

Director, Do You Want To Prevent/Fight Prosecution

Introduction

A Company under the Companies Act 1956 is a legal person having separate and independent existence than its shareholders. It acts through its Board of Directors who individually and collectively hold the position of trust and have fiduciary duties towards the company, the shareholders and others. In view of such important positions held by directors they are held responsible in case of violations/contravention of laws. The directors, and other persons who would be roped in such circumstances, have been defined as "officer in default" under the Companies Act.

Officer in default

Under Section 5 of the Companies Act the words "officer in default", for the purposes of punishment for violation of many sections, mean all of the following officers:

[a] Managing director and Whole time director. {MD & WTD}.

[b] Manager and company secretary.

[c] Any person according to whose direction/instruction Board is accustomed to act.

[d] Any person charged by Board with responsibility of complying with that provision and that person has given his consent.

[e] Where there are no MD, WTD or manager, any director specified by Board, or, if not so named, all directors.

One may carefully observe that all of those person who are invoking the above definition are to be reckoned as Officer in default. Thus, for example:

{I} if there is a MD,

{II} a company secretary,

{III} and the Vice President {Accounts} has been charged by the Board with the responsibility of compliance of provisions for proper maintenance and drawing up of accounts,

and there are no WTD, manager, or any person giving directions/ instructions to Board or any director specified by Board, then, in case of contravention in the area of accounts, MD and said two officers will be liable for prosecution. Other directors will not be liable.

Mens rea

What does "Mens Rea" mean? It simply means "Guilty mind". It requires the prosecution to prove that accused had guilty mind in committing an offence. This concept has , however, been deleted from the definition of "Officer-in-default" by the Companies Amendment law in 1988. The result has been that the prosecution need not prove that there was guilty mind and default was committed knowingly or willfully. The accused can be prosecuted even if he had no mala fide or guilty intention in committing the offence. But it is pertinent to note that there are a number of sections in the Companies Act, which do not have the words "Officer-in-default". In these cases guilty mind *does* have to be proved.

Offences under other laws

Besides provisions of "Officer in default" in Companies Act, several other Acts contain provisions for offences committed by companies. Interestingly these penal provisions are identical in many cases. The Supreme Court while interpreting these identical provisions had held, in the case of *Sheoratan Agarwal V. State of M.P.*, that persons who may be prosecuted, in case of violations, are:

[1] The company itself;

[2] Every person who, at the time contravention was committed, was in charge of and responsible to the company for conduct of the business; and

[3] Any director, manager, secretary or other officer of the company with whose consent or connivance or breach or whose neglect the offence has been committed.

The Apex Court had also held that any one or more or all of the above persons might be prosecuted. It is pertinent that the requirement of proving consent or connivance of the accused would mean substantiating by the prosecution that there has been guilty mind on part of the accused for committing the offence. Thus the concept of mens rea has relevance here unlike in respect of "Officer in Default" under the Companies Act.

There are however departure from the law laid down in the aforesaid identical penal provisions in many Acts:

- a. The Prevention of Food Adulteration Act, 1954 permits a company to nominate any of its directors, etc. to exercise all such powers and to take all such steps as may be necessary to prevent commission of any offence. Supreme Court has held that the person so nominated will be liable to be proceeded against and punished for the offence and no other person can be held liable.
- b. Under the Environmental laws, the word "directly" has been added before the words "----in charge---" appearing in penal provision. Hence if it is proved that the accused was not directly in charge of the conduct of the business of the company, it can afford a good defense for him.
- c. Under the Income Tax Act, 1961, there is a pecuniary liability attached to directors of a private limited company, jointly or severally, if the company fails to pay taxes due or makes default in tax payment during the time when they were directors. They can claim relief if they prove that non-recovery of tax cannot be attributed to any neglect or breach of duty on their part.
- d. Under the Factories Act, 1948, in the case of a company, any one of the directors shall be deemed to be the "Occupier" of the factory. The Occupier can seek relief from liability if another person, whom he charges as actual offender, is brought before the court and after commission of offence has been proved, he satisfies the court that he has exercised due diligence, offence was committed without his knowledge, etc.
- e. Under the Mines Act, 1952, in the case of a company, the Owner of a mine is all or any of the directors who may be prosecuted for an offence. However, if the company nominates a manager and gives notice thereof, he shall be deemed to be the Owner of the mines liable for prosecution. Nevertheless, the person nominated should:-
 - i. be resident in India; and
 - ii. be in charge of the management (not mines)

or

hold largest number of shares.

