INDIAN JOURNAL OF LEGAL REVIEW

VOLUME 6 AND ISSUE 6 OF 2026

INSTITUTE OF LEGAL EDUCATION

INDIAN JOURNAL OF LEGAL REVIEW

APIS – 3920 – 0001 | ISSN - 2583-2344

(Open Access Journal)

Journal's Home Page – https://ijlr.iledu.in/

Journal's Editorial Page - https://ijlr.iledu.in/editorial-board/

Volume 6 and Issue 6 of 2026 (Access Full Issue on - https://ijlr.iledu.in/volume-6-and-issue-6-of-2026/)

Publisher

Prasanna S,

Chairman of Institute of Legal Education

No. 08, Arul Nagar, Seera Thoppu,

Maudhanda Kurichi, Srirangam,

Tiruchirappalli – 620102

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INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 6 AND ISSUE 6 OF 2026

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

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DIRECTOR LIABILITY FOR FRAUDULENT TRADING: A CRITICAL EXAMINATION OF SECTION 339 OF THE COMPANIES ACT, 2013

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BEST CITATION – BHAVYA TRIPATHI & DR. MONIKA KOTHIYAL, DIRECTOR LIABILITY FOR FRAUDULENT TRADING: A CRITICAL EXAMINATION OF SECTION 339 OF THE COMPANIES ACT, 2013, *INDIAN JOURNAL OF LEGAL REVIEW (IJLR),* 6 (6) OF 2026, PG. 15-26, APIS – 3920 – 0001 & ISSN - 2583-2344.

ABSTRACT

The concept of limited liability stands for what makes modern enterprise acceptable. It helps the public put their assets in one place and take business risks. But this principle includes a standard flaw: people in charge of running a company can use it to defraud the people who do their job with it in good faith. Section 339 of the Companies Act, 2013 is India's primary legislative response, empowering the National Company Law Tribunal, during winding-up proceedings, to hold those knowingly party to fraudulent trading personally liable for all company debts without limit. This paper undertakes a critical examination of that provision. Drawing on doctrinal analysis of the statutory text, a detailed study of Indian and English case law, and a comparative assessment of the wrongful trading framework under the United Kingdom's Insolvency Act, 1986, the paper identifies three principal structural weaknesses: the winding-up trigger that delays intervention until recovery is most difficult; the inadequate criminal penalties under Section 339(2) that compare unfavourably with the general fraud offence under Section 447; and the fragmented enforcement architecture that impedes effective prosecution. The paper further identifies a significant gap in Indian law, namely the complete absence of wrongful trading liability, which leaves reckless but non-fraudulent mismanagement outside the reach of director accountability. A coherent set of reform proposals is advanced, including a standalone continuous fraudulent trading offence, rationalised penalties, a wrongful trading standard modelled on the English framework, a statutory deferred prosecution agreement mechanism, and stronger institutional coordination between the SFIO, the NCLT, and the Enforcement Directorate.

KEYWORDS: Fraudulent trading; Section 339; Companies Act, 2013; director liability; corporate veil; NCLT; wrongful trading; insolvency; corporate governance; mens rea.

INTRODUCTION

Every company registered under statute enjoys a legal personality wholly distinct from the individuals who compose it. That principle was settled by the House of Lords in Salomon v Salomon & Co Ltd,[27] and it has since shaped corporate law across every common law jurisdiction. Its practical consequence is limited liability: shareholders risk only the capital they have contributed, and the company alone answers for its debts. Without this assurance, the concentration of investment required for large-scale commerce would be considerably harder to achieve. As Dignam and Lowry have observed, the twin doctrines of separate personality and limited liability represent a

[27] *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL).

INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]
VOLUME 6 AND ISSUE 6 OF 2026
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bargain struck between the state and the commercial community incorporation confers significant privileges, but those privileges carry with them an implicit assumption of honest dealing.[28] Kraakman and his collaborators have similarly noted that limited liability is not merely a technical rule of company law but a foundational institutional choice that enables the mobilisation of capital at scales that individual proprietorship could never sustain.[29]

Yet the same doctrine that enables honest enterprise can be turned to dishonest ends. When those who control a company use the corporate form not for genuine commercial activity but as a device for defrauding those who deal with it in good faith, the justification for extending them the protection of limited liability falls away. The law has always understood this tension. As Sealy and Worthington have noted, the very attributes that make the corporate form commercially attractive its capacity to ring-fence assets and insulate members from personal claims are precisely what make it an effective vehicle for concealment when deployed without honest purpose.[30]The history of corporate enterprise is, in part, a history of efforts by legal systems to draw the line between legitimate risk-taking and deliberate abuse. Coffee has argued that this tension is structural rather than incidental: limited liability creates an asymmetry between the upside benefits that accrue to shareholders and the downside costs that fall on creditors, an asymmetry that rational actors have consistent incentives to exploit.[31] The question in every jurisdiction is how to craft rules that withdraw the corporate veil in cases of genuine fraud without making directors so fearful of personal liability that they are unable to take the commercial risks that drive economic growth.[32]

Section 339 of the Companies Act, 2013[33] represents India's principal answer to that question. Where a company is wound up and it appears that any part of its business was carried on with intent to defraud creditors or for any fraudulent purpose, the National Company Law Tribunal may declare that those who were knowingly party to such conduct are personally responsible, without limitation, for all or any of the company's debts. The provision thus performs a targeted piercing of the corporate veil, removing limited liability when the corporate form has been deliberately weaponised against the very people the law sought to protect. The legislative ancestry of Section 339 is traceable to Section 542 of the Companies Act, 1956,[34] which was itself modelled on the equivalent provision introduced into English company law by the Companies Act, 1929 a statute enacted expressly to address the practice of trading through insolvent companies at the expense of creditors.[35] Goode has observed that the fraudulent trading provision, in its English form, was designed to supplement general principles of creditor protection by creating a personal remedy against those whose dishonesty caused the harm, rather than leaving creditors to share rateably in whatever assets the company happened to retain.[36] The Indian provision reflects the same remedial purpose: it is not a punitive mechanism, but an accountability one.

Despite its structural importance, Section 339 has received considerably less sustained academic attention than its significance demands. Most Indian corporate law scholarship gravitates toward the general fraud

[28] A Dignam and J Lowry, *Company Law* (10th edn, Oxford University Press 2020) 11.
[29] R Kraakman and others, *The Anatomy of Corporate Law* (3rd edn, Oxford University Press 2017)
2–7.
[30] L Sealy and S Worthington, *Cases and Materials in Company Law* (10th edn, Oxford University
Press 2013) 51
[31] JC Coffee Jr, *Gatekeepers: The Professions and Corporate Governance* (Oxford University Press
2006) 3–5
[32] Celia Wells, *Corporations and Criminal Responsibility* (2nd edn, Oxford University Press 2001)
89.
[33] Companies Act, 2013 (Act 18 of 2013), s 339.
[34] Companies Act, 1956 (Act 1 of 1956), s 542.
[35] V Finch and D Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, Cambridge University Press 2017) 529–531.
[36] Roy Goode, *Principles of Corporate Insolvency Law* (5th edn, Sweet & Maxwell 2018) 642.

offence under Section 447 or toward the insolvency resolution framework of the Insolvency and Bankruptcy Code, 2016. Scholars such as Kumar have noted that Section 447's expanded definition of fraud and its severe mandatory penalties have tended to draw prosecutorial and academic focus away from the more specific fraudulent trading provision, leaving Section 339 in a state of relative doctrinal neglect.[37]

OBJECTIVE OF THE STUDY

This paper pursues five closely connected objectives, each aimed at developing a comprehensive understanding of Section 339 and its role within the broader framework of corporate fraud regulation. The first objective is to present a clear and structured account of the statutory requirements of Section 339, examining the meaning of each of its elements, the way in which these elements interact, and the extent to which the provision can be effectively applied through judicial interpretation.[38]

The second objective is to analyse how Indian courts have interpreted these elements in practice, with particular emphasis on the treatment of the "knowing party" requirement, the use of circumstantial evidence to establish fraudulent intent, and the challenges associated with attributing such intent within complex corporate structures.[39]

