

Whether a Company can Pay or Indemnify Fine, Penalty or Compounding Fee ordered to be paid by Directors or Officers of the Company?

Almost every provision of the Companies Act (whether it is providing for punishment by way of fine by a court or by way of penalty by an adjudicating authority or compounding fee by the Regional Director or National Company Law Tribunal), makes liable the company and every officer of the company who is in default (or in some cases the key managerial personnel). This liability arises by reason of the director or other officer of the company being made by law vicariously liable in respect of defaults for which the company as a distinct person is primarily liable.



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INTRODUCTION

Defaults, breaches, violations, failures, contraventions or non-compliances under the Companies Act, are all called 'offences' which give rise to a punitive liability. In different penal provisions of the Companies Act, different words are used, such as contravention, failure, default, refusal, non-compliance, negligence, etc. But the most frequently used word is 'default'. In the context of penal provisions under the Companies Act, default means failure to act; inaction or neglect; failure to perform an act or obligation legally required; failure to perform some legal requirement.

Almost every provision of the Companies Act (whether it is providing for punishment by way of fine by a court or by way of penalty by an adjudicating authority or compounding fee by the Regional Director or National Company Law Tribunal), makes liable the company and every officer of the company who is in default (or in some cases the key managerial personnel). This liability arises by reason of the director or other officer of the company being made by law vicariously liable in respect of defaults for which the company as a distinct person is primarily liable.

Etymologically, 'vicarious' means performed, exercised, received, or suffered in place of another; taking the place of another person or thing; acting or serving as a

substitute. The expression 'vicarious liability' denotes a legal liability imposed on one person for torts or crimes committed by another (usually an employee but sometimes an independent contractor or agent), although the person made vicariously liable is not personally at fault. When an offence under any law is committed by a company, prosecution is invariably launched against the company, its directors and some of its executives. As 'company' is an artificial person created by law, and is capable of acting only through human agency occupying the position of directors and executives, it is but natural that directors and executives are arraigned on a charge of an offence committed by the company.

A company or a body corporate, of which a company registered under the Companies Act, is a species, is an abstraction. It is a juristic person. It acts through human beings, who occupy the position of directors and officers; they are agents of the company. They are, therefore, liable for the offences committed, in law, by the corporation. As was stated in an old English case,¹ 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 directive 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 centre of the personality of the corporation. That person may be under the direction of the shareholders in general meetings; that person may be the board of directors itself, or it may be, and in some companies it is so, that person has an 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.

There are, thus, three types of monetary liability of director/officers of a company arising out of default in complying with any provisions of the Act, namely -

- Fine imposed by a court of law as a result of prosecution and criminal trial of an offence in respect of those provisions which lay down that for a default, the company and every officer shall be 'punishable' with fine and/or imprisonment;

¹ *Lennard's Carrying Co. Ltd. v Asiatic Petroleum Co. Ltd. (1915) AC 705, per Viscount Haldane L.C.*

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- An amount ordered to be paid by the NCLT or the Regional Director or any officer authorised by the Central Government, on compounding of an offence under Section 441 of the Act;
- An amount of penalty imposed by an Adjudicating Officer under Section 454 of the Act, in respect of those provisions which lay down that that for a default, the company and every officer shall be liable to a penalty.

When a director or other officer of a company is penalized for a non-compliance by the company with any provision of the Companies Act, or for negligence, default, misfeasance, breach of duty or breach of trust, there are often instances of directors/officers are called upon to pay fine or penalty for the company's default in complying with the law as the company's agents being vicariously liable. There is no explicit provision in the statute declaring that fine or penalty or compounding fee ordered against a director/officer must be borne and paid by the director/officer personally out of his/her own pocket. The language used in the relevant statutory provision, however, does indicate that it is the personal liability of the director/officer against whom the order is passed, to bear and pay the fine/penalty. For example, see the following two provisions:

- If default is made in complying with the provision of this Section the company and every officer of the company who is in default *shall be punishable* with fine or imprisonment or with both.
- Where any default is made in complying with the provisions of this Section, the company and every officer of the company who is in default *shall be liable* to a penalty of fifty thousand rupees.

There is no explicit provision in the statute declaring that fine or penalty or compounding fee ordered against a director/officer must be borne and paid by the director/officer personally out of his/her own pocket.

The words 'shall be punishable' and 'shall be liable', qualifying both the company and every officer who is in default, and the fact that the company and every officer who is in default are separately made liable for the fine/penalty, make the intention of the Legislature that the fine/penalty imposed on an officer of a company is personal liability of such officer who is liable to pay it out of his own pocket. Furthermore, the principle of vicarious liability (as explained below) makes such liability the personal liability of the officer.

