CHAPTER 6

REMEDIES AGAINST DIRECTORS BREACH OF DUTY WINDING UP OF THE BOARD OF DIRECTORS

ACTION FOR PROFITING FROM POSITION MISAPPROPRIATING COMPANY PROPERTY.

This is not the place for a detailed analysis of the remedies available for breach of fiduciary duties. For the reasons mentioned in the previous paragraph the issue that is most relevant for company lawyers is when a proprietary remedy can be sought against a director who has profited from position in breach of his duty to the company. Certainly, such a remedy will lie where the director's profit making involved misappropriation of company property: the director has wrongfully taken the company's property and, so, is rightly held liable to return it. But where there is no discernible misappropriation of company property, is the company limited to seeking a personal account of profits from the director or can it look for a proprietary remedy notwithstanding the absence of an original proprietary base. This is a question which has divided commentators. The insolvency implications of widening the availability of proprietary remedies to situations which do not have a proprietary base figure prominently in the debate: some argue that it is unfair to the general body of creditors, and contrary to the general principle of pari passu distribution in insolvency, for the court to treat creditors who can link their claim to breach of fiduciary duty more favourably than other categories of creditors; others argue that the general body of creditors of an insolvent fiduciary should not benefit from the pari passu distribution of
property that the fiduciary should never have obtained in the first place. \textsuperscript{1} The beneficiary's property but expands the concept of property to enable it to include 'soft' assets, such corporate opportunities or information. Cook v Deeks\textsuperscript{2} is a case where an expectancy, that is an opportunity not yet secured, was regarded as the property of the company, whilst in Boardman v Phipps\textsuperscript{3} the characterization of information as property of a trust was an important factor in the speeches of some of their Lordships concerning the liability of trustees who had used that information for their own personal advantage. There is an inherent artificiality in treating opportunities or information as property, and attempts to do so can trigger a jurisprudentially complex inquiry which is ultimately unsatisfactory and can leave a residual impression that the court has somehow manufactured property in order to grant a proprietary remedy. The characterization of soft assets as property has been widely criticized and currently has few supporters.

The second approach is that of the Privy Council in Attorney General for Hong Kong v Reid\textsuperscript{4}. This case concerned a fiduciary who had wrongfully accepted bribes. According to the English case of Lister v Stubbs the beneficiary's remedy in these circumstances was to require the fiduciary to account personally for the amount of the bribe. Lister v Stubbs had supporters amongst those commentators who favoured a restrictive approach to the availability of proprietary remedies: as a general rule, where the fiduciary made a wrongful profit from position but did not misuse the company's property in doing so (i.e., covering, but not limited to, bribes), the beneficiary should only have a personal remedy. Those who argued for a greater role for proprietary
remedies held that the fiduciary held the fruits of his wrongful conduct (i.e., property which had been acquired with bribe money) on trust for the beneficiary, Lord Templeman invoked the principle that equality regard as done that which ought to be done to reach this conclusion: the fiduciary was under a personal liability to account and therefore equity would regard the fiduciary as holding the bribe on trust for the beneficiary.

Although the Privy Council may have reached a satisfactory decision on the facts, this reasoning is open to criticism. One problem with it is its apparent rigidity: it seems that, on the basis of Attorney General for Hong Kong v Reid, a proprietary remedy will lie in every case where a fiduciary has made a wrongful profit from position without any scope for the court to examine the appropriateness of that remedy in the circumstances. If Attorney General for Hong Kong v Reid is followed by the English Courts, this will erode still further the insolvency principle of pari passu distribution which is already undermined by other devices, such as security interests and retention of title agreements, whereby certain creditors of an insolvent can obtain priority over the general body of creditors.

The third approach lies in the nascent doctrine in English law of the 'remedial constructive trust'. The remedial constructive trust is a proprietary remedy which lies at the discretion of the court. Its advantage over the other two approaches it that it allows the court to fashion a remedy that it considers appropriate to the circumstances: unlike the approach in Attorney General for Hong Kong v Reid it does not impose a proprietary straitjacket but
enable the court to grant a proprietary remedy, notwithstanding that the fiduciary has not diverted trust property, where a personal remedy might not be sufficient to make the fiduciary disgorge all of the profits that can properly be regarded as having been derived from the wrongdoing. The circumstances for the court to take into account in deciding whether to grant a proprietary remedy could include its effect on other creditors of the fiduciary. The disadvantage of the remedial constructive trust, especially in the commercial context, is its potential for creating uncertainty and unpredictability.

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**Weeks V Property**:

In another case the defendants were the directors of a railway company and they issued a prospectus inviting persons to lend money to the company on the security of debentures. Weeks was a trustee of certain funds and he lent 500 pounds of the trust money to the company, obtaining a debenture. The company had, unknown to Weeks, already exceeded its borrowing powers so that it was not possible to sue the company, the loan being ultra vires. Held – by the High Court – the plaintiff succeeded in this action against the directors. The latter were in breach of warranty that the company had power to borrow, which could be implied from the prospectus.
N.B. 1) The plaintiff in this case was Walter Weeks who was seeking redress against the directors, having failed to obtain his money from the company.

2) The misrepresentation here was one of fact, i.e., that the company was not exceeding its borrowing powers. The stature which set up the company gave it borrowing power limited to 60,000 pounds so if Mr. Weeks had compared his contract of loan with the statute, his contract of loan would not have been patently ultra vires but a mere limitation on powers indicating and it was the extent to which the company had already borrowed which the directors misrepresented and that was a misrepresentation of fact.