The third objective is to identify the structural and institutional limitations that affect the practical operation of the provision. These include the dependence on winding-up proceedings as a trigger for liability, the relatively weak criminal penalties prescribed under Section 339(2) when compared to the more stringent framework under Section 447, and the fragmented nature of enforcement across multiple regulatory and adjudicatory bodies.[40]

The fourth objective is to undertake a comparative analysis of the English legal framework, which recognises both fraudulent trading and the broader doctrine of wrongful trading, and to evaluate the extent to which this distinction can inform meaningful reform within the Indian context.[41]

Finally, the fifth and most forward-looking objective is to propose targeted legislative and institutional reforms that would enhance the effectiveness of Section 339. The aim is to transform it from a provision with primarily theoretical significance into one that operates as a credible mechanism for deterrence and accountability. Collectively, these objectives seek to produce a study that is not only doctrinally rigorous but also practically relevant for students of corporate law, legal practitioners, and policymakers concerned with the governance and integrity of India's corporate sector.[42]

RESEARCH METHODOLOGY

This paper adopts a doctrinal methodology supplemented by comparative legal analysis. Doctrinal research is the appropriate primary method because the central questions of the study concern the meaning, scope, and adequacy of a specific statutory provision. These are fundamentally questions about legal rules and their operation, not questions that call for empirical investigation of social behaviour.

The primary sources are: the Companies Act, 2013, with particular focus on Sections 339, 447, and 211; the Companies Act, 1956, Section 542, as the immediate predecessor provision; the Insolvency and Bankruptcy Code, 2016, Sections 66 and 69; and relevant provisions of the Indian Penal Code, 1860, the Prevention of Money Laundering Act, 2002, and the Code of Criminal

[37] R Kumar, "Fraudulent Trading Under the Companies Act 2013: A Critical Appraisal" 10(2) *Indian Journal of Corporate Law* 211, 214 (2016).
[38] Avtar Singh, *Company Law* 542–545 (Eastern Book Company, 17th ed., 2021).
[39] Andrew Keay, "Fraudulent Trading and the Concept of Dishonesty" (2016) 37 *Company Lawyer* 102.
[40] Umakanth Varottil, "Corporate Governance and Enforcement in India" (2018) 13 *Indian Journal of Corporate Law* 60.
[41] Vanessa Finch & David Milman, *Corporate Insolvency Law: Perspectives and Principles* 405–410 (3rd ed., Cambridge University Press, 2017).
[42] Roy Goode, *Principles of Corporate Insolvency Law* 670–675 (5th ed., Sweet & Maxwell, 2020).

Procedure, 1973. For the comparative dimension, the primary sources are Section 993 of the United Kingdom Companies Act, 2006, Sections 213 and 214 of the United Kingdom Insolvency Act, 1986, and Schedule 17 of the Crime and Courts Act, 2013. The case law analysis draws on decisions of the Supreme Court of India, the High Courts, the National Company Law Tribunal, and the National Company Law Appellate Tribunal, as well as English decisions applied or cited in Indian proceedings.

Secondary sources include leading academic treatises on Indian and English corporate and insolvency law, peer-reviewed articles published in Indian and international legal journals, reports of the Law Commission of India, the Companies Law Committee, and the Ministry of Corporate Affairs. Where data on prosecution rates or institutional capacity is relevant, it is drawn from official annual reports of the Serious Fraud Investigation Office and the Insolvency and Bankruptcy Board of India.

The interpretive method applied to statutory provisions is purposive: text is read in the light of the mischief the provision was designed to address and the legislative objectives it was intended to serve. Where ambiguity exists, the legislative history of the provision, including the Companies Law Committee's reports and parliamentary debates surrounding the 2013 Act, is used to illuminate intended meaning. The comparative analysis is functional rather than formalistic. The aim is not to transplant English doctrine wholesale into the Indian context, but to identify the purposes served by comparable mechanisms in other systems and assess whether the current Indian provisions serve those purposes equally well.