INDEMNITY AGAINST FINE, PENALTY, COMPOUNDING FEE OR EXPENSES IF ARTICLES OF ASSOCIATION OF A COMPANY SO PROVIDE

A question that often arises as to whether a fine or penalty or compounding fee imposed on a director or officer of a company is his personal obligation to be paid by him from his own pocket or the company can pay it or (if already paid by him) indemnify it. The Companies Act, 2013 is silent on this, although Table F does contain a provision enabling it to be indemnified by the company.

Position under Companies Act, 1956

The Companies Act, 1956 contained provisions on this subject in Section 201 and article 99 of Table A, which read as follows:

“201. Avoidance of provisions relieving liability of officers and auditors of company — (1) Save as provided in this Section, any provision, whether contained in the articles of a company or in an agreement with a company or in any other instrument, for exempting any officer of the company or any person employed by the company as auditor from, or indemnifying him against, any liability which, by virtue of any rule of law, would otherwise attach to him in respect of any negligence, default, misfeasance, breach of duty or breach of trust of which he may be guilty in relation to the company, shall be void:

Provided that a company may, in pursuance of any such provision as aforesaid, indemnify any such officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or discharged or in connection with any application under Section 633 in which relief is granted to him by the Court.”

“Indemnity:

99. Every officer or agent for the time being of the company shall be indemnified out of the assets of the company against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or in connection with any application under Section 633 in which relief is granted to him by the Court.”

Legislative history and object of Section 201

In England, a provision corresponding to this Section was first enacted in English Companies Act, 1929 (Section 152) on the recommendation of the Greene Committee which was

the result of the decision of Romer J in *Re, City Equitable Fire Insurance Co Ltd*² where the directors of the company successfully relied upon the company's articles modifying a director's duty to the company and exempting him from breach of that duty or granting blanket immunity to directors from liability for breach of duty. It was held in that case that where the articles of a company made the directors liable for losses only if those losses happened by their wilful negligence or default, they could not be held liable for a negligence which did not amount to a wilful negligence. Article 150 of the Articles of Association read as follows:

“The directors, auditors, secretary and other officers for the time being of the company, and the trustees (if any) for the time being acting in relation to any of the affairs of the company, and every of them, and every of their heirs, executors and administrators, shall be indemnified and secured harmless out of the assets and profits of the company from and against all actions, costs, charges, losses, damages and expenses which they or any of them their or any of their heirs, executors or administrators shall or may incur or sustain by or by reason of any act done, concurred in or omitted in or about the execution of their duty, or supposed duty, in their respective offices or trusts, except such (if any) as they shall incur or sustain by or through their own wilful neglect or default respectively, and none of them

² (1925) Ch 407; (1924) All ER 485.

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shall be answerable for the acts, receipts, neglects or defaults of the other or others of them, or for joining in any receipts for the sake of conformity, or for any bankers or other persons with whom any moneys of or belonging to the company shall or may be lodged or deposited for safe custody, or for insufficiency or deficiency of any security upon which any moneys of or belonging to the company shall be placed out or invested, or for any other loss, misfortune or damage which may happen in the execution of their respective offices or trusts, or in relation thereto, unless the same shall happen by or through their own willful neglect or default respectively.”

In the UK, in the Greene Committee’s opinion such exemption provision of the articles provided the directors with unwarranted protection. The Committee stated:³

“To attempt by statute to define the duties of directors would be a hopeless task and the proper course in our view is to prohibit articles and contracts directed to relieving directors and other officers of a company from their liability under the general law for negligence and breach of duty or breach of trust.”

In India, a provision similar to Section 152 of the English Companies Act, 1929 was enacted in 1937 by the Amendment Act of 1936 by inserting in the Indian Companies Act, 1913 a new Section 86C by which the provisions in the articles of association or in agreements exempting directors, managers and auditors from liability for negligence, default or breach of duty were declared void.

