CORPORATE CRIMINAL LIABILITY

By

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Introduction

"*Corporate bodies are more corrupt and profligate than individuals, because they have more power to do mischief, and are less amenable to disgrace or punishment. They neither feel shame, remorse, gratitude nor goodwill."*

Corporate criminal liability is never going to occupy a very large space in either Company Law or Criminal Law. But over the past ten years it has emerged from the cracks between those large unwieldy edifices to claim at least a small outbuilding of its own. Historically, Criminal Law has been founded upon the notion of individual responsibility. Criminal convictions were restricted to human beings, as only they could possess the mental and physical elements required of crimes. Since corporations are not living persons, the law has treated them differently to accommodate this shortcoming. It means, one manner by which corporations have been held responsible has been to consider them as collections of individuals rather than whole persons and make them vicariously liable for the actions of their employees. Although this allows corporations to be regarded as legal entities that can commit offence that are detrimental to society, the fact that they possess neither a body nor a mind prevents them from being moral entities with the capacity to form intent and be found liable for serious crimes. The criminal liability was traditionally determined by proving the *actus reus* or guilty act element of an offence through the establishment of absolute liability offences. These offences were based on policy oriented objectives, which sought to protect the interests of society for petty offences through regulatory mechanisms. It was felt that principle of absolute liability created such high standards that it would deter possible offenders. Since these crimes were not classified as *mens rea* offences, there was no need to prove a mental element. Therefore, these offences could be differentiated from true crimes as they did not demand the same legal protections that accompany *mens rea* offences. However as penalty and stigma for public welfare offences increased, there was a concern that classifying these offences as absolute liability in nature would violate principles of just punishment or retribution.

Originally, the prevalent view was that companies, which are separate legal entities, cannot be charged of offences because of procedural difficulties. The obvious reasons were that the party could not be personally present, no arrest or commitment was possible and no bodily punishment could be inflicted. 'A corporation is devoid not only of mind but also of body, and therefore incapable of the usual criminal punishments'. 'Can you hang its common seal?' asked an advocate in England during the rule of James II. It could however be fined and to this day imposing fine remains the only mode of punishment applicable to a company or body corporate. The evaluation of corporate responsibilities is a striking instance of judicial change in law. The non-liability of corporations soon gave way to the idea that they can be made liable for nonfeasance, *i.e.*, omission to act. If a statutory duty is cast upon a body incorporate, and not performed, the body incorporate can be convicted of the statutory offence. Over the decades, this principle has been well established.

Once the criminal liability of companies and incorporated bodies were legally recognised and firmly established, the next question which arose for consideration before the Courts was regarding the liability of persons like the directors and managers responsible for the management of the company or its day-to-day affairs for the offences committed by the company. The essential issue was over the nature of punishment that could be imposed on the individuals responsible for the company.

Concept of Corporate Governance

The concept of governance cannot be completed without acknowledging the contribution of the most celebrated scholar of ancient India, *Kautily*. One the world's most complete manuscript on the science of the governance was penned by *Kautily* in third century B.C. *Kautilya's* discussion on administration and management are striking modern and scientific covering almost all facets of governance. According to him, an ideal king is one for whom.

Praja sukhe, sukhamragyam,
Prajanan ca hite hitam,
Naatman priyam hitam ragyan,
Parajanan tu priyam hitam.

It means, in the happiness and well being of the subjects, lies the well being of the king, in the welfare of the subjects, is the welfare of the king, what is the desirable and beneficial to the subjects and not his personal desires and ambitions, is desirable and beneficial for the king. He further elaborates that a king has fourfold duties as *Raksha* or protection, *Vridhi* or enhancement, *Palana* or maintenance, *Yogakshema* or safeguard. It is duty of the king to protect the wealth of the State and its subjects, to enhance the wealth, to maintain it and safeguard it and the interest of the subjects. If we for a moment assume the today's business CEO or corporate board as king and subject as its shareholders, it brings out the quintessence of corporate governance as public good should be ahead of private good and company's resources should not be used for personal gains. The four duties of corporate parlance would imply protection of shareholder's wealth, enhancement of wealth by proper utilisation of assets, maintaining the wealth and safeguarding the interests of all stakeholders. *Chankya* endorsed this and said that "*Arthavaan sarva lokasya bahumatah*" wealth generating capacity earns all round reverence. *Kautilyas arthashastra* further says that "*Sukhasaya moolam dharma*" root of all happiness is doing right; "Dharmasuya moolam artha"- root of doing right is the root of wealth is enterprise. Therefore the ultimate end of earning all round reverence, from a corporate perspective, should be the improvement of stakeholder's value. Corporate governance is traditional defined as the system of laws, regulations, and practices, which will promote enterprise, accelerate performance and ensure accountability. It stimulates for effectiveness in the performance and operations of a corporate. The effectiveness, in today's parlance, means that business is run in a manner to enhance stakeholders value, skewing radically from established enhancement of shareholders value only and moving towards stakeholders value maximization.

