

Directors and Officers: Exposure to Liability

As a general rule, the officers and directors are not personally liable for the contracts of, or the actions or omissions of, the company that they serve because a company is considered to be a separate legal person at law. However, there are several exceptions to this general rule and there are many instances of officers and directors' liability under Indian statutes and more particularly under the Companies Act, 2013 of India (the "Act").

There has been a significant change in the Indian corporate legal regime ever since the enactment of the Act. For instance, the penalties, which were viewed as ineffective under the earlier legislation, i.e. the Companies Act, 1956, have been significantly increased under the Act.



In addition to the Act, an officer or director may face liability under various other laws such as the tax laws, foreign exchange regulations, securities regulations, employment laws including laws governing provident fund, gratuity, employee state insurance and the shops and establishments legislations.

This note provides an overview of the duties and liabilities of the officers and directors, under the Act.

Duties - The directors are expected to act in a fiduciary capacity towards the company, its shareholders and other stakeholders. The Act gives statutory recognition to the duties of a director, such as exercising due and reasonable care, skill, diligence and independent judgment. Any contravention of the duties will make a director liable to fine of Rs. 100,000 and which may extend up to Rs. 500,000.

Concept of 'officer who is in default' - The scheme of the Act incorporates the concept of 'officer who is in default', where such officer of the company who is in default shall be liable to any penalty for contravention of the Act. The expression 'officer who is in default' has an extensive definition and amongst other things, includes within its scope the whole-time director; the key managerial personnel (which includes the chief executive officer, managing director, manager, company secretary, the chief financial officer); such director(s) as specified by the board, or all the directors, if no director is so specified.

Penalties for contravention - The Act prescribes penalties for contravention of its provisions, which are in the nature of fine or imprisonment, or both. The liability for contravention of the Act generally lies on such persons who fall within the definition of 'officer who is in default'.

Some instances of contraventions and their penalties under the Act are as under:

For failure to file annual return of the company	Imprisonment up to six months or with fine of Rs. 50,000 (which may extend to Rs. 500,000), or with both
For failure to disclose interest in any contract or arrangement entered into by a company	Imprisonment up to one year or with fine of Rs. 50,000 (which may extend to Rs. 100,000), or with both
For failure to file financial statements with the Registrar of Companies	Imprisonment up to six months or with fine of Rs. 100,000 (which may extend to Rs. 500,000), or with both



It may be noted that certain provisions of the Act, such as the following, mandate imprisonment for contravention of the Act:

- ❖ Default in complying with the order of the National Company Law Tribunal, in relation to registration of transfer of shares.
- ❖ Tampering of minutes of the meeting of the board or shareholders of the company.
- ❖ For acts of fraud in relation to the affairs of the company.

Liability post resignation - The Act expressly provides that even after resignation, a director shall continue to be liable for offences that took place during his or her tenure.

The directors and officers of a company, whether acting in an executive or non-executive role, have the overall responsibility of ensuring legal compliances with the Act and other applicable laws, as well. The increased accountability of directors, in turn, increases their exposure to risks and liabilities. Lack of awareness, often leads to inadvertent non-compliances, which can cause unforeseen and severe consequences.

It is important that any person acting as an officer or director of a company treads carefully at all times and in order to protect themselves, ensure that their company is compliance driven. A clear understanding of their legal obligations and rights would help them focus on the right issues, ask the right questions and along the way, protect both themselves and the company.

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