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Article

Doctrine of attribution in corporate criminal liability

By **Dinesh Babu Eedi**

The question of making a company liable for for criminal offences committed by its directors, managers, officers and other employees while conducting business has gained importance in criminal law jurisprudence while being subject to debate. The traditional view was that a corporation could not be guilty of a crime, because criminal guilt required intent (*mens rea*), which a corporation does not possess. In addition, a corporation cannot be imprisoned.

The basic rule of criminal liability revolves around the basic Latin maxim *Actus non facit reum, nisi mens sit rea.* It means that to make one liable it must be demonstrated that (a) a forbidden act or omission has been done (b) with a deliberate intent. Hence, in order to attribute criminal liability to a company, it must be proved that there was a physical act i.e. *actus reus* and that there was an intention to commit the act i.e. *mens rea.*

Further, to counter the practical difficulty of sentencing companies to imprisonment created by the legal fiction of law, the courts have developed what is termed as the 'Doctrine of Attribution'. As per this doctrine, in the event of an act or omission leading to violation of criminal law, the *mens rea* i.e. intention of committing the act is attributed to those who are the 'directing mind and will' of the corporations. Although this doctrine was developed in the United Kingdom and has been in use in India since many years, the Supreme Court's recent judgment in *Iridium Indian Telecom Limited* v. *Motorola Inc.*, [(2011) 1 SCC 74] ("Iridium") has finally resolved the debate whether corporations can be held liable for offences inextricably possessing *mens rea* as one of the essential components.

Origin of the Doctrine of Attribution

The principle of vicarious liability was generally applied to hold corporations liable for the acts of its agents. Companies were called on to make good the loss occasioned by its agents when they acted in the course of their employment. However, this principle was not extended to pass on the liability of criminal wrong to corporations. As such, corporations could act with impunity in all such cases.

To plug this loophole, courts in England pierced the corporate veil and held that corporations are liable for criminal and civil wrongdoings if the offences were committed through the corporation's 'directing mind and will'. This attribution of liability to the corporations later came to be known as the 'Doctrine of Attribution'.

In *Lennard's Carrying Co. Ltd.* v. *Asiatic Petroleum Co Ltd.* ('*Lennard*')[1], trying an offence under the Merchant Shipping Act, the House of Lords applied the doctrine of attribution to identify Mr. Lennard, who was the owner of the ship and also responsible for the management of the ship, as the 'directing mind and will' of the

[1] [1915] A.C. 705 HL. Also see *Rudd* v. *Elder Dempster & Co. Ltd.*, [1933] 1 KB 566.

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company. Subsequently, in *H.L Bolton Co. Ltd.,* v. *T.J Graham and Sons ('Bolton')*[2], the Court of Appeals likened companies to a human body and their brain to the directors of the company, and confirmed the application of the doctrine of attribution to criminal cases.

Indian approach towards doctrine of attribution before Iridium

The debate on the liability of corporations for offences with *mens rea* as an essential component began much before the decision of the Supreme Court in *Iridium.* Indian High Courts were not inclined to declare corporations as liable and rejected appeals for punishing companies for criminal offences.

In 1964, in *State of Maharashtra* v. *Syndicate Transport Co. (P) Ltd.* [AIR 1964 Bom 195], the Bombay High Court developed a very forward-looking approach in this regard and in deciding a case in which a company was charged with cheating, criminal breach of trust and dishonest misappropriation, the Court held:

> "The question whether a corporate body should or should not be liable for criminal action resulting from the acts of some individual must depend on the nature of the offence disclosed by the allegations in the complaint or in the charge-sheet, the relative position of the officer or agent vis-a-vis the corporate body and the other relevant facts and circumstances which could show that the corporate body, as such, meant or intended to commit that act."

In 1975, the Bombay High Court, in *Esso Standard Inc* v. *Udharam Bhagwandas Japanwalla,* [1975 45 CompCas 16 Bom] (*'Esso Standard'*) further noted:

> "The law attributes to the company intention of the officers of the company under certain circumstances. The company's intention could be ascertained only when the company in a general body or at the meeting of the board or in accordance with the memorandum or articles of association has expressed that intention in the form in which it should be expressed."