Sir *Adrian Cadbury* has observed—

> "Corporate governance is concerned with holding the balance between economic and social goals and between individual and community goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interest of the individual, corporation and society."

Corporate Criminal Liability

When we refer to criminal liability, the contours of criminal liability may be considering under three headings:

(a) the range of offence,

(b) the scope of criminal liability,

(c) And the condition of criminal liability.

The process of globalisation and the growth of interdependence in economic, social and environment activities by corporate entities require greater international cooperation between countries. At the same time, the amount of economic and white collar crime has grown substantially. One of the most pressing global issues is the predominance of national and multinational corporations in economic transactions and their accountability. In this context, the development of corporate criminal liability has become a problem, which a growing number of prosecutors and Courts have to deal with nowadays.

In the modern day world, the impact of activities of corporations is tremendous on the society. In their day-to-day activities, not only do they affect the lives of people positively but also many a times in a disastrous manner which come in the category of crimes. For instance, the Uphar Cinema tragedy or thousands of scandals especially the white collar and organized crimes can come within the categories that require immediate concern. Despite so many disasters, the law was reluctant to impose criminal liability upon corporations for a long-time. This was for basically two reasons that are: That corporations cannot have the *mens rea* or the guilty mind to commit an offence; and those corporations cannot be imprisoned, the only other remedy being left is that of fine which merges criminal liability with that of a civil one. These two obstacles were in the late 20th century and very early 21st Century. The general belief in the early sixteenth and seventeenth centuries was that corporations could not be held criminally liable. In the early 1700s, corporate criminal liability faced at least four obstacles. The first obstacle was attributing acts to a juristic fiction, the corporation. Eighteenth-century Courts and legal thinkers approached corporate liability with an obsessive focus on theories of corporate personality; a more pragmatic approach was not developed until the twentieth century.

The second obstacle was that legal thinkers did not believe corporations could possess the moral blameworthiness necessary to commit crimes of intent. The third obstacle was the *ultra virus* doctrine, under which Courts would not hold corporations accountable for acts, such as crimes, that were not provided for in their charters. Finally, the fourth obstacle was Courts' literal understanding of criminal procedure; for example, Judges required the accused to be brought physically before the Court.

Although corporations are not natural persons, the acts and interests, rights and liabilities, attributed to them by law are those of a real or natural person. Otherwise, the purpose of the law of companies would be defeated. Criminal liability of corporations is necessary not only as means of obtaining justice but also a means of having deterrent value. By affixing criminal sanctions on corporations, there is a move to humanize them. This is true, especially in case of environmental offences where there is an attempt to increase sensitivity of corporations. The need to develop effective means of fixing liability on corporations has to be studied in light of the power wielded by corporations now. Multinational corporations are often in a position to dictate terms to developing countries. As a result, they escape liability for acts done in contravention of laws in such nations.

In India, the Criminal Law takes into account the fact that companies could commit crimes. Section 11 of the Indian Penal Code defines person as including any company or association or body of persons whether incorporated or not. But it is doubtful whether the code provides for fixing liability for serious crimes. How would the Courts resolve such a situation? One of the objectives

to fixing liability on corporations for crimes is that people commit crimes while corporations are incapable of doing the same. This does not take into account the fact that many of the crimes committed by corporations are such that it is difficult to pinpoint liability on an individual. Criminal Law is moulded according to acts committed by individuals. How should this be reconciled with criminal liability of corporations where individuals may or may not be involved?

Corporate crime is conduct of a corporation or of an employee on behalf of a corporation, which is proscribed and punishable by law. The conduct could be punishable by imprisonment, probation, fine, revocation of licence, community service order, internal discipline order or other penalties. It is type of white collar crime. Corporate crimes generally encompass three ideas,—

(1) Illegally by corporations and their agents differs from criminal behaviour of others. Corporate crimes are not only acts in violations of Criminal Law but are also civil and administrative violations.

(2) Both corporations and their representatives are recognised as illegal actors.

(3) The underlying motivation for corporate offending: illegally is not for individuals but is for organisational ends.

