

# Dispute Resolution Hotline

September 17, 2019

## DIRECTOR LIABILITY: SUPREME COURT QUASHES CASE AGAINST MANAGING DIRECTOR

The Supreme Court ("Court") in the recent case of *Shiv Kumar Jatia v. State of NCT of Delhi*,<sup>1</sup> quashed the criminal proceedings that were initiated only on the ground that the accused was the managing director of the company and that he was the only non-independent executive director of the company. The Court in this case reaffirmed its views set forth in the case of *Sunil Bharti Mittal v. Central Bureau of Investigation*<sup>2</sup> ("Sunil Bharti Mittal Case"), where it *inter-alia* held that *de hors* any vicarious liability provision, individual directors can be made accused only if there is sufficient material to prove their active role coupled with criminal intent.

### FACTS

The facts of the case relate to Hotel Hyatt Regency, New Delhi which is run by a public listed company, Asian Hotels (North) Limited ("Asian Hotels"). One of the guests who was at the hotel, went to the terrace of 6<sup>th</sup> Floor for smoking and suffered a fall. It was alleged that there was no light on the terrace and the hotel staff did not stop the guests from going there. Accordingly, there was lapse on part of the hotel management in taking proper safety measures for the guests and allowing them to smoke in an area which was not safe.

The investigation agency charged the managing director, general manager and other employees of the company for offences under Section 336<sup>3</sup> (*act endangering life or personal safety of others*) /338<sup>4</sup> (*causing grievous hurt by act endangering life or personal safety of others*) read with Section 32<sup>5</sup> (*words referring to acts include illegal omissions*) of the Indian Penal Code, 1100 ("IPC"). In other words, the case was made for criminal negligence endangering life or personal safety and for causing grievous hurt due to criminal negligence endangering life or personal safety and a charge sheet was filed by the investigation agency. In addition to Section 336/338 of IPC, the accused persons were also sought to be prosecuted under Section 4<sup>6</sup> of the Cigarettes and other Tobacco Products (Prohibition of Trade and Commerce, Production, Supply and Distribution) Act, 2003 ("COTPA").

The managing director and the general manager filed petitions under Section 482 of the Code of Criminal Procedure, 1973 ("CRPC") before the Delhi High Court ("DHC") for quashing of the aforesaid proceedings initiated against them. However, the DHC held that it was not proper to quash the proceedings against the said accused persons. Both the accused persons thereafter challenged the order of the DHC before the Court.

### JUDGMENT

The Court referred to its judgment in the Sunil Bharti Mittal Case. In this case, it was held that, in the absence of a vicarious liability provision in the statute, an individual who acts on behalf of the company can be made an accused, along with the company, only if there is sufficient evidence of his active role coupled with criminal intent. The Court in the present case held that though there are allegations of negligence on part of hotel and its officers who were in charge of day to day affairs of the hotel, so far as managing director was concerned, no allegation was made directly attributing the negligence with the criminal intent. Placing reliance upon its judgment of *Maksud Sayed v.*

*State of Gujarat & Ors.*<sup>7</sup> Court held that the penal code does not contain any provision providing for vicarious liability of directors, and even if it did, the complaint must make requisite allegations bringing the vicarious liability provision in play. Further relying upon the judgment in *Sharad Kumar Sanghi v. Sangita Rane*<sup>8</sup> the Court held that the allegations against directors and managing director cannot be vague in nature else they can be a ground for quashing of proceedings under Section 482 of CRPC.

In the present case, the Court observed that principally the allegations were made only against the company and other staff members who were in charge of day to day affairs of the company. So far as the managing director, the allegations were that he was attending all the meetings of the company and various decisions were being taken under his signatures. This, the Court held was clearly a vague allegation and does not establish any link between the managing director and the act/omission alleged. Hence, the Court quashed the proceedings so far as the managing director was concerned.

The Court however, did not quash the proceedings against accused no.4 who was the general manager of the hotel. He pleaded that he too was out of country on the date of incident but the Court held that general manager stands on a different footing than that of, Managing Director. It would be a matter of trial to assess whether any in charge arrangements were made for his responsibilities etc.

