

# Dispute Resolution Hotline

April 20, 2011

## CORPORATIONS NO LONGER IMMUNE FROM CRIMINAL PROSECUTION

### INTRODUCTION:

In the recent landmark case of *Iridium India Telecom Limited (“Appellant”) –Vs- Motorola Incorporated (“Respondent no.1”) & Others*<sup>1</sup>, the Supreme Court of India allowed criminal prosecution for cheating against corporation and held that corporations could no longer claim immunity from prosecution on the ground that they lacked *mens rea*.

### FACTS OF THE CASE:

The Respondent no.1, Iridium LLC and Iridium Inc. are part of one group of corporations created through mergers and takeovers. Respondent no.1 was the founder promoter of a corporation known as Iridium LLC incorporated in the State of Delaware, USA as a wholly owned subsidiary of Respondent no.1. Iridium LLC was the successor of another corporation known as Iridium Inc. which was also a wholly owned subsidiary of Respondent no.1. Later Iridium Inc. was merged into Iridium LLC.

Respondent no.1 was the primary contractor for *Iridium System/Project* which was Respondent no.1’s proprietary space-based satellite communication system. The entire *Iridium System/Project* comprised of five segments. These five segments were supplied, sold, maintained and operated through (i) the space system contract; (ii) the operation and maintenance contract and (iii) the terrestrial network development contract (“**Contracts**”). These Contracts were awarded by Iridium Inc. to Respondent no.1 and were allegedly so structured to ensure that although Iridium Inc. paid all development costs, Respondent no.1 would still own the most valuable assets of the *Iridium System/Project*. Incidentally, all the initial capital raised by Iridium Inc. was used to make payment to Respondent no.1.

It was alleged by the Appellant that Iridium Inc. was an instrumentality of Respondent no.1 and that Respondent no.1 conceived, orchestrated, directed and controlled Iridium Inc. and was at all material times Iridium’s dominant shareholder, supplier and financier. It was further stressed that Respondent no.1 exercised effective control over the Board of Iridium Inc. and was the developer of Iridium Inc.’s business model and creator of *Iridium System/Project*. The Respondent no.1 designed, developed, sold, maintained and operated the hardware and software of the *Iridium System/Project*.

In fact, it was alleged by the Appellant, that most of the persons on the Board of Iridium were either former or current employees of Respondent no.1.

It was alleged that representations were made by Respondent no.1 to individual institutions and entities handling public money to induce them to believe that Iridium Inc. was a company worth participating and investing in. The officers of Respondent no.1 impressed upon the prospective investors that *Iridium Project* was bound to succeed. Relying upon the said representations the Appellant, banks and financial institutions collectively invested a sum of USD 70 million for purchasing equity of Iridium Inc. as well as spent a sum of INR 150 crores in setting up a gateway in Pune.

However, the *Iridium System/ Project* was a complete failure – technically and commercially. It was therefore alleged that Respondent no.1 had full knowledge that the *Iridium System/ Project* was still born. Infact, it was alleged that earlier the Board of Directors of Respondent no.1 had rejected a proposal to fund billions of dollars needed to develop the *Iridium System/ Project* and therefore Respondent no.1 induced others to invest their money.

The Appellant had thus filed a criminal complaint *inter alia* against the Respondent no.1 alleging cheating under Section 420 of Indian Penal Code (“**IPC**”) read with Sec.120-B of IPC. The Bombay High Court quashed the criminal complaint and hence the present appeal by way of special leave was filed before the Supreme Court of India.

### ISSUES OF THE CASE:

*The moot issue with which he Hon’ble Supreme Court of India was confronted was whether a corporation was incapable of committing the offence of cheating which involves mens rea?*

### (A) APPELLANT’S ARGUMENTS: -

#### INTENTIONAL FAILURE TO MAKE TRUE AND FULL DISCLOSURE:

The High court according to the Appellant failed to appreciate that the Private Placement Memorandum (“**PPM**”) through which investment was sought for by Iridium Inc. was in the nature of a deemed prospectus. Therefore while issuing the aforesaid PPM, the Respondents were required to make a true and full disclosure of all the relevant facts as required under sections 3 and 64 of the Companies Act, 1956. The statements made in the PPM and the representations made to the high ranking officials of the prospective investors including the Appellant, have been proved to be incorrect and misleading and in support of such contention the Appellant relied upon *Central Railway Co. of Venezuela vs. Kisch*<sup>2</sup> and *New Brunswick and Canada Railway Co. vs. Muggeridge*.<sup>3</sup>

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#### DISHONEST INTENTION:

The Appellant also contended that the dishonest intention of the Respondent No.1 is evident from the fact that the proposal to invest in the *Iridium System* which was taken to the Board of Directors of the Respondent No. 1, was not accepted by them. They also had promised a global link from any place on earth. The falsity of such tall claims is evident from the fact that the phone would not operate under a tree or in a building and was proved to be utterly useless.

#### CORPORATION INCAPABLE OF COMMITTING OFFENCE OF CHEATING:

The Appellant further submitted that the High Court had committed a serious error of law in concluding that the Respondent No.1 being a corporation was incapable of committing the offence of cheating. They also contended that by now, it is settled in almost all jurisdictions of the world governed by the rule of law that companies can be prosecuted for certain criminal offences. It was further submitted that the Respondent No.1 cannot hide behind the defense that the Company is incapable of possessing the necessary mens rea for the commission of the offence of cheating and relied upon- *Standard Chartered Bank vs. Directorate of Enforcement*.<sup>4</sup>

#### (B) RESPONDENT'S ARGUMENTS: -

The Respondents contended that even the basic facts have not been placed before the court and that there were no representations made by the Respondents relating to the success of the *Iridium Project*. And also the representations were made for the future projections and not for the existing facts wherein every possible warning was given.

