

Directors' Criminal Exposure: Immediate Compliance and Defence Planning

Selective Internal Disclosure Under SEBI and Company Law: Directors' Responsibilities and Liabilities



Selective internal disclosure occurs when certain directors or officers within a company are provided with material information about potential regulatory violations, financial irregularities, or other significant corporate developments, while other board members, particularly independent directors are deliberately kept uninformed. This practice fundamentally undermines corporate



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governance principles and creates significant legal liabilities under both SEBI regulations and the Companies Act, 2013.

The practice has gained regulatory scrutiny following several high-profile cases where independent directors claimed ignorance of financial mismanagement while executive directors possessed complete knowledge of ongoing violations. This selective information sharing creates a dual-tier governance structure that contradicts the fundamental principles of board oversight and fiduciary responsibility.

Legal Framework Governing Disclosure Obligations

SEBI Regulatory Framework

Under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR), companies are required to ensure uniform and timely disclosure of material information to all stakeholders. Regulation 30 mandates comprehensive disclosure of material events, while Regulation 46 requires transparency in corporate governance practices.

The SEBI (Prohibition of Insider Trading) Regulations, 2015 establish strict controls over Unpublished Price Sensitive Information (UPSI), requiring companies to maintain structured digital databases.

Companies Act, 2013: Directors' Statutory Duties

Section 166: General Duties of Directors

Section 166 of the Companies Act, 2013 establishes comprehensive statutory duties for all directors:

Fiduciary Duty - Directors must act in good faith to promote the company's objectives for the benefit of members, employees, shareholders, community, and environment

Duty of Care and Diligence - Directors must exercise due and reasonable care, skill, and diligence with independent judgment

Conflict Avoidance - Directors must avoid situations involving direct or indirect conflicts of interest



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Prohibition of Undue Gain - Directors cannot achieve undue gains or advantages for themselves or associates.

Section 184: Disclosure of Interest

Section 184 requires directors to disclose their concern or interest in any contract, arrangement, or transaction involving the company. This provision ensures transparency and prevents conflicts of interest from remaining hidden.

Key disclosure requirements include:

Mandatory disclosure at first board meeting after becoming aware of interest

Annual disclosure at the first board meeting of each financial year

Comprehensive details about nature and extent of interest

Written disclosure to be recorded in board minutes

Independent Directors: Enhanced Liability Framework

Section 149(12): Limited Liability Protection

Section 149(12) provides that independent directors and non-executive directors (not being promoters or KMPs) shall be held liable only for acts of omission or commission that occurred:

With their knowledge (attributable through Board processes), and

With their consent or connivance, OR

Where they had not acted diligently

This provision creates two distinct liability tests connected by "or," meaning independent directors can be held liable under either the knowledge test or the diligence test.

Recent Case Law Analysis

Manpasand Beverages Limited (April 2024)



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Facts: SEBI found significant financial mismanagement including overstated sales, dubious transactions, and manipulated financial statements for FY 2018-19 and 2019-20.

Key Holdings:

Independent directors were held liable for failure to exercise due diligence despite claiming lack of access to documents

SEBI noted that independent directors failed to provide evidence of attempting to obtain necessary information

The diligence test was applied, emphasizing active oversight responsibilities

Penalties:

Former independent directors Milind Babar and Chirag Doshi: Rs. 2 lakhs each

Current independent directors Nishish Mobar and Bharti Naik: Rs. 1 lakh each

LEEL Electricals Limited (April 2024)

Facts: SEBI investigation revealed fund diversion including Rs. 40.53 crores GST input tax credit fraud and fictitious inventory recognition of Rs. 320.60 crores.

Key Holdings:

Independent directors penalized Rs. 10 lakhs each for failing to fulfill statutory duties as Audit Committee members

SEBI emphasized that lack of expertise does not excuse negligence in oversight responsibilities

Directors were held liable despite not being involved in day-to-day operations

Significance: This case demonstrates SEBI's stringent stance on independent directors' accountability, particularly for those serving on specialized committees.[25][2]



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Suseela Padmavathy Amma v. Bharti Airtel Limited (March 2024)

Supreme Court Holdings:

Mere directorship does not create automatic liability under Section 141 of Negotiable Instruments Act.

Person must be "in charge of and responsible for" company's business conduct at material time

No universal rule that directors are in charge of everyday affairs

Managing directors have different liability due to their operational involvement

Impact: This decision provides crucial protection for directors not involved in day-to-day operations while maintaining accountability for those with operational control.

Criminal Liability Framework

Section 447: Punishment for Fraud

Section 447 of the Companies Act, 2013 establishes severe penalties for fraud:

Punishment Structure:

Imprisonment: 6 months to 10 years (minimum 3 years for public interest cases)

Fine: Minimum equal to fraud amount, maximum three times the fraud amount

Fraud: Any act, omission, concealment, or abuse of position committed with intent to:

Deceive the company or stakeholders

Gain undue advantage from the company

Injure interests of company, shareholders, creditors, or others[31][33]



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Best Practices for Compliance

Information Governance Framework

Board-Level Controls:

Comprehensive information sharing protocols ensuring all directors receive material information simultaneously

Regular executive sessions for independent directors without management present

Direct access to external auditors and compliance officers

Documented escalation procedures for governance concerns

Director Training and Awareness

Mandatory Training Components:

Legal obligation awareness including fiduciary duties and disclosure requirements

Industry-specific regulatory training relevant to company operations

Financial literacy programs for audit committee members

Case study analysis of governance failures and regulatory enforcement

Technology and Documentation

Digital Infrastructure:

Secure board portals with comprehensive document access and audit trails

Automated compliance monitoring systems with real-time alerts

Structured databases for tracking UPSI sharing and board communications

Regular compliance dashboards showing regulatory adherence status

Conclusion



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Selective internal disclosure represents a fundamental breach of corporate governance that exposes directors to significant legal, regulatory, and reputational risks. Recent SEBI enforcement actions demonstrate an evolving regulatory approach that emphasizes substance over form in assessing directors' responsibilities.

Key takeaways for directors:

Independent directors cannot rely on ignorance as a defense against liability - they must exercise active diligence in seeking information necessary for informed decision-making

All directors have fiduciary obligations under Section 166 to act in good faith and exercise due care, regardless of their operational involvement

Disclosure obligations under Section 184 require transparency about conflicts of interest and must be strictly observed

Criminal liability under Section 447 can attach to directors who participate in or fail to prevent fraudulent activities

SEBI enforcement is increasingly focused on functional independence rather than mere formal compliance with independence criteria

Companies must establish robust governance frameworks that ensure equal access to information, comprehensive training programs, and clear accountability mechanisms to prevent selective disclosure practices and protect both the organisation and its directors from regulatory exposure.

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