This was perhaps prompted by the observations of Marten CJ in the case of *Govind Narayan Kakade v. Rangnath Gopal Rajopandhye*.⁴ In that case, a director of a bank was found liable for misfeasance or breach of trust for sum of Rs. 12,000 jointly with other directors of the bank. One of his defences was that the appellant not having been guilty of any wilful neglect or default is protected by the articles of association of the bank from this claim: or alternatively and that he had acted honestly and reasonably and ought fairly to be excused under Section 281 of the Indian Companies Act, 1913 (corresponding to Section 633 of the Companies Act, 1956 and Section 463 of the Companies Act, 2013). The company’s article 99 of the articles of association of the company granted wide indemnity to its directors against liability except as might be incurred or occasioned by a director’s own personal wilful act, neglect or default. It read as follows:

“Every person being or having been a director, agent or other officer of the company, his heirs, executors or administrators, shall at all times be indemnified and saved harmless, out of the funds of the company, from and against all costs, charges, losses, damages and expenses, whatsoever sustained or incurred in the proper execution of his respective powers, duties and office as well as from and against all claims, actions, suits and demands, whatsoever brought or made against him or them in respect of any engagement or liability of the company, save any such as may be incurred or occasioned by his own personal wilful act, neglect or default.”

While rejecting the indemnity claimed by the directors against liability in misfeasance proceedings, the learned Judge remarked:

“I would also like to add that in my opinion this appeal shews the desirability of some amendment of the Indian Companies

Act, 1913, so as to nullify... the wide indemnities given by such articles of association as articles 98 and 99 in the present case. In this connection I would draw attention to Section 152 of the new English Companies Act, 1929, which in effect makes articles of that nature void. That Act also makes other important amendments for the protection in England of the investing public. This, however, is a matter for the Indian Legislature to decide on here. Fools cannot wholly be protected from the wiles of company promoters, and agents, but the path of the latter may be made more difficult by the Legislature, and particularly so in a case like the present, where, thanks to the managing agents and the directors, the expressed objects of the company, viz., to ‘encourage the habit of saving money and to facilitate small but safe investments’, have been sadly falsified in actual practice..”

Prohibition under the Section

Section 201 was a declaratory as well as prohibitory Section and was mandatory in character; it not only declared but also prohibited doing something by a company. The Section applied to all companies.

What Section 201 rendered void was exemption from, or indemnity against, liability for negligence, default, misfeasance, breach of duty or breach of trust of which he might be guilty in relation to the company, on the part of a director, other officer or auditor of the company, except the indemnity in the situation permitted by the proviso (Regulation 99 in Table A in Schedule I to the Companies Act, 1956; corresponding to Regulation 91 in Table F in Schedule I to the Companies Act, 2013). Section 201, by its substantive provision of sub-section (1), which was very widely worded, avoided any exemption or indemnification against “any liability”, but such liability must be in respect of any negligence, default, misfeasance, breach of duty or breach of trust, in relation to the company. Moreover, such liability must attach to an officer “by virtue of any rule of law”.

The liability contemplated under Section 201 was a monetary liability which was incurred by an officer of the company in the form of fine, penalty, compounding fee or payment of compensation or damages (contractual or tortious or business liability, that is a liability for a breach of obligations or duties arising in the course of a business.) A liability which results in imprisonment without monetary liability (such as fine) is outside the scope of this Section (and, in any case, such a liability cannot be exempted from or indemnified against).

This Section applied to any provision contained in a company’s articles or in any contract or in any other document, and prohibits exempting any officer of the company (which includes director) or indemnifying him against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust of which he may be guilty in relation to the company. Any such provision was void. For instance, if a director was prosecuted, and convicted and fined for any contravention by the company of any provision of any law, the director could not be indemnified for the liability incurred by him, and could not, for instance, be reimbursed expenses incurred by him in respect of the proceedings including the amount of fine paid by him. This was the personal liability of the director concerned, and he could not claim it from the company.

Effect of the proviso

While the substantive provision in sub-section (1) declared that any provision for exempting any officer or an auditor from,

³ Cmnd 2657, 1925-6, paras 45 and 47.

⁴ (1930) ILR 54 Bom 226: 32 Bom LR 232: AIR 1930 Bom 572.

or indemnifying him against, any liability should be void; the words “Save as provided in this Section” sought to exempt the avoidance and it was set out in the proviso to sub-section (1), according to which a company may indemnify any such officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal, if a judgment has been given in his favour or in which he is acquitted or discharged or in connection with any application under Section 633 (corresponding to Section 463 of the Companies Act, 2013) in which relief is granted to him by the Court. But the rigour of this Section was mitigated and relaxed by the proviso which permitted indemnifying an officer for liability incurred by him in the event of a judgment having been given by a court in favour of the director or where he was acquitted or discharged by the court. Indemnity is also permissible where a director was granted relief under Section 633 of the 1956 Act. The proviso only allowed indemnification against any liability in defending any proceedings, civil or criminal, in which judgment was given in favour of the company’s officer or auditor or in which he had been acquitted or discharged or in connection with any application for relief under Section 633 if relief had been granted to him. Thus, the scope of the proviso is very limited.