### ANALYSIS AND CONCLUSION

The present judgment gives credence to the long standing jurisprudence that has developed over the years in relation to liability of directors. Broadly, there are two ways in which liability can be fastened on directors for the acts of the company:

(1) Vicarious liability provided under different statutes. This can be further divided into three categories:

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- a. **Companies Act, 2013:** primarily the Companies Act hold "officer in default" liable for most of the violations. The term 'officer in default' includes any whole-time director, key managerial person, person on whose advice board is accustomed to act, director with whose consent and connivance the default took place, etc. In some cases, specific individuals (such as director in charge of finance, company secretary) are identified who shall be held liable for violation of certain provisions.<sup>9</sup>
- b. **Vicarious liability provisions under different statutes:** these provisions are found in many statutes.<sup>10</sup> Primarily, they hold persons who, at the time of contravention, were in charge of, and responsible for the conduct of the affairs of the company liable or with whose consent or connivance the offence is committed.
- c. **Specific Liability on certain persons under statutes:** Some statutes provide for liability of certain designated individuals.<sup>11</sup>

(2) If no express provision providing for vicarious liability of directors exists, then the individuals can be prosecuted only if there is direct evidence of their role active role along with criminal intent.

Since, IPC does not contain any vicarious liability provision, liability for crimes under IPC can only stem from point (2) above, i.e. only if the director has committed the act coupled with the intention. Investigation agencies however, have continued to remain oblivious to this jurisprudence. Directors of the companies get rounded up and proceeded against for crimes under IPC simply on account of being a director. Hence, to ensure that innocent individuals who act as directors of the company are not harassed and trapped in protracted criminal litigations, there is a strong need to sensitize all investigative agencies regarding this law.

– **Mohammad Kamran & Ashish Kabra**

You can direct your queries or comments to the authors

<sup>1</sup> Criminal Appeal No. 1263 of 2019

<sup>2</sup> (2015) 4 SCC 609

<sup>3</sup> **S. 336, The Indian Penal Code, 1100% Act endangering life or personal safety of others** Whoever does any act so rashly or negligently as to endanger human life or the personal safety of others, shall be punished with imprisonment of either description for a term which may extend to three months, or with fine which may extend to two hundred and fifty rupees, or with both

<sup>4</sup> **S. 338, The Indian Penal Code, 1100% Causing grievous hurt by act endangering life or personal safety of others** Whoever causes grievous hurt to any person to doing any act so rashly or negligently as to endanger human life, or the personal safety of others, shall be punished with imprisonment of either description for a term which may extend to two years, or with fine which may extend to one thousand rupees, or with both.

<sup>5</sup> **S. 32, The Indian Penal Code, 1100% Words referring to acts include illegal omissions**

In every part of this Code, except where a contrary intention appears from the context, words which refer to acts done extend also to illegal omissions.

<sup>6</sup> **S. 4, Cigarettes and other Tobacco Products (Prohibition of Trade and Commerce, Production, Supply and Distribution) Act, 2003:** No person shall smoke in any public place provided that in a hotel having thirty rooms or a restaurant having seating capacity of thirty persons or more and in the airports, a separate provision for smoking area or space may be made

<sup>7</sup> (2008) 5 SCC 668

<sup>8</sup> (2015) 12 SCC 78

<sup>9</sup> **S. 128(6) The Companies Act 2013:** If the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person of a company charged by the Board with the duty of complying with the provisions of this section, contravenes such provisions, such managing director, whole-time director in charge of finance, Chief Financial officer or such other person of the company shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to Five lakh rupees or with both.

<sup>10</sup> See for example: **S. 141(2) of Negotiable Instruments Act, 1881.** 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

**S. 27, Securities and Exchange Board of India Act 1992:** Where an offence under this Act has been committed by 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 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.

Notwithstanding anything contained in sub-section (1), where an 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 the offence and shall be liable to be proceeded against and punished accordingly

<sup>11</sup> **S. 128(6) The Companies Act 2013, S. 42(2) Foreign Exchange Management Act 1999** 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.

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