

# Liability of Non-Executive and Independent Directors



**R.S.Loona**  
Managing Partner  
Alliance Law  
Former E.D. (Law), SEBI

The issue pertaining to role and liability of non-executive directors, particularly independent directors, has been a matter of enormous interest amongst law makers, government authorities, courts and regulators like Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI). The concept of independent directors is relatively of recent

origin in India which have evolved more with the concept of corporate governance in listed entities. It has, of course, now got statutory recognition under the Companies Act, 2013 (Companies Act) and has become applicable to all companies across the board. The purpose of mandating minimum number of directors in a listed or unlisted entity is to improve ethical behavior and business practices of a corporate body. It is generally believed that the induction of independent directors will enhance the professionalism and corporate governance which in turn may increase the shareholders value.

The role of independent directors however has come under public scrutiny in India when prominent companies like Enron Power, Satyam Computers, IL&FS, Gitanjali Gems, Dewan Housing Finance and HDIL were found indulging in unethical and fraudulent practices. The questions were raised on the vigilance and integrity of the so called high-profile professionals and bureaucrats decorating boards of the said companies.

With a view to attract talented professionals to the institution of independent directors as also to minimize the undue hardships which may accrue to them from legal proceedings initiated against the company and its directors, the law makers and regulators have tried to insulate the independent directors from incurring any liability when they act bona-fide and with due diligence. Section 149(12) of the Companies Act provides that an independent director or non-executive director shall be held liable, only in respect of such omission or commission by a company which had occurred with his knowledge, attributable through Board process and with his consent, connivance or where he had not acted diligently. Similar provisions are contained in section 27(2) of the SEBI Act, regulation 25(5) of SEBI (LODR) Regulations, 2015 and Master Circular dated July 1, 2015 of RBI on Wilful

Defaulters. Ministry of Corporate Affairs have also from time to time issued circulars to emphasize that non-executive directors and Independent Directors should not be prosecuted unless there's adequate proof that they had knowledge through Board process or that the acts of omission or commission were committed by the company with their consent, connivance or negligence.

There is no bar on commencement of prosecution or any other legal proceedings against such directors, they can however be exonerated by the concerned authorities / courts if their bona-fides are proved. In the confirmatory order dated January 24, 2020 passed against Mrs. Seema Khandelwal & Ors. in the matter of **Raghukul Shares India Private Limited**, the WTM, SEBI disposed of the show cause issued to the Noticee Nos.1, 2 & 4 without any directions as they were non- executive / independent directors not involved in the day to day affairs of the company.

In **Sayanti Sen Vs SEBI** the Hon'ble SAT held that "... WTM was required to arrive at a specific finding that a Director or Directors were responsible for the acts of the Company. The mere fact that a person is a Director would not make him automatically responsible for refund of monies under Section 73(2) of the Companies Act." The said view was reiterated by Hon'ble SAT in **Pritha Bag vs. SEBI** wherein the Hon'ble SAT held that in the absence of any finding that the appellant was entrusted to discharge his functions contained in Section 73 of the Companies Act, the appellant could not be penalized under Section 73(2) of the Companies Act. The basis for such a consistent view by the Hon'ble SAT is ingrained in the relevant provisions of the Companies Act and SEBI Act. While interpreting the provisions of Section 27 of the SEBI Act in **Rahul H. Shah v. Securities Exchange Board of India**, the Hon'ble SAT held as under:

*"13: Section 27 of the Act states that a person is deemed to be guilty of an offence on condition that he was in charge and responsible to the Company. The proviso to Section 27 states that "Provided that nothing contained in the sub- section shall render 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."*

*"22: Therefore, having held that the Appellants have not had anything to do with the day to day affairs of the Company, as admitted by SEBI, in its impugned Order, we do not think that the Appellants can be fastened with any liability."*

In ***Agritech Hatcheries & Food Ltd. vs Valuable Steels India Pvt. Ltd.***, it has been held by the Madras High Court 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. Similar view was also reiterated in ***Smt. G. Vijaylakshmi & Ors. vs. SEBI***. The reason is not far to see. It is not necessary that every director is required to be penalized merely because he is a director. If the director can explain that he had no role to play in the alleged default, the presumption of guilt and thereafter penalty cannot be fastened upon him.

In ***SEBI vs. Gaurav Varshney***, the Hon'ble Supreme Court held that **the liability arises from being in charge of and responsible for the conduct of business of the company at the relevant time when the offence was committed and not on the basis of merely holding a designation or office in a company**. Conversely, a person not holding any office or designation in a company may be liable if he satisfies the main requirement of being in charge of and responsible for the conduct of business of a company at the relevant time. **Liability depends on the role one plays in the affairs of a company and not on designation or status.**

The Hon'ble 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. Similar approach was adopted by the Apex Court in ***Municipal Corporation of Delhi v. Ram Kishan Rohtagi and Ors.*** wherein it

was observed that 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, the Hon'ble Supreme Court held that no case against the accused directors has been made out ex-facie on the allegations made in the complaint and the proceedings against them were rightly quashed by the High Court.

The aforementioned judicial pronouncements of SEBI, SAT and higher courts clearly show that if a non-executive or independent director is able to satisfy the concerned authority/ court that the alleged violation has been committed by the company without his knowledge, consent, connivance or negligence, he shall not be held liable. Hence, the liability of a non-executive or independent director will depend on the facts of each case, the determinant factor being the role one plays in the alleged violation and not merely designation or status one holds. It is pertinent to note that there is no blanket exemption available to non-executive or independent directors under any law from prosecution or other legal proceedings and they shall be required to prove that they had acted diligently and were not party to the company's alleged violations, else they shall be held liable like any other director for the acts of omission or commission by the company.

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