as abroad, have decided respective cases both for and against such class of directors depending on the facts and circumstances of each case.

An important fact for enabling the Courts to conclude on the liability of directors, is the role played by them in the company, while at the same time disregarding the position held by them in the same company. Securities Appellate Tribunal ('SAT') by way of its several decisions, has clearly laid down that it is not the designation but the function or role played by a director, which is instrumental in affixing liability on such person.

SAT has penned the clear reasons for taking this view and as such provides a landmark yet again after one of its judgement in the matter of [Neesa Technologies Limited](#)¹ in the year 2016 which released a director for events taken place before his appointment.

Further, the Bombay High Court in its recent ruling in the matter of Meena Anand Suryadutt Bhatt vs. UOI and Ors has also held up the principle of vicarious liability.

In this write up, we shall briefly cover the summary of the cases recently decided by SAT and Bombay High Court while on the liability of directors and referring to some other relevant cases decided in the same context.

[Matter of Sayanti Sen v. SEBI](#) ² - Function, and not the designation, is important for becoming liable

SEBI issued directions to Silicon Projects India Limited ('SPIL') and its directors, for contravening the provisions of the Companies Act, 1956 and SEBI ILDS Regulations and SEBI Act, 1992, for issuance of NCDs in the year 2009-10, 2010-11 and 2011-12, which SPIL and its directors did not comply with. Accordingly, SEBI initiated recovery proceedings against them and also debarred the directors to accessing the securities and market and issuing prospectus for soliciting money from the public for the issue of securities.

One of the directors, Ms. Sayanti Sen (Ms. Sen) filed her reply to the interim order by stating that she was initially appointed as a receptionist and was subsequently appointed as one of the directors on the Board of SPIL. Ms. Sen, being the appellant contended that she tendered her resignation on December 01, 2011 and the same was duly communicated to the Registrar in Form 32. She further submitted that she had nothing to do with the issuance of NCDs since she never attended any board meeting nor signed any documents in relation with such issuance. She also submitted that she was

¹ <https://taxguru.in/wp-content/uploads/2016/10/Nimain-Charan-Biswal.pdf>

² <https://indiankanoon.org/doc/104250675/>

never involved in any activity of the Company which was also proved by one of the instigation reports conducted by CBI in 2016, where the key person of SPIL was found to be Mr. Shib Narayan Das, one of the directors of SPIL.

While the Whole Time Member ('WTM') of SEBI held Ms. Sen liable considering the position held by her in SPIL, in terms of provisions of section 5, 56 and 73 of the Companies Act, 1956 (Act, 1956), SAT clearly mentioned that the approach of the WTM in the said case was erroneous and therefore, illegal and unsustainable.

SAT gave the following reasons for allowing the appeal of Ms. Sen and quashed the decision of the WTM of SEBI:

- Section 5 (g) of the Act, 1956 makes it apparently clear that if there is an MD appointed in a company, he would be an officer in default;
- In [Agritech Hatcheries & Food Ltd. vs Valuable Steels India Pvt. Ltd.](#), (1999) 96 Com Cases 534 (Mad), it has been held that where there is a managing or whole time director or a manager, it would be an abuse of the process of the court if proceedings are launched against the ordinary directors without examining their role in default.;
- In *Smt. G. Vijaylakshmi & Ors. vs. SEBI*; (2000) 100 Comp Cases 726 (AP), it was held that it is not necessary that every director is required to be penalized merely because he is a director on the ground that he is responsible for the affairs of the company. **If the director can explain that he had no role to play in the alleged default or that he did not perform his duties assigned to him under the agreement of his appointment, the presumption of guilt and thereafter penalty cannot be fastened upon him.;**
- The Supreme Court in [Sunil Bharti Mittal vs. Central Bureau of Investigation & Ors](#), held that a Director can only be prosecuted if there was sufficient **evidence of his active role or where the statutory regime attracts the doctrine of vicarious liability.**;
- Ordinarily directors of a company are not allowed to be prosecuted under Section 220 of the Act, 1956 for default in filing the accounts when the company has a managing director at the relevant time as has been held in [Ravindra Narayan vs ROC, Jaipur](#), (1994) 81 Com Cases 925 (Raj). The Department of Company Affairs accepted this decision and issued a circular dated 24.06.1994 accordingly.;
- While section 27 of the SEBI Act, 1992 states that a person is deemed to be guilty of an offence on condition that he was in charge and responsible to the company, however the proviso mentions as follows-

“Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, 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.”