Taking benefit of the saving clause contained in the proviso to Section 201, the articles of most companies included ‘Indemnity’ provision which resembled regulation 99 in Table A in Schedule I to the Act noted above. This regulation saved the directors against liability, and entitled them to be reimbursed the expenses in connection with any liability which attached them as directors in relation to the company.

As to the indemnification permitted by articles, etc. in pursuance of the proviso the MCA’s views in one of its circulars are set out below:

“Reimbursement of the expenses to the Managing Directors, etc. for defending criminal cases — Companies sometimes place funds at the disposal of their managerial personnel for defending themselves in criminal proceedings instituted against them. Section 201 specifically provides that any provision whether contained in the articles of a company or in an agreement with a company or in any other instrument, for exempting any officer of the company or any person employed by the company as auditor from, or indemnifying him against, any liability which, by virtue of any rule of law, would otherwise attach to him in respect of any negligence, default, misfeasance, breach of duty or breach of trust of which he may be guilty in relation to the company, shall be void. It has also been laid down in the proviso to sub-section (1) of the said Section that a company may in pursuance of any such provision, indemnify any such officer or auditor against any liabilities incurred by them in defending any proceeding whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or discharged or in connection with any application under Section 633 of the Act in which relief is granted to him by the court. Thus, it is not permitted to a company to make its funds available to the managing directors, etc. in connection with any civil or criminal case instituted against them unless they are found by a competent court to be innocent and the question of reimbursement will arise only after the termination of the proceeding in favour of the officers of the company concerned.”⁵

⁵ Circular No. 8/72(12)/42/71-CL-V, dated 8 May, 1972.

POSITION UNDER COMPANIES ACT, 2013

Section 201 of the Companies Act, 1956 has not been included in the Companies Act, 2013. However, strangely, Regulation 99 of Table A in Schedule I to the Companies Act, 1956 has been included as Regulation 91 of Table F, which is substantially identical to Regulation 99. It reads as follows:

Indemnity.

“91. Every officer of the company shall be indemnified out of the assets of the company against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or in which relief is granted to him by the court or the Tribunal.”

The fact of not re-enacting Section 201 implies that a provision for exempting or indemnifying directors against, any liability shall not be void and the proviso may be incorporated by a company in its articles of association to avail of the benefit of indemnity subject to the condition stipulated in the concluding part of the proviso. This is what precisely has been done by Regulation 91 of Table F.

While omitting Section 201 of the Companies Act, 1956, and, at the same time, retaining in Regulation 91 of Table F, a provision similar to Regulation 99 of Table A in Schedule I in the Companies Act, 1956, has to be presumed to be a deliberate act on the part of the Legislature. It should be noted that Regulation 99 of Table F is identical to the proviso to Section 201. This seems to be the reason why the Parliament while enacting Companies Act 2013, has omitted Section 201 but retained Regulation 91 (which was in fact the proviso in Section 201), thereby allowing companies to have included in their Articles of Association a provision similar to Regulation 91, so that the company can indemnify a director and other officer, for the fine or penalty and expenses incurred directly related to the proceedings in question, if such director or officer is acquitted, or in which relief is granted to him, by the court or the Tribunal (e.g. NCLT/NCLAT). Indemnity means protection or security against damage or loss or compensation for damage or loss sustained; and to indemnify means to compensate for damage or loss sustained, expense incurred, etc; to give (someone) money or another kind of payment for some damage, loss, or injury.

Thus, while the 2013 Act has done away with the provisions that Section 201 of the 1956 Act contained, it retained the provision in article 99 of Table A in Regulation 91 of Table F. Regulation 91 permits a company to indemnify an officer of the company out of the assets of the company (asset includes money) against any liability incurred by him in defending any proceedings, whether civil or criminal, in which -

- a judgment is given in his favour; or
- he is acquitted; or
- relief is granted to him by the court or the Tribunal.

This means that no indemnification would be permitted if an officer is held guilty and liable to pay fine or penalty levied by a court or tribunal.

Section 5(6) of the Act provides that the articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company. As per Section 5(7), a company may adopt all or any of the regulations contained in the model articles applicable to such company; and as per Section 5(8), in case of any company,

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which is registered after the commencement of this Act, insofar as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company. These provisions of Section 5 make it clear that in order to avail of the benefit of the indemnification contemplated by Regulation 91, a company must have in its Articles of Association an express provision similar to Regulation 91. In other words, in absence of an express provision in the articles, a company cannot indemnify the director or other officer if a judgment is given in his favour or in which he is acquitted or in which relief is granted to him by the court or the Tribunal. Needless to state, no indemnification would be permitted if a director or other officer is held guilty and liable to pay fine or penalty fee levied by a court or tribunal.