However, the Calcutta High Court in a series of cases did not apply the attribution principles adopted by the Bombay High Court. In *Sunil Chandra Bannerjee* v. *Krishna Chandra Nath*, [AIR 1949 Cal 689] the Calcutta High Court acquitted a bank, on the basis that a company cannot be said to possess *mens rea* to cheat. In *Kusum Products* v. *S.K Sinha,* [1980 126 ITR 804 Cal.] it held that a company being a juristic person could not be punished.

The Supreme Court in 1997 in *MV Javali* v. *Mahajan Borewell* [(1997) 143 CTR (SC) 320] further held that mandatory sentence of imprisonment and fine is to be imposed where it can be imposed, but where it cannot be imposed namely, on a company, fine will be the only punishment. This 'One Size Fits All' approach was dismissed, in *the Asst. Commissioner* v. *Velliappa Textiles* [(2003) 11 SCC 405] where the Supreme Court held that since company is an artificial person, it cannot be physically punished to a term of imprisonment. But the court also held that where the statute provides for imprisonment

[2] [1957] 1 Q.B. 159 CA

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or fine, it is not a problem, but where the statute provides for imprisonment *and* fine, the court is not given the discretion to impose fine in lieu of imprisonment.

The Supreme Court in the case of *Standard Chartered Bank* [AIR 2005 SC 2622] without making any reference to doctrine of attribution held that a company can be prosecuted for offences which are punishable with mandatory imprisonment. However, the Court left open the question of whether a company could be punished for crimes requiring *mens rea*. Hence, till the pronouncement of Apex Court ruling in the *Iridium* case, there were conflicting judgments of various High Courts on attribution of criminal intent to a company.

Deadlock resolved by Iridium

The Supreme Court in the *Iridium* case discussed the doctrine of attribution, not to adjudge the liability of the directors, but to determine the liability of the corporation. The Apex Court held that criminal liability of corporations would arise when the offence is committed in relation to the business by a person or body of persons in control of its affairs and when the degree of control is such that a body or body of persons can be said to be its 'directing mind and will'. The Court also held that such *mens rea* would be attributable to the corporation on the principle of 'alter ego' and upheld its earlier decision in the *Standard Chartered* case discussed *supra*. Thereby, the Apex Court has finally resolved the position regarding criminal liability of corporations.

Conclusion

In the *Iridium* case, the Supreme Court discussed the doctrine of attribution to determine the liability of Motorola Inc. This doctrine is applicable not only for the acts committed by the directors of the company, but also for the acts committed by the company through its promoters, who are controlling the affairs of the company. The acid test is to determine the 'mind and will' of the controlling person vis-à-vis the controlled company and is valid even when two or more layers above the controlled company exist.

It will be very interesting to see how the doctrine is applied in cases such as the liability of a company for misstatement or non-disclosure in an information memorandum issued in connection with an offering of securities. Although the decision is an important step in promoting the use of criminal sanction to regulate corporate behavior, it is important to note that the Supreme Court did not throw light on the methods by which *mens rea* of a company can be proved. Moreover, the risk factors and disclaimers contained in the Private Placement Memorandum in *Iridium* were disregarded by the Apex Court even though these provisions seek to pass on risks of uncertainty to the investors.

In conclusion, although the decision clarifies the position on criminal liability of a company and the possibility of criminal intent, the prosecution of officers of the company or promoters for the criminal acts of a company would depend on the facts and circumstances of each case and is not likely to be applied very widely.

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Notifications & Circulars

Realization period of export proceeds: Reserve Bank of India has clarified that time period for realization and repatriation of export proceeds from 1st April, 2013 onwards to 30th September, 2013, shall be reckoned as nine months from the date of export. A.P. (DIR Series) Circular No.14, dated 22nd July, 2013 issued in this regard, notes that realization and repatriation period in terms of Circular No. 52, dated 20-11-2012 was valid till March 31, 2013 only, and Circular No. 105, dated 20-5-2013 had brought down the realization period of export proceeds from twelve months to nine months from the date of export valid till September 30, 2013. Provisions relating to SEZ units remain unchanged.