The remedial constructive trust granted by the court at its discretion and the proprietary remedy, also conventionally described as a constructive trust, which is the means whereby a beneficiary recovers its property from a fiduciary who has wrongfully subtracted it, are different creatures. Equally, although the remedy granted in Attorney General for Hong Kong v Reid was arrived at by a route which appears to remove any discretionary element, that too was a case where a proprietary remedy was found otherwise than to enable a beneficiary to recover its property that had been wrongly subtracted by the fiduciary. This point makes it possible to argue that the profit/property distinction relied upon by company lawyers to explain authorization and ratification is still valid: it simply has to be fine-tuned to make it clear that it is based on cases where a proprietary remedy is available because the director has wrongfully taken the company's property, and not
on those there the proprietary remedy is at the discretion of the court or follows from equitable maxims as applied in Attorney General for Hong Kong v Reid. However, this would be to ignore the fact that the availability of proprietary remedies otherwise than as a means of recovering property wrongfully subtracted from the company removes the impetus to strain to characteristic's soft assets, such as corporate opportunities case, which has traditionally been classified as a case involving the wrongful subtraction of company property, which is commonly cited in support of the proposition that misappropriation of corporate property is an unratifiable wrong. All of this suggests that company lawyers should look again at authorization and ratification. A starting point in that inquiry may be the judgement of Vinelott J. Although that decision was widely criticized, developments with regard to remedies may in time reveal just how perceptive was Vinelott J's rejection of the argument that limits to ratification.

In Aberdeen Railway Co. v Blaikie Brothers case:
Aberdeen Railway Co. v Blaikie Brothers case the Aberdeen Railway Co. ordered a quantity of iron chairs from Blaikie Brothers. At the time of the contract John Blaikie was a partner in Blaikie Brothers and also the chairman and a director of the Railway Company. When the company refused to take delivery of the chairs, Blaikie Brothers sued for specific performance and damages.
It was held as follows:
The House of Lords reversed the decision of the Scottish Court of Session and held that John Blaikie was in breach of his fiduciary
duty to avoid a conflict of interest between himself and the company. The contract was voidable at the company's option.

B. Enforcement of Civil Liabilities against Directors:
When a director has been guilty of a breach of duty and has no ground for relief from liability, an action for the appropriate remedy or remedies may be instituted in the appropriate court by the company or, in some cases, by a minority member. If the company is in liquidation, the liquidator will in general have the conduct of the action in the company's name, though if the breach of duty falls within §212 of the Insolvency Act 1986, he or the official receiver, or any creditor or contributory, may instead be able to invoke the simpler procedure of a summons in the liquidation.

In the case of the death of a director, his estate remains liable for any breach of duty he may have committed, including any wrongful dealing with company's property, such as a payment of dividend out of capital or sale of its assets at an undervalue. A discharge in bankruptcy does not release a director from liability for a fraudulent breach of duty of a claim for a refund of secret profits, for the retention of them is a breach of trust. The company can prove in the bankrupt estate for the secret profit.

If two or more directors are implicated in the same breach of duty, their liability is point joint and several, accordingly, if in the same transaction they have each misappropriated company assets, each of them is liable for the total amount so misappropriated by himself and his co-directors. If one of them has been rendered liable, he can usually recover contribution from any of the other directors.
who were responsible also. The liability to contribution is not determined by death or discharge in bankruptcy, nor does the Limitation Act 1980 commence to run until the claim has been established against the director seeking contribution. But he cannot recover contribution if the money was applied for his sole benefit, even if the director against whom he claims contribution agreed to its being so used. In Scotland, a claim for contribution prescribes (normally) to its being so used. In Scotland, a claim for contribution prescribes (normally) two years after the date of liability arose.

C. Directorship, not merely a matter of prestige:

1. With the phenomenal growth of corporate culture, there seems to be a growing need for creating adequate awareness in the minds of persons who are fascinated by designations such as director, executive director, managing director, chairman, chairman and managing director, of the obligations, duties and responsibilities of these high officers. Even persons who do not intend doing business of a big size are forming companies. While formulating guidelines on the availability of names, the Department of Company Affairs had once clarified that those companies with a paid up capital of Rs. 50 lakh and above would be treated as big sized companies.

D. High office not a bed of roses: Accountability inherent in office:

Promoters and directors have to understand the following before formation of companies or before occupying the office of a director:
To understand that compliance with various provisions of Companies Act 1956 ('the Act') calls for a separate mindset.

To understand that it is the duty of directors and other officers of companies to take necessary steps for ensuring effective compliance of the provisions of the Act.

To understand that such compliance is in addition to an not in subrogation of complying with the provisions of other legislations that call for compliance irrespective of the form or organization.

To understand that if such provisions are not complied with, every such non-compliance will be constructed to be an offence.

To understand that there is the need for strict internal discipline expected to be employed by persons in charge of administration, whether on a day-to-day basis or otherwise.

To understand that professional help is required while selecting the proper form of organization.