The provisions, allowing the Owner to seek relief from liability under the Mines Act, are in line with those of the Occupier under the Factories Act as mentioned above.

What prosecution has to prove?

The Karnataka High Court in the case of *Nucor Wires Vs HMT [1998] 30 CLA, 319, [KAR]* had laid down certain parameters in respect of launching prosecution against directors, which briefly are as follows:

[1]. There must be specific allegation by the prosecution against the director and vague submissions are liable to be set aside by the Court.

[2]. The prosecution must conclusively prove that:

- Accused was in charge of the company.
- He was responsible for the conduct of business.
- Offence was committed with his knowledge.
- He did not exercise due diligence to prevent commission of the offence which will mean that there was an element of negligence on his part.

The prosecution must also:

{a} prove that the director knowingly, willfully and with connivance has committed or authorized or permitted the offence. [This is not very important in case of "Officer-in-default" where guilty mind is not to be proved.]

{b} bring in material in the indictment, which will indicate that the accused actually held the post on the date of occurrence of the offence. [See case of *Sivalingam Chettiar V. Labour Officer {1986} 59 Comp. Cas. 701.*]

Significantly, it may be noted that mere allegation by prosecution that the accused is director will not be sufficient. The court had held in a case of *A S Dalela, Food Corporation of India V. State of Haryana [1995] 1 Comp LJ 546* that in a complaint it

must be disclosed specifically as to how the offence was committed and how the particular accused was responsible.

What defence the director has?

On initiation of prosecution against him, the director needs to defend his case. Some indicative defenses, culled out from various judgements of courts, are itemized below:

[A]. Director has to prove that he does not fall under the ambit of "Officer-in-default" u/s 5 of the Companies Act.

[B]. He was not in charge or control of the day to day affairs of the company, and hence, not responsible.

It was held by Supreme Court that to be in charge would mean that the person should be in overall control of the day to day business of the company.

[C]. Offence in question was committed without his consent/knowledge/connivance and he was not negligent in ensuring that laws are complied .

[D]. Allegation is vague and not specific.

[E]. The company has not been prosecuted along with the director. {In the case of *U.P. Pollution Control Board Vs Modi Distillery AIR 1988 SC 1128* the Supreme Court had held that there can be no vicarious liability of the director or officer for the acts of the company unless the company is also prosecuted along with the accused}.

[G]. The offences was committed after his tenure and he cannot be held responsible for any thing happening after his resignation/retirement. [See the case of *Chokkalingam Chettiar vs. Official Liquidator{1943}13 Comp.cas 263 {Mad}*]. In an interesting case of *Anita Chadha V. Registrar of Companies [1998] 31 CLA 60 [Delhi]* it was held by Delhi High Court that, for a continuing offence committed during his tenure, a director may not be held liable after his resignation /retirement, if he can prove that he had no access to the records of the company and also no connection.

[H]. The prosecution is time barred u/s 468 Code of Criminal Procedure 1973. However, this defense cannot be put forward for continuing offences as Section 472 of the Code applies and fresh period of limitation begins to run at every moment during which such offence continues. {See the case of *Bhagirath Kanoria V. State of M P [1984] 3 Comp LJ 49*}

[I] U/s 633{1} of the Companies Act, the director can seek relief from the court by proving that he has exercised all due diligence to prevent the commission of the offence, acted honestly, reasonably and having regard to all circumstances ought to be fairly excused.