CONCEPTUAL FOUNDATIONS OF FRAUDULENT TRADING

A. Meaning and Jurisprudential Basis

Fraudulent trading is the carrying on of a company's business with the deliberate intent to deceive creditors or for some other dishonest purpose. The concept is grounded in the broader common law principle that fraud vitiates all transactions, and that no person should be permitted to use the mechanisms of the law to commit an injustice against those who deal with them honestly. As Dignam and Lowry observe, the doctrines of separate legal personality and limited liability rest on an implicit bargain: the state confers significant commercial privileges through incorporation, but those privileges assume honest dealing.[43] Where directors consciously breach that assumption, the law's appropriate response is to withdraw the protection.

Wells, writing from a comparative perspective, describes fraudulent trading provisions as among the clearest expressions of the tension between enabling commerce and ensuring accountability.[44] The law cannot penalise directors every time a company fails, for that would stifle the risk-taking that commerce requires. But it cannot allow the corporate form to serve as a vehicle for systematic deception. Section 339 navigates this tension by reserving personal liability for cases of proved dishonest intent, leaving commercial failure, however costly, outside the scope of individual accountability.

B. The Critical Distinction: Fraud Versus Commercial Failure

The distinction between fraudulent trading and ordinary business failure is central to the operation of Section 339 and carries significant practical implications. A company that fails due to poor judgment, adverse market conditions, or unforeseen circumstances does not automatically expose its directors to personal liability. Liability arises only where the business has been conducted with deliberate intent to deceive, and where directors knowingly engage in conduct that results in loss to creditors.[45]

[43] A Dignam and J Lowry, *Company Law* (10th edn, Oxford University Press 2020) 11.

[44] Celia Wells, *Corporations and Criminal Responsibility* (2nd edn, Oxford University Press 2001) 3

[45] Andrew Keay, "Fraudulent Trading" (2015) 36 *Company Lawyer* 67.

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Under the Companies Act, 2013, directors are entrusted with the governance and management of the company's affairs, but this responsibility does not render them guarantors of commercial success.[46] The law therefore draws a crucial line between mismanagement and misconduct, and between honest failure and intentional wrongdoing. This distinction forms the conceptual foundation of Section 339 and ensures that liability is imposed only in cases of genuine abuse of the corporate form.

THE STATUTORY FRAMEWORK OF SECTION 339

A. Legislative History

The fraudulent trading provision has a long ancestry in Indian corporate legislation. Section 542 of the Companies Act, 1956[47] drew directly on the English Companies Act, 1929, which had itself emerged from the recognition that the corporate veil must not shelter deliberate wrongdoing. Section 542 combined a civil remedy, a court declaration of unlimited personal liability, with a parallel criminal sanction. That dual-track architecture was preserved in Section 339 of the Companies Act, 2013. The 2013 Act did not fundamentally alter the structure of the fraudulent trading provision, but it significantly changed the surrounding legislative landscape. Section 447[48] introduced a comprehensive general fraud offence with penalties far more severe than those available under Section 339(2). The Insolvency and Bankruptcy Code, 2016, added Section 66,[49] which applies parallel civil remedies in the insolvency resolution context. Section 339 thus operates within a multi-layered framework, retaining a distinctive role as the provision most directly concerned with the fraudulent conduct of the company's business viewed as a course of conduct.

B. The Operative Provisions and Their Elements

Section 339(1) provides that, during the course of winding up, if it appears that the company's business has been carried on with intent to defraud creditors or for any fraudulent purpose, the Tribunal may declare that individuals who were knowingly parties to such conduct shall be personally liable, without limitation, for the company's debts. Section 339(2) establishes a corresponding criminal offence punishable by imprisonment or fine, or both.[50]

Three key elements must be satisfied before liability can be imposed.