E. Awareness of all legal implications of the corporate directorship essential:

At a time when tax laws have been simplified enabling business restructuring including conversion of firms and proprietary concerns into companies, formation of companies can be postponed to any appropriate future date. Mostly small private companies and closely held public companies have in their Board Directors who are very close relatives. Merely for the sake of meeting the minimum number of directors stipulated by the Act, housewives and students are inducted as directors, exposing them to the liabilities and penalties that are stipulated by the Act and...
other laws. Merely because they are also directors, they may face prosecution. It is, therefore, essential that everyone who sets up a company should be aware of its implications.

Nature of duties/responsibilities important and not whether directorship is part-time or whole time.

In Jagjivan Hiralal Doshi v Registrar of Companies & the Bombay High Court held that in order to understand the nature of liability of the directors, certain provisions of the Act which highlight the responsibility of directors need to be borne in mind. The High Court pointed out that in the case cited supra that in the matter of proceedings for negligence, default, breach of duty, misfeasance and breach of trust, the Act and Rules admitted of no distinction between members of the Board of Directors based on their full time or part time performance of duties. Their liability for any proceedings for such acts was equal.

In this connection a reference to the definition of the word 'officer' in clause (30) of section 2 would be useful. As per the definition, officer includes any director, manager or secretary or any person in accordance with whose directions or instructions the Board of directors or any one or more of the directors is or are accustomed to act. The definition of officer makes no distinction, as held by the Bombay High Court in the case cited above, based on part time performance of duties or the equality of the responsibilities of the members of the Board of Directors; and definition of "director" which admits of no differentiation between part time and full time directors, has to be construed according to its plain meaning. The
plain meaning of director is the person occupying the position of director — call him a part time director or a full time director. The High Court further held that the rules of construction do not call for any modification or qualification of this meaning.

Biba Ltd., and Stratford Investments Ltd.: On a motion by the plaintiff company for interim relief the defendant company gave an undertaking to the court not to infringe the plaintiff company's registered trade mark in certain clothing, and not to advertise, offer for sale or sell clothing under or by reference to the plaintiff company's trade mark. The undertaking was embodied in the written order of the court, which otherwise did not make any order on the plaintiff company's motion. Subsequently it was discovered that the Defendant Company had been acting in breach of the undertaking. The plaintiffs sought a committal order under RSC Ord 45, R 5A, against L, a director of the defendant company, in respect of the breach, L was a solicitor who had taken only a superficial interest in the ordinary day to day affairs of the defendant company and had nothing to do with the staffing, advertising, selling or the stock of the company. Moreover, L had not aided or abetted the Defendant Company's breach of the undertaking but had adopted a purely passive role. It was submitted on behalf of L that since an undertaking had been accepted from the defendant company, an distinct from an order having been made against it, the provisions of RSC Ord 45, R 5, had no application, and L was not therefore liable to proceedings for contempt because he personally had neither given an undertaking nor aided or abetted the defendant company's breach of the undertaking which it had given. It was held that an
undertaking given to the court and embodied in the written order of the court, whereby a party undertook to abstain from doing an act, had the same effect for the purposes of RSC Ord 45, R 5, as a judgement or order enjoining that act. L, as a director of the Defendant Company, was therefore personally liable, under RSC Ord 45, R 5, to proceedings for contempt.

LIABILITIES OF DIRECTORS

The liabilities of directors may be considered under the following heads:

1. Liability to the Company
2. Liability to third parties
3. Liabilities for breach of statutory duties
4. Liability for acts of co-directors
5. Criminal liability

1. **Liabilities to the Company:** The liability of a director to the company may arise from:
   a) Breach of fiduciary duty
   b) Ultra vires Acts
   c) Negligence, and
   d) Mala fide Acts

a) Breach of fiduciary duty: - Where a director acts dishonestly to the interest of the company, he will be held liable for breach of fiduciary duty. Most of the powers of directors are powers in trust and therefore, should be exercised in the interest of the company and not in the interest of the directors or any section of members. Thus where the directors, in order to forestall a take-over bid, transferred the unissued shares of the company to trustees to be help for the benefit of the employees, and an interest-free loan from
the company was advanced to the trustees to enable them to pay for the shares, it was held to be a wrongful exercise of the fiduciary powers of the directors.

b) Ultra Vires Acts: - Directors are supposed to act within the parameters of the provisions of the Companies Act, Memorandum and Articles of Association, since these lay down the limits to the activities of the company and consequently to the powers of the Board of directors. Further, the powers of the directors may be limited in terms of specific restrictions contained in the Articles of Association. The directors shall be held personally liable for acts beyond the aforesaid limits, being ultra vires the company or the directors. Thus, where the directors pay dividends or interest out of capital (except the payment under section 208 of the Act), they will be liable to indemnify the company for any loss or damage suffered due to such act.

c) Negligence: - As long as the directors act within their powers with reasonable skill and care as expected of them as prudent businessmen, they discharge their duties to the company. But where they fail to exercise reasonable care, skill and diligence, they shall be deemed to have acted negligently in discharge of their duties and consequently shall be liable for any loss or damage resulting therefrom. However, error of judgement will not be deemed as negligence. It may be noted that the directors cannot be absolved of their liability for negligence by any provisions in the Articles (Section 201).
d) Mala fide Acts: - Directors are the trustees for the moneys and property of the company handled by them, as well as for exercise of the powers vested in them. If they dishonestly or in a mala fide manner, exercise their powers and perform their duties they will be liable for breach of trust and may be required to make good the loss or damage suffered by the company by reason of such mala fide acts. They are also accountable to the company for any secret profits they might have made in course of performance of duties on behalf of the company.