The Respondents also submitted that the Appellant company was not controlled by the Respondents but by the strategic investors.

The Respondents further presented the contention that the *Iridium Project* was and is a success as it is being used in global aerospace programmes and defense departments of different countries. Merely because the satellite mobile system could not be a commercial success does not establish that Respondent company had any dishonest intention.

The Respondent said that the representations were made to strategic investors. These were individuals, firms and entities, who were experts in their field. They had been duly forewarned of the risk factors. Therefore, the Respondents submitted that the High Court rightly held that even if the complaint is accepted in toto, would not disclose the necessary ingredients to establish criminal liability.

The Respondent also put further that the facts pleaded would disclose only the civil liability at the best and it was not necessary for the High Court to permit the matter to proceed any further.

Further it was submitted that the High Court on a correct interpretation concluded that this was a case of pure and simple civil liability and the High Court was within its jurisdiction to look at all the documents including the documents which were not on record.

#### JUDGMENT AND THE RATIONALE:

The Supreme Court held that the corporations can no longer claim immunity from criminal prosecution on the ground that they are incapable of possessing the necessary *mens rea* for the commission of criminal offences. The Supreme Court observed that the legal position in England and the United States has now crystallized to leave no manner of doubt that a corporation would be liable for crimes of intent. The notion that a corporation cannot be held liable for the commission of a crime had been rejected by adopting the doctrine of attribution and imputation. The criminal intent of the "alter ego" of the corporation i.e. the persons or the group of the persons that guide the business of the corporation, would be imputed to the corporation.

Further it was held that a corporation is virtually in the same position as any individual and may be convicted of common law as well as statutory offences including those requiring *mens rea*. The criminal liability of a corporation would arise when an offence is committed in relation to the business of the corporation by a person or body of persons in control of its affairs. In such case it would be ascertained that the degree and control of the person or body of persons is so intense that a corporation may be said to think and act through the person or the body of persons and quoted with approval the ratio in *Standard Chartered Bank vs. Directorate of Enforcement*, (Supra)

According to the Supreme Court a corporation cannot escape liability for a criminal offence merely because the punishment prescribed is that of imprisonment and fine and the conclusion reached by the High Court that the Respondent could not have the necessary *mens rea* was held to be clearly erroneous.

The Supreme Court referred to Section 415 of Indian Penal Code, 1100% ("IPC")<sup>5</sup> and held that deception is an essential ingredient for the commitment of cheating under both parts of Section 415 of IPC. Such deception must induce the person deceived to either (a) deliver property to any person or (b) consent that any person shall retain any property.

Accordingly, the Appellants were entitled to an opportunity to prove the averments made in the complaint. They were entitled to establish that they have been deliberately induced into making huge investments on the basis of representations made by Respondent I and its representatives, which representations subsequently turned out to be completely false and fraudulent.

The Hon'ble Supreme Court held that in their opinion, the High Court clearly exceeded its jurisdiction in quashing the criminal proceeding in the peculiar facts and circumstances of the case. It was observed by the Hon'ble Supreme Court in relation to exercising jurisdiction under Section 482 Cr. P. C. that "*the complaint in its entirety will have to be examined on the basis of the allegations made therein. But the High Court has no authority or jurisdiction to go into the matter or examine its correctness. The allegations in the complaint will have to be accepted on the face of it and the truth or falsity cannot be entered into by the Court at this stage*".

Therefore, the Hon'ble Supreme Court allowed the appeal and set aside the impugned judgment of the Bombay High Court and held that there should be no order as to costs.

#### ANALYSIS

The judgment delivered by the Supreme Court is a step in the right direction. It settles any doubts if existing in relation to corporate criminal liability and that the corporate are liable to be prosecuted for offences under IPC. The

judgment is an apt illustration of judicial activism.

The courts earlier had rescinded from imposing criminal liability on corporate, on grounds of inability of a corporate to possess *mens rea* and the impossibility of a corporate to be subject to mandatory imprisonment. It was observed that it was the legislature's duty to bring requisite amendments in the law to provide for criminal liability of a juristic person.

However relying on the *Standard Chartered Bank Case (Supra)*, the Supreme Court in the present matter settled the law. Equating the juristic person with a human being the Court made the corporate bodies amenable to criminal prosecution. It is now abundantly clear that a corporate which acts through its directors and managers could also possess the requisite *mens rea* to commit a crime. The brains of those who run the juristic entity is the brain of the entity itself and hence fully capable of possessing the guilty mind.

Thus the present case, brings the position of law in India in line with various jurisdictions over the entire globe such as the USA and UK. The judgment however eliminates the protection sought by the directors of the Companies from criminal liability under the facade of being a juristic person. It allows companies to be subject to offences such as cheating, embezzlement or misappropriation over and above the requirements imposed upon them under various other laws such as the Companies Act, thereby imposing greater accountability on the directors and managers of the companies for their actions.

**- Debargha Basu & Vyapak Desai**

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1 (2011) 1 SCC 74

2 1867 LR 2 HL 99

3 (1100%) 1 Dr & Sm 363 at pp. 381-82: 62 ER 418.

4 (2005) 4 SCC 530: 2005 SCC (Cri) 961.

5 Sec. 415 of Indian Penal Code, 1100% reads, "Whoever, by deceiving any person, fraudulently or dishonestly induces the person so deceived to deliver any property to any person, or to consent that any person shall retain any property, or intentionally induces the person so deceived to do or omit to do anything which he would not do or omit if he were not so deceived, and which act or omission causes or is likely to cause damage or harm to that person in body, mind, reputation or property, is said to "cheat".

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