The first is that the company must be in the course of winding up. This requirement serves both as a procedural gateway and as a limitation, as it restricts the application of the provision to post-failure scenarios, regardless of how evident fraudulent conduct may be during the company's operational phase.[51]

The second element is that the business must have been carried on with intent to defraud or for a fraudulent purpose. The use of the word "any" before "business" and "fraudulent purpose" is significant, as it indicates that it is not necessary for the entire business to be fraudulent; even a segment conducted with dishonest intent is sufficient.[52] Goode emphasises that the credibility of this requirement is essential to maintaining the provision's deterrent value.[53] Kumar further notes that the phrase "for any fraudulent purpose" extends the scope beyond creditor fraud to include other forms of dishonest conduct connected with the business.[54]

The third and most contested element is that the individual must have been a "knowing party" to the fraudulent conduct. This extends liability beyond the principal architects of the fraud to include those who participate in the business with actual awareness of its dishonest nature.[55]

[46] Companies Act, 2013, s 2(34).
[47] Companies Act, 1956 (Act 1 of 1956), s 542.
[48] Companies Act, 2013, s 447.
[49] Insolvency and Bankruptcy Code, 2016 (Act 31 of 2016), s 66.
[50] Companies Act, 2013, s 339.
[51] Vanessa Finch & David Milman, *Corporate Insolvency Law* (3rd ed., CUP, 2017) 410.
[52] Re Patrick and Lyon Ltd [1933] Ch 786.
[53] Roy Goode, *Principles of Corporate Insolvency Law* (5th ed., 2020) 678.
[54] S. Kumar, "Fraudulent Trading in India" (2019) 11 *NUJS Law Review* 89.
[55] Re Gerald Cooper Chemicals Ltd [1978] Ch 262.

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C. The Discretionary Civil Remedy

Even where these elements are established, the Tribunal retains discretion in determining whether to impose liability and the extent of such liability. The phrase "may, if it thinks it proper so to do" reflects the flexible nature of the remedy, allowing the Tribunal to tailor its response based on the seriousness of the conduct and the degree of involvement of each party.[56] The imposition of unlimited personal liability represents a significant departure from the principle of limited liability, justified only in cases where that principle has been abused.

JUDICIAL INTERPRETATION AND ATTRIBUTION OF LIABILITY

A. The Requirement of Genuine Dishonesty

Indian courts have consistently held that fraudulent trading must involve real dishonesty and cannot be established merely from the fact of insolvency or financial failure. The Supreme Court in Standard Chartered Bank v Directorate of Enforcement[57] affirmed that corporate fraud liability requires proof of actual deceit rather than inference from the bare fact that creditors have been left unpaid. In Sunil Bharti Mittal v Central Bureau of Investigation,[58] the Court added that personal liability of a director must rest on specific findings of actual involvement and knowledge, not simply on the holding of a corporate office. The English courts expressed the same standard in Re Patrick and Lyon Ltd,[59] where Maugham J described the required dishonesty as involving "real moral blame according to current notions of fair trading among commercial men." This formulation has been received with approval in subsequent Indian jurisprudence, ensuring that Section 339 is reserved for genuine wrongdoing rather than functioning as a mechanism for penalising commercial misfortune.

B. The "Knowing Party" Requirement

The "knowingly a party" element has generated the most contested litigation under the fraudulent trading provision. In the English context, Re Gerald Cooper Chemicals Ltd[60] established that the requirement is satisfied not only by those who designed the fraud but by anyone who participated in the company's business with actual awareness of its fraudulent character. Indian courts have drawn an important further distinction between actual knowledge and wilful blindness: where a director deliberately avoids acquiring information that would have revealed the dishonest character of the business, that deliberate ignorance is treated as equivalent to actual knowledge.[61] This prevents senior executives from insulating themselves through the careful management of information flows. The Supreme Court confirmed in CBI v Blue Sky Tie-up Pvt Ltd[62] that knowledge may be inferred from circumstances where a defendant had every reason to investigate and consciously chose not to do so.

C. Attribution of Liability Within a Corporate Structure

The identification doctrine, which treats the acts and mental states of the directing mind of the company as the acts and mental states of the company itself, has been the principal attribution mechanism in Indian corporate fraud cases.[63] Lord Hoffmann proposed a more flexible purposive approach in Meridian Global Funds Management Asia Ltd v Securities Commission,[64] suggesting the attribution question should be resolved by reference to the purposes of the particular rule being applied. Denning LJ's earlier analogy in HL Bolton (Engineering) Co Ltd v TJ Graham & Sons Ltd[65] compared the company's senior management

[56] Andrew Keay, *Company Directors' Responsibilities to Creditors* (2019) 215.