Directors can also be held liable for their acts of 'misfeasance' i.e., misconduct or willful misuse of powers. However, misconduct which is not willful shall not amount to 'misfeasance'. Moreover, the directors are entitled to relief against liability for breach of trust or misfeasance under section 633.

Where a director misapplies or misappropriates money or properties of the company or has been guilty of breach of trust or misfeasance, the Court may order him to repay the money or restore the property or to pay compensation. P.K. Nedungadi v Malayalee Bank Ltd.¹⁰

2. **Liability to third parties:** The discussion on liabilities of directors towards third parties may be grouped as under:
   a) Liability under the provisions of the Companies Act 1956
   b) Liability for breach of warranty of authority
a) Liability under the Companies Act: - The directors shall be personally liable to the third parties, inter alia, under the following provisions of the Companies Act 1956.

i) Prospectus – Failure to state any particulars as per the requirements of section 56 and Schedule II to the Act or misstatement of facts in a prospectus renders a director personally liable for damages to the third party. Section 62 provides that a director shall be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damages, he may have sustained by reason of any untrue or misleading statement included therein. He may, however, escape liability where he proves his innocence.

ii) With regard to allotment – Directors may also incur personal liability for:

1. Irregular allotment, i.e., allotment before minimum subscription is received (Section 69), or without filing a copy of the statement in lieu of prospectus [Section 70-Section 71 (3)] Under Section 71 (3), if any director of a company knowingly contravenes or willfully authorizes or permits the contravention of any of the provisions of section 69 or 70 with respect to allotment, he shall be liable to compensate the company and the allottee respectively for any loss, damages or costs which the company or the allottee may have sustained or incurred thereby. However, proceedings to recover any
such loss, damages or costs must be commenced before the expiry of two years from the date of the allotment.

II. For failure to repay application monies in case of minimum subscription having not been received within 60 days of the closure of the issue. Under section 69 (5) read with SEBI guidelines, in case monies are not repaid within 70 days from the date of the closure of the issue the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of fifteen percent per annum from the expiry of 70th day. However, a director shall not be so liable if he proves that the default in repayment of money was not due to any misconduct or negligence on his part.

III. For failure to repay application monies when application for listing of securities is not made or is refused. Under section 73 (2) where the permission for listing of the shares of a company has not been applied or such permission having been applied for, has not been granted, the company shall forthwith repay without interest all moneys received from applicants in pursuance of the prospectus, and, if any such money is not repaid within eight days after the company becomes liable to repay, the company and every director of the company who is an officer in default shall, on and from the expiry of
the eighth day, be jointly and severally liable to repay that money with interest @ 15 percent per annum.

iii) Unlimited Liability – Directors will also be held personally liable to the third parties where their liability is made unlimited in pursuance of section 322 (i.e., vide Memorandum) or section 323 (i.e., vide alteration of Memorandum by passing special resolution).

iv) Fraudulent Trading – Directors may also be made personally liable for the debts or liabilities of a company by an order of the Court under section 542. Such an order shall be made by the Court where the directors have been found guilty of fraudulent trading. Section 542 (1), in this regard, provides that if in the course of the winding up of a company, it appears that any business of the company has been carried on, with intent to defraud creditors of the company or any other person, or for any fraudulent purpose, the Court, on the application of the Official Liquidator, or the Liquidator or any creditor or contributory of the company, any if it thinks it proper so to do, declare that any persons who were knowingly parties to the carrying business in the manner aforesaid shall be personally responsible without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct.
Further, sub-section (3) of section 542 provides that every person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to fifty thousand rupees or with both.

b) Liability for breach of warranty: - Directors are supposed to function within the scope of their authority. Thus, where they transact any business in respect of matters, ultra vires the company or ultra vires the articles, they may be proceeded against personally for any loss sustained by any third party.

3. Liability for breach of statutory duties: The companies act 1956 imposes numerous statutory duties on the directors under various sections of the Act. Default in compliance of these duties attracts penal consequences. The various statutory penalties which directors may incur by reason of non-compliance with the requirements of the Companies Act are referred to in their appropriate places.

4. Liability for acts of co-directors: A director is the agent of the company except for matters to be dealt with by the company in general meeting and nor of the other members of the Board. Accordingly, nothing done by the Board can impose liability on a director who did not participate in the Board’s action or did not know about it. To incur liability he must either be a party to the wrongful act or later acquiesce (consent) to it. Thus, the absence of a director from meeting
of the Board does not make him liable for the fraudulent act of a co-director on the ground that he ought to have discovered the fraud. Dovey v Cory\textsuperscript{12} except where he had the knowledge or he was a party to confirm that action. Where a director is made liable for the acts of a co-director, he is entitled to contribution from the other directors or co-directors who were a party to the wrongful act. Ramskill v Edwards\textsuperscript{13}. However, where the director seeking contribution alone benefited from the wrongful act, he is not entitled to contribution.

5. *Criminal Liability*: Apart from civil liability under the Act or under the common Law, directors of a company may also incur criminal liability under common laws as well as under the companies act.