Alternative Investment Funds - Guidelines for change in category: SEBI has laid down procedure with regard to change in the category of Alternative Investment Funds (AIF) under the SEBI (Alternative Investment Funds) Regulations, 2012. SEBI Circular No. CIR/IMD/DF/12/2013, dated 7th August, 2013 issued for the purpose states that: (i) Only AIFs who have not made any investments under the category in which they were registered earlier shall be allowed to make application for change in category; (ii) Such AIFs shall make an application in Form A alongwith application fee of INR 1 lakh. (iii) If the AIF has received commitments/raised funds prior to such application, option may be given to investors to withdraw their funds without any penalties/charges. Partial withdrawal may be allowed subject to compliance with the minimum investment amount required under the AIF Regulations. Any fees collected from investors seeking to withdraw commitments/ funds shall also be returned to them; (iv) AIF shall not make any investments other than in liquid funds/banks deposits until approval for change in category is granted by SEBI; (v) On approval by SEBI, the AIF shall send a copy of the revised placement memorandum and other relevant information to all its investors.

Statement on foreign currency exposures: AD Category-I banks are now required to submit the quarterly statement on foreign currency exposures and hedges undertaken by corporates based on bank's books as per the revised format online only from quarter ending September 2013 through the XBRL system. RBI A.P. (DIR Series) Circular No. 17, dated July 23, 2013 issued in this regard states that AD Category-I banks which require login ID/passwords for accessing XBRL system may submit their e-mail addresses and contact numbers to specified email ids.

News Nuggets

Companies Bill passed by Rajya Sabha

The Rajya Sabha recently passed the Companies Bill, 2012. The new law is set to finally replace the half a century old law in place for companies in India. The Bill will come into force after it receives the assent of the President of India. Once enacted, a company with upto 200 members shall be considered as a private company as against

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the earlier cap of 50 members. Companies with a net worth of more than INR 500 crore or turnover of more than INR 1000 crore or net profit of more than INR 5 crore during the past three financial years will be required to spend 2% of their average net profit of three years on activities related to corporate social responsibility (CSR). The new dispensation also proposes to introduce concepts of one person company, dormant company and small companies. The maximum number of directors in a private company has been increased from 12 to 15, which can be increased further by special resolution. Auditors shall be subject to criminal liability if they knowingly or recklessly omit certain information from their reports. An association of persons or partnership may now have upto 100 partners instead of the earlier limit of 20. Other provisions relate to increased protection for minority shareholders and fixed deposit holders, better governance mechanisms including a woman director on the Board of certain companies and transparency and disclosure of information relating to the company.

SEZ Norms relaxed for exit of units – Rules amended

India has relaxed norms for exit of present units in the Special Economic Zones, and has also made the scheme more attractive by reducing the minimum area requirements for units in specified SEZs. As per the amendments dated 12-8-2013 through Special Economic Zones (Amendment) Rules, 2013, new Rule 74A has been inserted in the SEZ Rules, 2006. This Rule provides for transfer of assets and liabilities, by SEZ unit upon its exit, to another person by way of transfer of ownership. Export obligation of the transferor unit will also be transferred to the transferee unit. Hitherto, SEZ units could exit from the scheme only after payment of applicable duties on raw material, finished goods, capital goods, etc. As regards minimum area requirement, while multi products SEZs can now be operated with 500 hectares instead of 1000 hectares, single product SEZ would require only 50 hectares instead of 100. This minimum area requirement has been further relaxed in the case of SEZ dealing with Information Technology (IT) goods/services. Further, required built-up area has been specified considering the grade of city the SEZ is located in.

Spot trading of commodities banned

The National Spot Exchange stopped issuing contracts with more than 11 days of settlement period on 23-7-2013, while the government moved on 6-8-2013 to ban all spot trading of all commodities on the exchange. The reason behind this move the probe ordered last year by the Ministry of Consumer Affairs into the contracts being traded on the National Spot Exchange and the government felt that allowing any delivery settlement beyond the period of 11 days would lead to speculation. The spot exchange was not regulated by the Future Markets Commission (FMC) set up under the

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Forward Contract Regulatory Act but was under the domain of Agricultural Produce Market Committee. Now FMC is exploring whether spot exchange has the required commodity in its warehouses to meet its contract settlement and also the option of regulating the exchange. As per reports, the Indian government is also preparing new regulations for spot exchanges that offer electronic platforms for trading in commodities.

