

Liabilities of Directors under Negotiable Instruments Act, 1881

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This Presentation gives an indication of law applicable to prosecution of directors of a company in case of bouncing of cheque..

Quick Overview

- ❖ Vicarious Liability - rare case of vicarious criminal liability
- ❖ Director responsible only if he is active
- ❖ Non-executive and independent directors not liable
- ❖ Managing Director, Executive Director, Joint Managing Director, Whole-time Director presumed to be liable
- ❖ Quick and almost certain prosecution unless carefully defended

A. Relevant Sections of NI Act

A1. Section 138

A2. Section 141

A3. Key Points of Section 141

A1. Section 138

Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice to any other provisions of this Act, be punished with imprisonment for ~~1~~[a term which may be extended to two years], or with fine which may extend to twice the amount of the cheque, or with both: Provided that nothing contained in this section shall apply unless--

(a) the cheque has been presented to the bank within a period of ~~6~~^{*}six months from the date on which it is drawn or within the period of its validity, whichever is earlier;

(b) the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice in writing, to the drawer of the cheque,

A1. Section 138 (Continued)

²[within thirty days] of the receipt of information by him from the bank regarding the return of the cheque as unpaid; and

(c) the drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.

Explanation.-- For the purposes of this section, "debt or other liability" means a legally enforceable debt or other liability.]

* As per RBI Direction dated 16th November 2011, the period for depositing Cheque has been reduced from six months to three months. Please refer MANU/RMIC/0373/2011.

1 . Substituted by Act 55 of 2002 , sec. 7 , for "a term which may be extended to one year" (w.e.f . 6 - 2 - 2003).

2 . Substituted by Act 55 of 2002 , sec. 7 , for "within fifteen days" (w.e.f . 6 - 2 - 2003).

A2. Section 141

(1) If the person committing an offence under section 138 is 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 person liable to punishment 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:

2[Provided further that where a person is nominated as a Director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government, as the case may be, he shall not be liable for prosecution under this Chapter.]

A2. Section 141 (Continued)

(2) Notwithstanding anything contained in sub-section (1), 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.

Explanation.--For the purposes of this section,--

(a) "company" means any body corporate and includes a firm or other association of individuals; and

(b) "director", in relation to a firm, means a partner in the firm.]

A3. Key Points of Section 141

- Director should be in charge of **AND** be responsible to the company for the conduct of the business of the company
- Not responsible if he proves that the offence was committed without his knowledge **OR** that he had exercised all due diligence to prevent the commission of the offence

B. Key Provisions of Case Law

- B1. Key Principles
- B2. Company Must be Liable for Director to be Liable
- B3. Directors Need Not be Served Notice
- B4. Specific Averment Necessary

B1. Key Principles

(i) The primary responsibility is on the complainant to make specific averments as are required under the law in the complaint so as to make the accused vicariously liable. For fastening the criminal liability, there is no presumption that every Director knows about the transaction.

(ii) Section 141 does not make all the Directors liable for the offence. The criminal liability can be fastened only on those who, at the time of the commission of the offence, were in charge of and were responsible for the conduct of the business of the company.

(iii) Vicarious liability can be inferred against a company registered or incorporated under the Companies Act, 1956 only if the requisite statements, which are required to be averred in the complaint/petition, are made so as to make accused therein vicariously liable for offence committed by company along with averments in the petition containing that accused were in-charge of and responsible for the business of the company and by virtue of their position they are liable to be proceeded with.

B1. Key Principles (Continued)

(iv) Vicarious liability on the part of a person must be pleaded and proved and not inferred.

(v) If accused is Managing Director or Joint Managing Director then it is not necessary to make specific averment in the complaint and by virtue of their position they are liable to be proceeded with.

(vi) If accused is a Director or an Officer of a company who signed the cheques on behalf of the company then also it is not necessary to make specific averment in complaint.

(vii) The person sought to be made liable should be in-charge of and responsible for the conduct of the business of the company at the relevant time. This has to be averred as a fact as there is no deemed liability of a Director in such cases.

National Small Industries Corp. Ltd. vs. Harmeet Singh Paintal and another, MANU/SC/0112/2010

B2. Company Must be Liable for Director to be Liable

Applying the doctrine of strict construction, we are of the considered opinion that commission of offence by the company is an express condition precedent to attract the vicarious liability of others. Thus, the words "as well as the company" appearing in the Section make it absolutely unmistakably clear that when the company can be prosecuted, then only the persons mentioned in the other categories could be vicariously liable for the offence subject to the averments in the petition and proof thereof.