WHETHER OFFICERS OF A COMPANY CAN BE INDEMNIFIED AGAINST FINE, PENALTY, OR EXPENSES IF ARTICLES OF ASSOCIATION OF A COMPANY SO PROVIDE

Defaults, breaches, violations, failures, contraventions or non-compliances under the Companies Act are called 'offences' which give rise to a penal liability. In different penal provisions of the Companies Act different words are used, such as contravention, failure, default, refusal, non-compliance, negligence, etc. But the most frequently used word is 'default'. In the context of penal provisions under the Companies Act, default means failure to act; inaction or neglect; failure to perform an act or obligation legally required; failure to perform some legal requirement.

Almost every provision of the Companies Act (whether it is providing for punishment by way of fine by a court or by way of penalty by the National Company Law Tribunal), makes liable the company and every officer of the company who is in default (or in some cases the key managerial personnel). This liability arises by reason of the director or other officer of the company being made by law vicariously liable. There are, thus, three types of monetary penal liability of director/officers of a company arising out of default in complying with any provisions of the Act, namely -

- Fine imposed by a court law as a result of criminal trial of an offence in respect of those provisions which lay down that, in case of default, the company and every officer shall be 'punishable' with fine and/or imprisonment;
- An amount ordered to be paid by the NCLT or the Regional Director or any officer authorised by the Central Government, on compounding of an offence under Section 441 of the Act;
- An amount of penalty imposed by an Adjudicating Officer under Section 454 of the Act, in respect of those provisions which lay down that, in case of default, the company and every officer shall be liable to a penalty.

When a director or other officer of a company is penalized for a non-compliance by the company with any provision of the Companies Act, or for negligence, default, misfeasance, breach of duty or breach of trust, there are often instances of directors/officers are called upon to pay fine or penalty for the company's default in complying with the law as the company's agents being vicariously liable. Almost all penal provisions of

the Act make directors and officers of a company liable for punishment of fine or penalty or compounding fee. When a director or other officer of a company is punished by way of fine (by a court) or made liable to pay penalty or compounding fee (by an adjudicating officer), can the company indemnify or reimburse the money paid by the director/officer by way of fine or penalty or compounding fee and expenses incurred in defending the case?

WHETHER COMPOUNDING FEE LEVIED ON A DIRECTOR OR OTHER OFFICER CAN BE PAID BY THE COMPANY

It may also be noted that a compounding fee is imposed in pursuance of a voluntary act on the part of a director/officer of a company who on his own approaches the concerned authority (Regional Director/NCLT) for compounding an offence and agrees to pay the compounding fee. Therefore, in my opinion, a compounding fee cannot be brought within the ambit of article 91 of the Articles of Association of the Company.

Thus, so far as compounding fee levied by the regional Director or National Company Law Tribunal, in lieu of fine, when an offence which makes officers of a company liable to punishment by way of fine, it appears that, following the principle that a fine or penalty imposed on a director or officer is his personal obligation and not the company's, such fee cannot be paid by the company or indemnified/reimbursed by the company, since when an offence is compounded on an application of an officer of a company, he accepts the guilt of non-compliance or default and prays for exoneration from prosecution and excuse him for the default, the compounding fee is not of the same character as the fine which would otherwise have been payable and hence the case does not fall under any of the three circumstances specified in Regulation 91 of Table F, namely, a liability incurred by him in defending any proceedings, whether civil or criminal, in which a judgment is given in his favour; he is acquitted; or relief is granted to him by the court or the Tribunal.

In the interim order in *Prem Jain v. Union of India* (W.P. No. 30273 of 2024), it was submitted that payment of the compounding fee paid by any other person apart from the petitioner (director of a company) is contrary to Section 441(1) of the Act which clearly requires that the Regional Director or any officer authorized by the Central Government has to pay/credit to the Central Government such sum as the Tribunal or the Regional Director or any other officer authorized by the Central Government may specify. The compounding fee levied on a director was, however, paid by the company but shown in records as paid by the concerned director. The Telangana High Court has expressed a view that a compounding fee is a personal liability that cannot be reimbursed by the Company. If a company pays the fee, it effectively results in an unauthorized reimbursement, which violates the punitive intent of the statute. The Regional Director's order specifically mandated that fees be paid from the individual's "own sources". The Court noted that the company paying approximately Rs.30,000 on behalf of multiple directors was a factual error that required rectification to reflect that the Petitioner did not satisfy the requirement through that specific transaction. □