Corporate Criminal Liability in India

The Bhopal Principles address concerns about corporate accountability across a wide range of issues. We have chosen to call them the 'Bhopal' Principles because this disaster, more than any other, highlights the current failure of Governments to protect public welfare and the failure of corporations to observe basic standards *e.g.* the avoidance of liability by parent corporations, and the avoidance of responsibility for compensation and environmental cleanup. On 3 December, 1984, the world witnessed the worst chemical disaster ever when a gas leak in the Union Carbide Plant in Bhopal, India, killed at least 8,000 workers and residents in the first three days after the disaster and caused permanent and debilitating injuries to more than 1,50,000. The tragedy, caused by the leakage of a cocktail of methyl isocyanine and other lethal chemicals into the area surrounding the plant was caused mainly by insufficient safety systems and cost-cutting measures by Union Carbide. 24 years after this tragic disaster, the legacy of poisoning continues. Even today chronically ill survivors remain in desperate need of medical attention. Thousands of survivors and the children born since the disaster continue to suffer debilitating health problems. Many are unable to work.

The corporate criminal liability in India is based on the theory of *respondent superior* as well as the theory of sanctioning. Corporations are recognised as person under the Indian Penal Code. The Courts in India have also followed this reasoning and have introduced inability serve a mandatory sentence of imprisonment as an exception to the imposition of criminal liability on corporations. The law in India is, hence clear that since corporation cannot be imprisoned, it cannot be tried under such sections which stipulates an exclusive mandatory sentence.

The evolution of Corporate Governance in India can be traced back to 1998, when the Confederation of Indian Industry published India's first comprehensive code on Corporate Governance. In 1999 the Kumar Mangalam Birla Committee on Corporate Governance was set up by SEBI to promote and raise the standards of Corporate Governance. Subsequently, in 2002, the Naresh Chandra Committee was set up to examine various Corporate Governance issues. Many recommendations of the report were incorporated in the companies (Amendment) Bill, 2003. The key recommendations included the disclosure of

a company's contingent liabilities, CEO/CFO certification, the definition of an independent director, the independence of audit committee and independent director exemptions, that is, the explicit settings out of exemptions of non-executive and independent directors from criminal and civil liabilities under certain circumstances.

Corporate criminal liability has been an important issue on a legal agenda for a long-time. Corporations play a significant role not only in creating and managing business but also in common lives of most people. That is why most modern criminal law systems foresee the possibility to hold the corporation criminally liable for the perpetration of a criminal offence. The doctrine of corporate criminal liability turned from it's infancy to almost a prevailing rule. But, because a corporation is not a natural person and cannot be subject to one of the most important sentencing options, namely, imprisonment, it requires special consideration in an inquiry into sentencing law. Punishing a corporation undermines the theoretical foundations of criminal law, which presupposes that crimes involve an act and a culpable mental state. Corporate criminal liability or corporate crime is very difficult to define because this phrase in present day scenario covers wide range of offences. However for understanding purpose it can be defined as illegal act of omission or commission, punishable by criminal sanction committed by individual or group of individuals in course of their occupation. It can be even defined as socially injurious acts committed in course of occupations by peoples who are managing the affairs of the company to further its business interest. Corporate criminality also represents a kind of instrumentalities through which the trust of the people continues to be betrayed by persons in positions of responsibility, authority and power in the business sector. Corporate crime has been defined as "the conduct of a corporation or of employees acting on behalf of a corporation, which is proscribed and punishable by law". In this sense, "Corporate Criminal Liability" refers to the imposition of criminal liability on either the corporation or its employees and agents. The latter is also referred to as white-collar crime.

The development of the law relating to corporate criminal liability in India is not only similar to that in English Law, but also greatly influenced by the English Law. At one point of time, 'corporations' were viewed as a convenient shield to evade liability. However, under our present penal structure, for an offence by the corporation, both the corporation and its officer can be made liable. The law on corporate criminal liability is however, not confined to the general criminal law in the penal code but it is, in fact, scattered over a plethora of statutes with specific provisions for the same. The need for proper law relating to corporate criminal liability in a legal system, specially in the developing countries like India was observed by the Supreme Court in the following terms:

> "In India, the need for industrial development has led to the establishment of a number of plants and factories by the domestic companies and undertakings as well as by Transactional Corporations. Many of these industries are engaged in hazardous or inherently dangerous activities which pose potential threat to life, health and safety of persons working in the factory, or residing in the surrounding areas. Though working of such factories and plants is regulated by a 614 number of laws of our country, there is no special legislation providing for compensation and damages to outsiders who may suffer on account of any industrial accident". The major law relating to Corporations in India is codified in The Company Act, 1956 and the definition of "Corporation" as given in the Act under Section 2(7) includes a company. Hence under Indian Law the liability of the corporation is essentially liability of the company only. Further,

under Indian Law as well as under the English Law, a Company is a creation of the law. It is not a human being but is an artificial person. On incorporation, the company acquires a separate legal entity distinct from and independent of its members. When a company is incorporated, all dealings are with the company and all persons behind the company are disregarded, however important they may be. Thus, a veil is drawn between the company and its members. Normally, the principle of corporate personality of a company is respected in most of the cases. The separate personality of the company is, however, a statutory privilege; it must be used for legal and legitimate business purposes only. Where a fraudulent, dishonest or improper use is made of the legal entity, the concerned individual will not be allowed to take shelter behind the corporate personality. The Court will break through the corporate shell and apply the principle of "Lifting of the corporate veil". The Court will look behind the corporate entity and take action as though no entity separate from the members existed. In other words, the benefit of separate legal entity will not be available and the Court will presume the absence of such separate existence. The Companies Act, 1956 contains certain provisions, which empower the Courts to lift the veil to reach the persons who are in fact responsible for the culpable or wrongful act. The corporate veil can be lifted in the following cases:

(1) Where the doctrine conflicts with the public policy,

(2) Where corporate veil has been used for fraud or improper conduct,

(3) Where the corporate facade is only an agency instrumentality,

(4) For determining the real character of the company,

(5) Where the veil has been used for evasion of taxes,

(6) In quasi-criminal cases,

(7) For investigating the ownership of the company,

(8) For investigating the affairs of the company,

(9) Where the company is used as a medium to avoid various welfare and labour legislations,

(10) In case of economic offences,

(11) Where the company is used for some illegal and improper purpose, *etc.*

The following provisions of the Companies Act, 1956 provide that the Members or the Directors/ officer(s) of a company will be personally liable if:

(1) A company carries on business for more than six months after the number of its members has been reduced below seven in the case of a public company and two in the case of a private company. Every person who was a member of the company during the time when it carried on business after those six months and who was aware of this fact, shall be severally liable for all debts contracted after six months,

(2) The application money of those applicants to whom no shares has been allotted is not repaid within 130 days of the date of issue of the prospectus, then the Directors shall be jointly and severally liable to repay that money with the prescribed interest,

(3) An officer of the company or any other person acts on its behalf and enters into a contract or signs a negotiable instrument without fully writing the name of the company, then such officer or person shall be personally liable,

(4) The Court refuses to treat the subsidiary company as a separate entity and instead treat it as only a branch of the holding company,

(5) In the course of winding up of the company, it appears that the business of the company has been carried on with intent to defraud the creditors of the company or any other person or for any fraudulent purpose; all those who were aware of such fraud shall be personally liable without any limitation of liability.

Thus, the protection of separate legal entity cannot be claimed in these cases and the limited liability of the shareholder becomes unlimited if he is engaged in these activities. The concept of "limited liability" restricts the liability of a shareholder to the nominal value of the shares held by him. If he has paid the entire amount which is payable towards his shares, he cannot be held liable for the debts of the company, even if he holds almost the entire share capital of the company. This rule, however, does not apply if the Court lifts the corporate veil and finds the shareholder responsible for the wrongful act. Not less recently, in the landmark judgment of *Kapila Hingorani v. State of Bihar*, the Apex Court analysed the rights and liabilities of a company *vis-à-vis* the Fundamental Rights and Human Rights of the individuals. The Court observed:

> "A company incorporated under the Companies Act is a juristic person and has a distinct and separate entity *vis-à-vis* its shareholders. The corporate veil, however, can in certain situations be pierced or lifted. Whenever a corporate entity is abused for an unjust and inequitable purpose, the Court would not hesitate to lift the veil and look into the realities so as to identify the persons who are guilty and liable thereof. The veil can indisputably be lifted when the corporate personality is found to be opposed to justice, convenience and interest of the revenue or workman or against public interest". It has also been observed that a corporation deemed to be "State" within the meaning of Article 12 of the Constitution and acting as agency of the Government, would be subject to the same limitations in the field of Constitutional or Administrative Law as the Government itself, though in the eyes of law they would be distinct and independent legal entities.

Conclusion

While Corporate Governance is a necessary tool for managerial performance, it also leads to corporate growth and excellence. Corporate is a path on which a corporate can drive to reach the heights of excellence and from there, proceed for other milestones only through good corporate governance practices. It is an issue of mindset and attitude, something which cannot be legislated, nowhere in the world. In sum, good governance means, amongst others, transparency, fair dealings, proper disclosure of financial results, proper care of stakeholders, *etc.*, corporation governance is not merely to enact legislation. It is to establish a climate of trust and confidence. Ethical business, behaviour and fairness cannot be legislated. For strengthening Corporate Governance, Government and the private sector must encourage synergy of political, social and cultural processes. Corporate Governance extended beyond corporate laws. Their fundamental objective is not mere fulfilment of requirements of law ensuring commitment of the long term shareholder value. It is much more. It is a living concept. Now living shall never die.

With the evolution of various theories, the most vital issue with regard to corporate criminal liability settled *i.e.*, the issue of *mens rea*. Concept of vicarious and strict liability is an important aspect of corporate criminal liability.