- Accordingly, the Supreme Court in a number of pronouncements held as follows:- [Municipal Corporation of Delhi v. Ram Kishan Rohtagi and Ors.](#) –

“vicarious liability being an incident of an offence under the Act. So far as the Directors are concerned, there is not even a whisper nor a shred of evidence to show, apart from the

presumption drawn by the complainant, that there is any act committed by the Directors from which a reasonable inference can be drawn that they could also be vicariously liable. In these circumstances, therefore, we find ourselves in complete agreement with the argument of the High Court that no case against the Directors (accused 4 to 7) has been made out ex-facie on the allegations made in the compliant and the proceedings against them were rightly quashed”.;

- MCA issued a [circular](#) dated 25th March, 2011, on prosecution of Directors and clarified that the prosecution should be filed primarily against the Managing Director and against such Directors who were in charge and responsible for the affairs of the Company.;
- In [Manoj Aggarwal vs. SEBI](#), the Tribunal found that there was no material to show that any of the officers set out in Clauses (a) to (c) of Section 5 or any specified director of the said Company was entrusted to discharge the obligation contained in Section 73 of the Companies Act.;
- In [Mr. Yogesh G. Gemawat vs. SEBI](#), it was found that in the absence of any document to show that any director was specified as per Clauses (a) to (c) of Section 5 of the Companies Act or any valid document to show that any person was authorized by the Board of Directors, the appellant could not escape the liability as per Clause (g) of Section 5 of the Act, 1956.
- It was found that the WTM has given a categorical finding that Shri Shib Narayan Das was responsible for the affairs of the Company, accordingly, it was not open for the WTM to pass further orders on the other Directors, namely, the appellant especially when there is no finding nor there is a shred of any evidence to indicate that the appellant was also responsible for the affairs of the Company.

Accordingly, the impugned order of the AO to the extent of refund liability by the appellant is rejected and quashed.

[Matter of Dr. Uppal Devinder Kumar v. SEBI](#)³ - Director appointed after the initiation of an event in which default occurred will not attract liability for such director

PACL Limited ('PACL'), a real estate company mobilised funds under a Collective Investment Scheme (CIS) without obtaining registration from SEBI. While a penalty of INR 7269.49 cr was imposed on PACL and its directors, Dr. Uppal Devinder (appellant) was not a party to the proceedings. However, a separate SCN was issued to the appellant wherein it was clearly mentioned that he was a director in PACL for a period of 50 days. The appellant being aggrieved by the order of the AO wherein penalty was levied, made the appeal to SAT.

The Tribunal referred to the meaning of 'sponsor' under various dictionaries which clearly stated that one who promises or takes the responsibility for another is known as surety. SAT discussed the provisions of the SEBI (CIS) Regulations, 1999 where any person who sponsors a CIS without registration will attract liability. Accordingly, SAT clearly mentioned the following:

- The appellant has not given surety for another, nor is there any evidence to show that any money has been pledged in advance or contribution has been made to bear with the expenses of the scheme;

³ <https://indiankanoon.org/doc/141669979/>

- There is no evidence to show that the appellant attended any board meetings in connection with CIS nor has any role being played by him in this regard;
- The Scheme was approved by the board even before the appellant was appointed as the director;
- The following case rulings were also referred to in the aforesaid matter:
 - Ms. Sayanti Sen v. SEBI – as discussed above;

- [Pritha Bag v. SEBI](#) -

“Tribunal held that in the absence any finding that the appellant was entrusted to discharge his functions contained in Section 73 of the Companies Act and in the absence of any material to show that the said appellant was entrusted to discharge as an officer in default as set out in Clauses (a) to (c) of Section 5 of the Companies Act, the said appellant could not be penalized under Section 73(2) of the Companies Act.”

