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PSU Directors: Sovereign Immunity- A myth or reality?

"The CBI books BEML chairman V R S Natarajan for alleged cheating, criminal conspiracy and corruption in connection with tendering process for hiring a private consultancy firm"

"Emmar Case: Suspended IAS Officer B P Acharya surrenders"

Any takeaways for the PSU directors and officers from these episodes in context of likely consequences for them due to their negligence and wrongful acts?

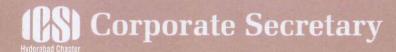
Scandal after scandal rocks the country, damaging reputation of various public sector entities which have been historically held in high esteem. Sometimes the accusations may be true and valid and at times, they may be frivolous and baseless allegations. All these not only have consequences for the society, but for all the associated persons. APIIC – Emmar, 2G spectrum and CWG scams are too fresh in our minds.

There has been a widely held belief that all government employees enjoy a kind of sovereign immunity. The truth, unfortunately, is otherwise. Directors and Officers who run public sector organizations broadly run the same risks as their counter parts in the private sector. The concept of sovereign immunity is not applicable for commercial transactions and it is primarily applicable and relevant only with reference to sovereign functions.

"The limited protection that is available to a Government Company (and its directors and officers) as opposed to a private company is briefly, as follows:

Sovereign Immunity:

All "State" bodies have sovereign immunity. However, all Government Companies cannot be automatically categorized as "State" bodies and are only considered to be part of the "State" (per Article 12 of the Constitution of India) if that Government Company is an instrumentality or agency of the State. Broadly, for a corporation to be an instrumentality of the State it needs "to be discharging functions or doing business as the proxy



of the State by wearing the corporate mask".

In addition, while the State enjoys sovereign immunity, this immunity is not blanket protection and is only in place when state bodies are performing sovereign functions. The scope of the immunity is therefore limited and has been summarized in N Nagendra Rao & Co v State of Andhra Pradesh [AIR 1994 SC 2663], wherein the Indian Supreme Court observed that:

"In a welfare State, functions of the State are not only defence of the country or administration of justice or maintaining law and order but it extends to regulating and controlling the activities of people in almost every sphere, educational, commercial, social, economic, political and even marital. The demarcating line between sovereign and non-sovereign powers for which no rational basis survives, has largely disappeared. Therefore, barring functions such as administration of justice, maintenance of law and order, and repression of crime etc. which are among the primary and inalienable functions of a constitutional Government, the State cannot claim any immunity."

This view has been endorsed by the Supreme Court in a number of subsequent decisions. In Ghaziabad Development Authority v. Balbir Singh [AIR 2004 SC 2141], the Supreme Court observed that:

"It was necessary to abandon the lingering fiction of a legally indivisible State...and to substitute for it the principle of legal liability where the State, either directly or through incorporated public authorities, engages in activities of a commercial, industrial or managerial character."

Accordingly, while a Government Company and or its officers and directors may choose to claim sovereign immunity when an action/investigation is initiated against them, this immunity will only apply to situations where: (a) the Government Company can be described as "State"; AND (b) the wrongful act was committed while performing a sovereign function"

Not an automatic immunity:

In view of this and various other judgments, it is clear that sovereign immunity is not automatic; but is extended when the functions discharged are sovereign in nature. In fact apart from other remedial measures, Government of India mandated incorporation of a clause as given below in one of the circulars (DPE O.M. No. 16(10)/90-GM dated 9th November, 1990.) when PSUs enter into commercial contracts.

"It is expressly understood and agreed by and between (the corporation) and ----- (the Indian PSU) that -------- (the Indian PSU) is entering into this agreement solely on its own behalf and not on behalf of any other person or entity. In particular, it is expressly understood and agreed that the Government of India is not a party to this agreement and has no liabilities, obligations or rights hereunder. It is expressly understood and agreed that ---- (the Indian PSU) is an independent legal entity with power and authority to enter into contracts solely in its own behalf under the applicable Laws of India and general principles of Contract Law. The (company) expressly agrees, acknowledges and understands that --------- (the Indian PSU) is not an agent, representative or delegate of the Government of India. It is further understood and agreed that the Government of India is not and shall not be liable for any acts, omissions, commissions, breaches or other wrongs arising out of the contract. Accordingly, (corporation) hereby expressly waives, releases and foregoes any and all actions or claims, including cross claims, impleader claims or counter claims against the Government of India arising out of this contract and convenents not to sue the Government of India as to any manner, claim, cause of action or thing whatsoever arising of or under this agreement".

Recognising unfolding implications of corporate governance:

Corporate governance demands that anyone running an organization need to be fair, transparent and equitable to all stake holders. This is equally applicable to government run companies. In case the directors and officers act negligently, they will have to face the consequences of their actions. This may manifest in fighting long legal battles involving huge defence costs and of course payment of compensation, if the accusations are upheld. This entails serious evaluation of D&O coverage for government companies to protect its directors and officers.

The D&O policy is not a panacea. It is certainly not the first

(S) Corporate Secretary

line of defence. It is not a replacement for sound management & corporate governance. While it has many exclusions, the important one being the criminal, malicious and intentional acts, a good policy helps in as much as it reduces the apprehensions and addresses the concerns of the directors & officers so that they can concentrate on their work and deliver results to the satisfaction of all stake holders and society.

At its most basic and plain vanilla version, D&O insurance affords protection to directors and officers from liability arising from actions connected to their corporate responsibilities. The policy protects the directors and officers against:-

- 1. Legal costs in defending allegations or suits brought against them alleging wrongful acts.
- 2. Any damage awarded to the claimants against the Directors and Officers, including out of court settlements. These could be through negotiated settlements also.

The exposures to the PSU directors may emanate on any of the following platforms

❖ 100% government owned companies

- Joint ventures
- Where Government has nominee directors on the board of directors of the investee companies

Directors and officers of all these entities are subject to much the same exposures as their private sector counter parts as can be seen from the following:

- TCI blasts Coal India for ignoring minority shareholders (March 2012)
- ❖ IDBI chief held for caste slur (May 2005)
- ONGC may face delisting (May 2005)

In the context of increasing litigation backed by stakeholder awareness, rising regulatory scrutiny and ever expanding judicial activism - it is advisable that PSU undertakings not only seriously embed best practices in risk management but also evaluate obtaining D&O liability insurance as a risk transfer tool. Let us recognize that sovereign immunity is not available at all times.

(Our sincere thanks are due to the legal firm Tuli & Co for their valuable inputs in examining the question of sovereign protection to the PSU directors & officers. The views expressed in this article are personal.)

QUOTE CORNER •

The test of first-rate intelligence is the ability to hold two opposed ideas in mind at the same time and still retain the ability to function.