US Drug Approval Norms made stringent

The United States Food and Drug Administration (US FDA) has recently mandated companies to give data related to safety, efficacy and stability for three batches of products instead of one while seeking drug approvals in the United States of America (USA). The decision shall come into force from January 2014. This requirement is likely to lead to a hike in the development cost by three times for several pharma companies who are the major suppliers of generic drugs to the USA market. The decision is also expected to increase the time taken for such development studies. A few companies may not be impacted by this decision if they enhance capacity and manpower to conduct the extended studies.

Ratio Decidendi

Section 45QA of RBI Act has overriding effect on provisions of Companies Act: The Supreme Court of India has held that Section 45QA of the Reserve Bank of India Act does act as a bar to a scheme under Sections 391-394 of the Companies Act and that a scheme pertaining to an NBFC, therefore, under Section 391 cannot be approved unless it is in compliance with the provisions of the RBI Act. The court held that Chapter IIIB of the RBI Act, applicable to NBFC, is a self contained code; will have an overriding effect over provisions of the Companies Act; and should not be given limited application. It was noted that though the court is not expected to act as a super auditor or step into the shoes of the stake holders while evaluating a scheme or arrangement, it is not expected to superficially add its seal of approval and is required to see that all legal requirements have been complied with. The Apex Court observed that the scheme to avoid repayment to the small depositors by converting the unpaid amounts into debentures, was clearly contrary to the mandatory requirements under Section 45QA(1) of the RBI Act. Lack of bonafides, on the part of the company, was also noticed by the Supreme Court as the appellant had not disclosed the letter/notice issued by the RBI.

Earlier RBI after noticing various violations of the NBFC Prudential Norms (Reserve Bank) Directions, 1998, such as, negative net owned funds, excess credit exposure, etc., had prohibited the appellant from accepting deposits from any person, in any form and had directed not to sell or transfer its properties and assets, without prior permission of the RBI. This allegedly reduced profitability and appellant

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introduced a scheme of compromise with their creditors which was approved by the board of directors. The petitioner had stated that the scheme was approved by a majority and the company had complied with all the statutory requirements. [*Integrated Finance Co. Ltd.* v. *Reserve Bank of India* – Supreme Court Judgment dated 16-7-2013 in Civil Appeal Nos. 5505 – 5508 of 2013]

Stamp duty on agreements to sell: In a case pertaining to payment of deficient stamp duty and impounding of the documents by the Deputy Registrar, the petitioner argued that pursuant to Sections 2, 3 and 10 of the Indian Stamp Act, 1899, no stamp duty is payable on agreement to sell and also that instead of dealing with the case under Sections 33/38 of the Act, the case should have been dealt with under Section 47A of the Act. The Supreme Court however, referred to the State amendment to Section 28 of the Act and Article 5 (b-1) of Schedule IB of the Act as applicable to the State of Uttarakhand. Section 28(1) of the Act provides that when any property is sold for a particular consideration but is conveyed in separate parts through separate instruments, and the consideration being apportioned over each instrument; such conveyance shall be chargeable with ad valorem duty in respect to such distinct consideration. Article 5(b-1) imposing duty on instruments relating to the sale of an immovable property where possession is not admitted to have been delivered nor is agreed to be delivered nor is agreed to be delivered without executing the conveyance was also noted by the Court which held that the conjoint reading of the aforesaid provisions indicates that the stamp duty is payable on 50% of the value of consideration of the sale agreement. Further, the court held that the case was rightly dealt with under Section 33 of the Act as the instrument was impounded by the Deputy Registrar who satisfies the criterion of "every person having, by law or consent of parties authority to receive the evidence or every person in-charge of a public office is duty bound to impound the instrument".

The Court also observed that just because the agreements to sell were subsequently cancelled by the parties and they did not go through with the sale, is no ground for not taking action under Section 33 of the Act, when the documents were presented before the Dy. Registrar. [*Tirupati Developers* v. *State of Uttarakhand* - Supreme Court Judgement dated 8-8-2013 in Civil Appeal No. 6619 of 2013]

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