- [SEBI v. Gaurav Vashney](#) –

“The Supreme Court held that 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. “

- Liability depends on the role one plays in the affairs of a company and not on designation or status.

With this, it was concluded that the AO has already penalised the PACL and its directors. Accordingly, the appeal was allowed.

Matter of [Meena Anand Suryadutt Bhatt vs Union of India & Anr.](#) (Writ Petition - Bombay High Court)– Active role of each director necessary for making them vicariously liable

Meena Anand Surya Bhatt legal heir of late Mr. Bhatt, filed a writ petition in Bombay high Court challenging 9 orders passed by Jt. Director General of Foreign Trade in 2008 against TPI India Ltd ('TPL' / 'Company'), its directors and ex-directors. Mr. Bhatt, who resigned as an independent director of the Company in March, 1999, also appeared in the impugned orders. It was clearly mentioned that it was no one but TPL which failed to comply with the export obligations as mentioned in the licence issued to them by DGFT and penalties were imposed accordingly. In this case, Bombay High Court held that since Mr. Bhatt was an independent director in the Company and as such had no role to play in the active management of TPL. It was held that the order of DGFT clearly specifies that, TPL has failed to comply with its export obligation and nowhere in the order it is mentioned that Mr. Bhatt was identified for any specific acts attributable to him. An extract from the oral judgement of the High Court produced hereunder, read as –

“It is the cardinal principle of criminal jurisprudence that where there are allegations of vicarious liability, then there has to be sufficient evidence of the active role of each director. There has to be a specific act attributed to a director or the person allegedly in control of management of the company, to the effect that such a person

was responsible for the acts committed by or on behalf of the company. From the impugned orders, it is clear that the entire charge undisputedly, is levelled against TPI for not fulfilling the advance licence obligations. Nowhere it is stated that Mr. Bhatt was in control and management of TPI as a director or that he was personally responsible for the acts committed by or on behalf of the company. No notice was admittedly issued to petitioner in petitioner's name. That being the case, there was a clear violation of the principles of natural justice."

In the above case, Bombay High Court issued a writ in the nature of Certiorari and quashed and set aside all the orders passed against Mr Bhatt and held all the proceedings against Mr. Bhatt as void ab initio. Furthermore, the said Order also referred to another similar case where the [Gujarat High Court](#) also took a similar stand.

Liability nexus

While section 166 of the Companies Act, 2013 ('Act, 2013') bestows enormous duties on the directors, the same should not be read in isolation. Courts have time and again settled that affixing liability should not be automatic, rather it should be attributed to the role of the director. The tag of 'Officer in default' as discussed above goes out to the executive wing of the board before touching the non-executive part depending on the circumstances of each case. Further, section 149 (12) of the Act, 2013 reinstates the fact that independent directors and non-executive directors can be held liable only in respect of items of omission and commission which had occurred with their knowledge or attributable through Board processes, and with their consent or connivance or where they had not acted diligently.

Even if the director in question is an executive of the company, still the role and function of such director must be evaluated before concluding on his liability in case of default. Merely, holding a position of director will not certainly be enough to fix liabilities for non-compliances.

Conclusion

Looking at the reasoning given by SAT and Bombay High Court, the picture is clearer on the circumstances where a director can be said to be liable for wrongful actions and evasions. Thus, situations where the person is made a part of board for reasons other than the requirement of law, it is most likely that such person remains unaware of events taking place in the company, however, the same cannot be used as a shield for evading liability in case of default. It is obvious that the facts surrounding the case will have to be evaluated minutely for coming to a conclusion.