IN THIS era of globalisation and free enterprise, business associations have emerged as a distinct and powerful force at the global level. Weilding enormous economic power, they have the potential to influence the lives of human beings socially, politically and economically. Of all business association, a corporation with limited liability offers maximum advantage and is considered ideal for carrying on business activities of a large magnitude. This is due to the fact that it is a legal person having a personality of its own. It also has an independent and perpetual existence. The corporation has emerged as a social entity capable of actions independent of readily identifiable human agents. This has given rise to problems in fixing criminal responsibility on a corporation.
Criminal law seeks to prevent conduct that invites social condemnation. It proscribes conduct which offends the moral conscience of the collectively and not just that of individual members. The purpose of substantive law of crime is 'to forbid and prevent conduct that unjustifiably and inexcusably inflicts or threatens substantial harm to individual or public interests.

History indicates that people often resort to the device of incorporation as a shelter to commit offences. The law should be developed to the extent of tackling crimes committed behind the mask of incorporation. This should be viewed in the context of the rapid development of corporations in the recent past. Their progress has been such that in many aspects they adversely affect society. Thus, criminal law ought to regulate corporate behaviour in public interest.

An attempt is made in this paper to examine whether the present law is adequate to control corporate behaviour and criminality and suggest alternatives for a more effective legal control in this regard.14

Development of corporate criminal liability
The issue of corporate criminal liability has undergone tremendous changes over the last few centuries. Until the 17th century, corporations were limited in size and less complex in their organisation. Individuals could usually be identified to bear responsibility for corporate action. Thus, criminal law maintained its orientation towards individual responsibility though it recognised the existence of corporations. With increase in size and expansion
of corporate activities, individual accountability became a problem. Organisations became a complex and responsibilities for their activities were diffused. The problem of accountability became even more acute during the period of industrial Revolution in UK. During this period, courts there refused to hold a corporation liable for crime.

However, at the turn of the 19th century, courts began to recognise corporate criminal liability. Initially, corporations were held liable for acts of non-feasance. In 1842, a corporation was convicted for failing to fulfil a statutory duty. In 1846, liability was extended to acts of misfeasance as well. The Court upheld an indictment against a rail-road for illegally destroying public property. In this case, however, it pointed out that corporations could not be held liable for treason, felony, perjury or offences against personal since these crimes require human agents.

During this period, liability of a corporation for an act of its agent was treated at par with that of a master for an act of his servant. Therefore, corporate criminal liability was based on the principle of vicarious liability. Such liability could be imposed on a corporation only in the case of public welfare offences as this principle did not apply to offences involving mens rea. Therefore, wherever mens rea was an essential ingredient of an offence, a corporation could not be made liable for the offence.

The difficulty posed by the principle of vicarious liability was overcome by the House of Lords in the path-breaking decision in Lennard's *Carrying Company Ltd. v Asiatic Petroleum*
Company Ltd., where it was held that a company could be held liable for an offence involving mens rea. Here, the court rejected the application of the principle of vicarious liability in the area of corporate criminal liability and evolved the new 'doctrine of identification'. This doctrine was most lucidly expressed by Viscount Haldane in the following terms:

My Lords, a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and center of the personality of the corporation. That person may be under the direction on the shareholders in general meeting; that person may be the board of directors itself, or it may be, and in some companies it is so, that person has authority co-ordinate with the board of directors given to him under the Articles of Association and is appointed by the general meeting of the company, and can only be removed by the general meeting of the Company.

Therefore, under this doctrine, the state of mind of the agent will be imputed to the corporation.

This doctrine was followed by the court in Mousell Bros. v London North Western Railway Co., where it was held that a company can be criminally liable even if the offences involve a
The development in Indian law is similar to that in English law. Earlier, courts viewed that a judicial entity was incapable of having mens rea and therefore a corporation cannot be indicated for an offence involving mens rea. However, in later cases courts have adopted the identification doctrine and have stated that a corporation can be held liable for mens rea offence.

Traditionally, criminal law has evolved principles of liability to tackle offences committed by individuals. With the growth of corporate activity, corporations have been found to possess the capacity to commit criminal acts of a varied nature. As a result, ordinary criminal law, quipped with conceptual tools to attach responsibility on individuals, is used to regulate corporate behaviour as well. Thus, criminal jurisprudence that is based on individualism is being used to regulate the behaviour of a collectively. The attempt has been to fit corporate liability into the existence structure rather than to alter the structure suitably.

Under Indian law, Section 11 of the Indian Penal Code (IPC) defines the word 'person' as including a company, association or body of persons whether incorporated or not. Corporate criminal liability is thus recognised under IPC. However, the courts have read in certain limitations. In State of Maharashtra v Syndicate Transport Co. (P) Ltd., the court identified two limitation to corporate criminal liability. First, there are several offences under the Code which can be committed only by an individual human
beings, e.g., murder, treason, rape, perjury, etc. Secondly, there are certain other offences which necessarily entail the consequences of corporeal punishment or imprisonment. A Company cannot be subject to such punishment. Prosecuting a company would only result in the court stultifying itself by embarking on a trail in which if a verdict of guilty is returned, not effective order by way of sentence can be passed. However, the relevance of these limitations today needs to be re-examined in the light of recent trends in corporate law.