Aneeta Hada v. Godfather Travels and Tours Pvt. Ltd., MANU/SC/0335/2012

B3. Director need not be served notice

9. The question, therefore, is whether notice Under Section 138 of the Act is mandatorily required to be sent to the directors of a Company before a complaint could be filed against such directors along with the Company. At the outset we must consider whether the decision of this

The notice Under Section 138 is required to be given to "the drawer" of the cheque so as to give the drawer an opportunity to make the payment and escape the penal consequences. No other person is contemplated by Section 138 as being entitled to be issued such notice. The plain

16. In our view, Section 138 of the Act does not admit of any necessity or scope for reading into it the requirement that the directors of the Company in question must also be issued individual notices Under Section 138 of the Act. Such directors who are in charge of affairs of the Company and responsible for the affairs of the Company would be aware of the receipt of notice by the Company Under Section 138. Therefore neither on literal construction nor on the touch stone of purposive construction such requirement could or ought to be read into Section

Krishna Texport and Capital Markets Ltd. v. Ila A Agrawal and Ors., MANU/SC/0562/2015

B4. Specific Allegation Necessary

responsible for the conduct of the business of the Company? In our opinion, in the case of offence by Company, to bring its Directors within the mischief of Section 138 of the Act, it shall be necessary to allege that they were in charge of and responsible to the conduct of the business of the Company. It is necessary ingredient which would be sufficient to proceed against such Directors. However, we may add that as no particular form is prescribed, it may not be necessary to reproduce the words of the section. If reading of the complaint shows and substance of accusation discloses necessary averments, that would be sufficient to proceed against such of the Directors and no particular form is necessary. However, it may not be necessary to allege and prove that, in fact, such of the Directors have any specific role in respect of the transaction leading to issuance of cheque. Section 141 of the Act makes the Directors in charge and responsible to Company "for the conduct of the business of the Company" within the mischief of Section 138 of the Act and not particular business for which the cheque was issued. We cannot read more than what has been mandated in Section 141 of the Act.

A.K. Singhania v. Gujarat State Fertilizer Co. Ltd. and Anr., MANU/SC/1081/2013

C. Position of Independent Directors

- C1. Who is Independent Director
- C2. Liability of Independent Directors under Companies Act
- C3. Position of Independent Director under NI Act
- C4. Companies Act vs. NI Act
- C5. Suggested Action Points

C1. Who is Independent Director

- Independent Director is a new class of directors introduced by Companies Act, 2013.
- Independent director must not be related in any way to promoter(s), key managerial personnel and other director(s).
- Independent director should not be a shareholder of the company.
- Independent director must meet the criterion of independence as defined under section 149(6) of the Companies Act, 2013.
- It is necessary for listed public companies to appoint independent directors.
- As and when a person is appointed as an independent director of a company, this is duly mentioned in the form DIR12 filed with Registrar of Companies. So, there is no confusion whether a person is independent director or not.

C1. Who is Independent Director (Continued)

(6) An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

C1. Who is Independent Director (Continued)

(d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(e) who, neither himself nor any of his relatives—

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

C1. Who is Independent Director (Continued)

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

(f) who possesses such other qualifications as may be prescribed.

C2. Liability under Companies Act

Independent Director (ID) liable only when:

- Acts of omission or commission by the company done with ID's **knowledge**
- ID's knowledge ought to be attributed to ID through **processes of Board of Directors**. So knowledge obtained through other sources such as newspaper etc. will not count.
- In addition to knowledge, there must be one of three – (a) **consent** or (b) **connivance** or (c) **absence of diligence** in ID's actions.

C2. Liability under Companies Act (Continued)

(12) Notwithstanding anything contained in this Act,—

(i) an independent director;

(ii) a non-executive director not being promoter or key managerial personnel,

shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

C3. Position under NI Act

It must be presumed that the independent director (ID) was:

- NOT “in charge of the company” AND
- NOT “responsible to the company for the conduct of the business of the company”.

Hence, unless strong evidence exists to the contrary, it is difficult or inappropriate to apply section 141 of NI Act in case of independent director.

- Additional defense of ID will be that the offence was committed without his knowledge.
- Any knowledge will be hurtful for ID even though the knowledge was not acquired through Board process.

C4. Companies Act vs. NI Act

- Nature of independent director (ID) as defined under Companies Act helps ID against prosecution under NI Act since by definition ID cannot be “in charge of the company”.
- Under Companies Act, an ID can be prosecuted merely on the basis of knowledge acquired in Board combined with tacit consent.
- Under NI Act, while absence of knowledge is a valid defense, knowledge by itself is not sufficient to make the ID liable.
- Under NI Act, it should be presumed that ID is not in charge of the company and is not responsible for the business of the company and is not covered under section 141. No such presumption under Companies Act.
- The above position will need to be confirmed by some court judgments.

C5. Suggested Action Points

If you are an independent director of a company and you receive a notice about bouncing of a cheque issued by the company, the following action points are suggested:

- You should reply promptly to the notice stating that you are an independent director and that you are not in charge of the company and you are not responsible for the business of the company.
- Do not rely on the company lawyer to defend you.
- From the outset defend yourself independent of the company and its executive director(s).
- Remember that the company, its Managing Director, Executive Director etc. have often no way to save themselves, but you have a good defense. So do not be part of their boat.

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