[57] *Standard Chartered Bank v Directorate of Enforcement* (2005) 4 SCC 405 (SC India).

[58] *Sunil Bharti Mittal v Central Bureau of Investigation* (2015) 4 SCC 609 (SC India).

[59] *Re Patrick and Lyon Ltd* [1933] Ch 786 (Ch D).

[60] *Re Gerald Cooper Chemicals Ltd* [1978] Ch 262 (Ch D).

[61] Andrew Keay, "Knowing Participation" (2016) 37 *Company Lawyer* 102.

[62] *CBI v Blue Sky Tie-up Pvt Ltd* (2011) 11 SCC 498 (SC India).

[63] *Tesco Supermarkets Ltd v Nattrass* [1972] AC 153 (HL).

[64] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500 (PC).

[65] *HL Bolton (Engineering) Co Ltd v TJ Graham & Sons Ltd* [1957] 1 QB 159 (CA).

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to the brain directing the corporate body, providing an intuitive but imprecise framework. Goswami has observed that Indian courts have not applied the identification doctrine consistently, producing uncertainty for both applicants and respondents in Section 339 proceedings.[66]

D. Burden of Proof

Proceedings under Section 339 are civil and the standard of proof is the balance of probabilities. However, because fraud is a serious allegation with significant personal consequences, courts require clear and cogent evidence rather than a bare preponderance. This approach mirrors the principle in Derry v Peek[67] that fraud must be established with particularity. Since direct evidence of dishonest intent is rarely available, courts regularly draw inferences from circumstantial evidence: patterns of debt incurred without prospect of repayment, falsification of financial records, diversion of funds through related parties, and preferential treatment of insiders while external creditors went unpaid. The Supreme Court in Arun Kumar Jagatramka v Jindal Steel and Power Ltd[68] endorsed a purposive approach to creditor protection provisions, supporting robust inferential methodology. In Sahara India Real Estate Corporation Ltd v SEBI,[69] the Court affirmed that substance must prevail over form: legal structures serving no purpose other than to conceal wrongdoing will not be permitted to shield those responsible from accountability.

CHALLENGES IN ENFORCEMENT

A. The Winding-Up Trigger

The most fundamental structural limitation of Section 339 is its restriction to the winding-up context. The provision is simply unavailable while the company remains a going concern, no matter how obvious the fraud may be. By the time winding-up proceedings are initiated, the company's assets are typically depleted, the proceeds of the fraud may have been moved beyond reach, and the directors responsible may have distanced themselves from the corporate entity. The unlimited personal liability that Section 339 theoretically imposes becomes a hollow remedy when the respondents have nothing recoverable.

The contrast with English law is instructive. Section 993 of the Companies Act 2006[70] creates a criminal offence of fraudulent trading that operates throughout the company's life, regardless of its financial condition. The corresponding civil remedy under Section 213 of the Insolvency Act 1986[71] is confined to the insolvency context, but the parallel criminal offence gives enforcement agencies a tool for intervention at any stage of the company's existence. Finch and Milman have observed that this temporal separation allows English enforcement agencies to treat fraudulent trading as the ongoing commercial wrong it is, rather than waiting for the company's collapse before acting.[72]

B. Inadequacy of Criminal Penalties

The criminal penalties prescribed under Section 339(2) are manifestly inadequate when viewed against the scale and impact of modern corporate fraud. The provision prescribes a maximum punishment of two years' imprisonment and a fine of up to three lakh rupees, which is disproportionate to the financial harm typically caused in such cases.[73] This inadequacy becomes more apparent when compared to Section 447 of the Companies Act, 2013, which provides for imprisonment ranging from six months to ten years along with fines proportionate to the amount involved in the fraud.[74]

[66] P Goswami, "Corporate Criminal Liability in India: The Road Ahead" 30 *National Law School of India Review* 55, 62 (2018).