These limitations were borrowed from English law. However, English courts have subsequently adopted a more liberal approach and brought in various other situations within the scope of corporate criminal liability. E.g., a company was convicted of an offence requiring proof of intent to deceive. Companies have been indicated for 'aiding and abetting' an offence under motor vehicles legislations. They have also been held liable for 'counseling and procuring' the commission of an offence under toad traffic legislations. A Company has also been held guilty of 'using' a motor vehicle on a road contrary to road traffic legislation. Recently, in two cases, R v H M Coroner for East Kent, Ex.P. Spooner, and D.P.P. v P & O European Ferries (Dover) Ltd., courts have held that a company could even be held liable for manslaughter, an offence hitherto considered beyond a corporation. In the latter case, the company and even of its employees were prosecuted following the capsize of a ferry which left the port with its bow doors open. Though the court did not find any difficulty in the indictment of the company for man-slaughter,
the tribal collapsed for lack of evidence of recklessness of the employees.

In U.S.A., corporate criminality was recognised at a very early stage by courts. A landmark decision is that of the U.S. Supreme Court in *New York Central and H.R. Railway Co. v U.S.*

The court's judgement effectively expresses the concern of U.S.A., courts in curbing corporate criminality, where in the early part of this century itself, it was accepted corporation for homicide. Corporations have been convicted of theft by deception, deceptive business practices and unsworn falsification to authorities. A Corporation has been held to be a person under criminal legislations where homicide is made an offence and consequently has been convicted for homicide. In 1978, the Ford Motor Company was indicated for the offence of criminal homicide as it had acted deliberately to endanger human life. In 1985, an Illinois court convicted a corporation of involuntary manslaughter and reckless conduct for knowingly exposing its workers to the risk of cyanide poisoning leading to the death of one worker. Thus, the judges have been evolving new principles of liability to tackle the increase in corporate deviance.

In Holland too, the legislature and courts have responded progressively to this problem. In 1976, article 51 of the Dutch Criminal Code, which hitherto made corporations liable only for public welfare offences, was amended to allow conviction for a whole range of offences. In 1987, a court convicted a hospital for
negligence homicide when a patient died as a result of a wrong tube connection during an operation.

Thus, in UK, USA, and Holland, the legislature and courts have geared themselves to control corporate activities that have traditionally been excluded from the parameters of criminal law. Thus, corporations no longer enjoy definitional immunity in respect of any offence. Unfortunately, the same cannot be said of India law which in the context of increasing corporate influence, remains to be archaic.

'Mens rea' and corporate liability
Earlier, the doctrine of vicarious liability was used to affix criminal responsibility on a corporation. In the course of time it was realised that the doctrine was inapplicable to offences requiring mens rea. Therefore, a corporation ceased to be vicariously responsible for the acts of its employees for offences which require a mental element.

To overcome this difficulty, the English courts evolved the 'identification doctrine', where a corporation was identified with its controlling officers. In other words, these who controlled or managed the affairs of the corporation were regarded as the corporation. Whenever they are acting in the capacity of controlling officer, the corporation is identified with their acts as well as state of mind.

In 1994, English courts rendered three decisions that strengthened the identification doctrine.
In *D.P.L. v Kent and Sussex Contractors Ltd.*, the court, while dealing with charges of offences under the Defence General Regulations, held that where the respondents had produced and furnished documents for the purposes of an order with intent to deceive, the knowledge and intention of the servants were imputed to the body corporate. It examined the principle in detail in *R. v I.C.R. Haulage.* Here, the principle was laid down that the question whether the criminal act of an agent including his state of mind, intention, knowledge or belief is the act of the company employing him, depends on, (i) the nature of the charge, (ii) relative position of the servant or agent to the company and other relevant facts and circumstances. On the facts of the case the court held that the acts of the managing director were the acts of the corporation and the fraud of that person was the fraud of the corporation. In *Moore v Bressler Ltd.*, the court held that when an officer was acting within the scope of his employment, the fact that the act was done with intent to deceive the corporation did not render the officer immune from liability. The decision is a landmark one due to the fact that the corporation was held liable for the act of its officer though it was act done with the intention to deceiving the company itself.

Using the identification doctrine, the court in *Regina v McDonnel* held that a company cannot be convicted for conspiring with its controlling officers. The basis of conspiracy was the acting in concert of two or more persons and although a company was a separate legal entity, where the sole responsible person in a company was its controlling officer, there could not be two or more minds and therefore there could be no conspiracy.
Lord Denning in *Bolton Engineering Co. Ltd.*, v *T.J. Graham and Sons Ltd.*,24 evolved the 'organic theory' of corporate liability. He likened a company to the human body. The servants and agents are the hands of the company who do the work while the directors and the managers represent the directing mind and will of the company. The state of mind of these managers is the state of mind of the company as such, and their fault will be the personal fault of the company. In *Gopal Khaitan v State*, this theory was adopted in India too.

The identification doctrine was limited in its application in *Tesco Supermarkets v Nattrass*,25 where a company was held not liable for the acts of the branch manager as he was not sufficiently in control of the company’s affairs to have his fault attributed to the company as the personal fault of the company. The court created an artificial distinction between members of the top echelons of the company with whom the company is identified and others who are mere servants and agents of the company. Lord Reid observed that only the board of directors, managing director and other superior officers of the company speak and act as the company. Their subordinates do not. Thus, whether the acts of an individual should be imputed to the company or not depends on his status in the company’s organisational hierarchy.

Though this case has been accepted as the law on the point, it has been subject to widespread criticism. It seems to be based on a flawed reasoning that only certain people are capable of acting as the company while others are not. The line has been drawn too
tightly in the Tesco case, which limits the effectiveness of legal
control over corporate activities. A Company may escape liability
by devolving power or responsibility in such a way that it is difficult
to say that any particular individual is the 'directing mind' of the
company and that his failure is the failure of the company. Another
problem faced in this regard is the difficulty attending the
identification of officers who represent the directing mind. This
requires an investigation into the inner workings of a corporation.
This is an extremely arduous task since an outsider would not be in
a position to comprehend the complexities involved in the
 corporative organisation. Further, such a demarcation is also
fallacious for the reason that a company is not liable for an offence
committed by a branch manager who, after all, represents the
company in a particular locality while it is liable for the acts of top
officials who are often far removed from the daily operations of the
company. The test laid down also fails to take into account the
inextricable connections between individuals in a collective
enterprise like a corporation. The court seems to have gone on an
assumption or compartmentalisation of work in a corporation.
Therefore, there is a need to device new legal criteria for setting
limits for fixing responsibility on a corporation. This way, the
purpose of deterrence would also be better served.

The courts in USA have taken the lead in recognising the
limitations placed by the identification theory, and have evolved
broader principles in fixing corporate responsibility. Corporations
have been held liable even for acts of minor employees, thereby
ignoring the distinction of the kind made in the Tesco case. In US
v George Fish Inc., as the court held that where the purpose of an
Act is a deterrent one, to deny the possibility of corporate responsibility for the acts of minor employees is to immunise the offender who really benefits, and open the door for evasion. In Commonwealth v Beneficial Insurance Co.,27 the court opined that the quantum of proof necessary to sustain the conviction of a corporation is sufficiently met if it is shown that it has placed the agent in a position where he has enough authority and responsibility to act for and on behalf of the corporation in handling the particular corporate business, operation or project in which he was engaged at the time he committed the criminal act. This standard does not depend upon the responsibility or authority with respect to the entire corporate business, but only to his position in relation to the particular business in which he was serving the corporation. Thus, the courts have avoided a watertight compartmentalisation and have adopted a more rational distinction in identifying the corporate agents for whose acts the company will be liable.

Recently, the English courts extricated themselves from the rigidity created by the Tesco test. In Tesco Stores Ltd., v Brent London Borough Council,28 the court was posed with a question whether 'knowledge' or 'information' required under section 11 (2)(b) of the English Video Recording Act 1984 which prohibits sale of video cassettes to minors, was concerned with knowledge of those who represent the directing mind or knowledge of the company who actually supplied the video film to the minor. The court created an exception to the general rule propounded in the Tesco case and held that a statute may provide that a company is liable for the behaviour of its servants. The court examined the purpose of the
legislation and concluded that it would be defeated if the Tesco test was adopted. The court held that Parliament intended that the 'knowledge' referred to in the section is the 'knowledge' of the employee who actually supplied the video cassettes.

Courts in UK and India, while trying to attribute criminal liability to corporations for mens rea offences, have attempted to identify the mens rea in a single individual, who is to be a high-ranking official. This makes it difficult for the prosecution to attribute 'culpable failure' to a corporation. It is often not possible to find the requisite culpable intention in a single individual in a collectivity such as the corporation. The US courts have taken note of this fact, and in U.S. v Bank of England, a held that "corporations compartmentalise knowledge, sub-dividing the elements of specific duties and operations into smaller components. The aggregate of these components constitutes the 'knowledge' of the corporation of a particular operation". Further, corporations have been convicted of crimes requiring knowledge on the basis of 'collective knowledge' of the employees as a group, even though no single employee possessed sufficient information to know that the crime was being committed.

'Collective knowledge' of the corporation could be manifest in a general body meeting or at the meeting of the board of directors or in the memorandum or articles of association of the company. It may also be reflected in regulations, standing orders, policies and practices of the company that are not reducible to the aims, intentions and knowledge of the individuals within the corporations. Adoption of the 'collective knowledge' test in England and India
would temper the rigour of the Tesco test in fixing corporate responsibility.

Once the 'collective responsibility' test is applied in India, the limitation that a corporation cannot be liable for an offences like murder, perjury, treason etc., would cease to apply. Since the corporate knowledge is made akin to human knowledge, a corporation is capable of committing all offences created by the law, be it the Indian Penal Code or any other special legislation. The only limitation to corporate liability would be in the case of handful of offences such as bigamy and adultery, which can be committed only by human beings.

**Sentencing options**

After a discussion on the various aspects relating to corporate criminal liability, it would be necessary to deal with the options available to sentencing a corporation. Once a corporation is convicted of an offence, a suitable and effective sentence ought to be imposed, which would act as a deterrent, preventing the corporation from committing further crimes.

The sentencing policy under Indian legislations is directed towards individual offenders. The same framework has been used to sentence corporations as well. As a result, the court is left with only two sentencing options, viz., imprisonment and fine. A Company cannot be subject to any bodily punishment such as imprisonment and therefore, fine remains the only effective option. In this regard, the Indian courts have been confronted with
problems in convicting a company for offences for which there is a mandatory punishment of both imprisonment and fine.

In several cases, the courts have held that a company cannot be convicted of an offence where both imprisonment and fine ought to be imposed, on the ground that the legislature could not have contemplated a company being imprisoned on being found guilty of the offence. The courts in these cases relied on the decision of the Supreme Court in State of Maharashtra v Jugmantar Lal, where the court stated that where it has been made mandatory to impose both punishment, the court is bound to award the sentence of imprisonment. The courts have denied themselves the power to impose a sentence of fine alone in these cases as "this would amount to usurpation of legislative function".

On the other hand, some courts have held that where the sentence is one of both imprisonment and fine, it does not mean that the company is granted exemption from liability, as it can be sentenced to a punishment of fine only. In Oswal Vanaspathi and Allied Industries v State of U.P., the court held that a sentence of fine alone can be awarded to a company under section 16 of the Prevention of Food Adulteration Act 1954.

If the prescribed sentence is both imprisonment and fine, it would be illegal to award only part of the punishment to a natural person. In the case of a company however, awarding only part of the prescribed punishment, namely fine, cannot be held to be illegal as the company cannot suffer imprisonment. This appears to be the correct view.
The courts which have held that a company cannot be convicted of an offence involving punishment with both imprisonment and fine have relied on the decision of the Supreme Court in *State of Maharashtra v Jugmantar Lal.* The decision in that case was rendered in the context of a natural person, who is capable of suffering both imprisonment and fine. Thus, the case is not a precedent where a company is involved.

In construing provisions which impose a mandatory sentence of both imprisonment and fine, it seems more plausible that the legislature inadvertently omitted to provide a suitable punishment for the offence when committed by a corporation, than that it intended to give the wrong-doer impunity simply because it happened to be a corporation. Therefore, these provisions must be constructed by applying the 'mischief rule' of interpretation. They should be constructed so as to prevent the mischief and advance the remedy according to the true intention of the makers of the statute, irrespective of the consideration whether the offender is a corporation or an individual.

Another rule of construction to be adopted here is that of reading conjunctive words disjunctively. It is proper to use the word 'and' as 'or' to more accurately express, or to carry out the obvious intent of the legislature, and especially where it will avoid absurd or impossible consequences, or operate to harmonies the statute and give effect to all its provisions. The substitution of the words 'and' and 'or' is also permissible in criminal statutes. Therefore, the word 'and' can be substituted by the word 'or' where both
punishments are prescribed, and a company can be sentenced to a punishment of fine only, as this will be in furtherance of the legislative intent derived from the purpose of the statute.

Thus, where there is a mandatory sentence prescribed of both imprisonment and fine, the courts must impose a sentence of fine on corporations.

At the same time, the legislature should also look towards new modes of sentencing designed to deter corporate offenders specifically. This would ensure that a sentence imposed on a corporation would be effectively carried out. Among the sentencing options available, a fine would deprive the corporation of the benefits accrued to it by its criminal conduct. Although the incidence of fine primarily falls on the shareholders, it is justified as the shareholders assume the risk on behalf of the company to the extent of their shareholding. Another method of sentencing is to impose an 'equity fine' where the corporation would be forced to issue new equity securities to the state's crime victim compensation fund to the extent of the fine. This would result in a drop in the shareholding of the existing shareholders and would deter the company from committing crimes. It would also benefit the victims of corporate crimes.

The delinquent company can be deterred through publicity sanctions where its conviction is widely published. The adverse publicity would be commensurate with the illegal gain to the company. A novel method of corporate punishment is the introduction of interventionist sanctions where the internal affairs of
the company can be regulated by an outside director, auditor or quality control expert appointed by a court. Other new forms of sentencing suggested are self-regulation, stock dilution, probation, punitive injunctions and community care. The purpose of sentencing a corporation is, therefore, to compel a change of behaviour in the group and to induce a 'clean corporate culture'.

It would also be good policy to focus on the individuals who are in charge of the affairs of a corporation. This is necessary because deterrence will not be of any use without a human element in it. This reasoning was adopted by the court in *U.S. v Park*, where the chief executive officer of a corporation was convicted for an offence of the corporation as he was under a duty to ensure that measures to prevent violations of the law where implemented. This policy has been followed under the various socio-economic legislations in India.

The legislature has thus pierced the corporate veil in an attempt to identify the real offender and punish him.

The Companies Act 1956, under section 5, also identifies an 'officer who is in default' for an offence committed by the company and holds him liable for punishment either by imprisonment or fine or otherwise.

Thus, sentencing policy in relation to corporations ought to focus on both the corporation as a collectivity, and individuals, to achieve the purpose of deterrence.
The growing recognition of corporate capacity to commit wrong has not been accompanied by a corresponding alternation to the framework of criminal law. The attempt thus far has been to fit corporate wrongdoing into the existing structure. This attempt has failed as is evidenced from the steady rise in corporate misdemeanour. Corporations have caused considerable harm by price-fixation, false advertisement, defrauding customers and have affected millions with impurity. However, they are not treated or perceived as sharing the same stigma as individual offenders. Illegal activities of corporations have still not been recognised as conventional crimes. The harms produced by these activities must be recognised as conventional harms. In fact, corporate crimes strike at the very root of the trust and confidence in the political and economic institutions in the country. Social justice would demand that corporate criminals be pursued and prosecuted with as much vigour as traditional criminals. If the guarantee of equality is to be ensured and law were to be enforced equitably, then corporate criminality must be viewed with more seriousness as it can damage the nation's social, economic and political institutions.

If law is to be an 'instrument of social change' it ought to be restructured to tackle the growing menace of corporate crimes, thereby ensuring a clean corporate environment.
Foot note:

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