[67] *Derry v Peek* (1889) 14 App Cas 337 (HL).

[68] *Arun Kumar Jagatramka v Jindal Steel and Power Ltd* (2021) 7 SCC 474 (SC India).

[69] *Sahara India Real Estate Corporation Ltd v SEBI* (2013) 1 SCC 1 (SC India).

[70] Companies Act 2006 (UK), s 993.

[71] Insolvency Act 1986 (UK), s 213.

[72] V Finch and D Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, Cambridge University Press 2017) 531.

[73] Companies Act, 2013, s 339(2)

[74] Companies Act, 2013, s 447.

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APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

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The disparity between these provisions lacks any clear legislative justification and creates an internal inconsistency within the statutory framework. In practice, this has led enforcement agencies to rely primarily on Section 447 in serious cases, thereby marginalising the specific fraudulent trading provision. As a result, Section 339(2) risks becoming largely redundant, despite its conceptual importance within the overall scheme of corporate liability.[75]

C. Enforcement Fragmentation

A single significant corporate fraud in India typically generates proceedings across multiple forums simultaneously: before the NCLT under Section 339; before the criminal courts under the Indian Penal Code or Section 447; before the Debt Recovery Tribunal in respect of banking debts; before SEBI for securities law violations; and before the Enforcement Directorate under the Prevention of Money Laundering Act, 2002.[76] Each forum operates under its own procedural rules, its own standards of proof, and its own appellate structure, with no statutory framework for coordination between them.

The Serious Fraud Investigation Office, established under Section 211 of the Companies Act, 2013,[77] has built genuine investigative expertise and its reports carry evidential weight before the NCLT. But its resources are finite and coordination between SFIO investigations and NCLT proceedings is largely informal. The Law Commission of India identified these structural failures as early as 1994 and recommended legislative intervention.[78] The intervening decades have produced incremental improvements, but no comprehensive solution has emerged.

D. The Corporate Group Problem

Section 339 applies to the business of the specific company being wound up. In a corporate group structure, where fraud is orchestrated across multiple subsidiaries, this company-specific focus means that a declaration against one entity does not automatically extend to affiliated companies. Promoter groups in India frequently use networks of related entities to conduct business in ways that obscure the flow of funds and complicate attribution. Khanna has noted that the formal availability of corporate criminal liability in such structures often produces far less enforcement than the applicable legal rules nominally require,[79] a point Laufer has made with equal force in the comparative context.[80]

COMPARATIVE PERSPECTIVE: THE CASE FOR WRONGFUL TRADING

One of the most notable features of the English insolvency framework, which remains absent in Indian law, is the doctrine of wrongful trading. Section 214 of the Insolvency Act 1986 imposes civil liability on directors who allow a company to continue trading beyond the point at which they knew, or ought reasonably to have concluded, that there was no realistic prospect of avoiding insolvent liquidation, provided they fail to take every reasonable step to minimise losses to creditors.[81] A defining feature of this provision is that, unlike fraudulent trading, it does not require proof of deliberate dishonesty. Instead, the standard combines an objective element based on what a reasonably diligent person in a similar position would have concluded with a subjective element that takes into account the actual knowledge, skill, and experience of the director concerned.[82]

The importance of this distinction for the Indian legal framework is considerable. The high evidentiary threshold required to establish fraudulent intent under Section 339 leaves a significant category of cases effectively unregulated namely, those involving reckless or overly optimistic trading decisions that cause

[75] Umakanth Varottil, "Corporate Fraud Regulation in India" (2018) 13 *Indian Journal of Corporate Law* 62.

[76] Prevention of Money Laundering Act, 2002 (Act 15 of 2003).

[77] Companies Act, 2013, s 211.

[78] Law Commission of India, *One Hundred and Forty-Seventh Report: Trial and Conviction of Companies and Other Corporate Bodies* (1994) para 4.2.

[79] VS Khanna, "Corporate Criminal Liability: What Purpose Does It Serve?" 109 *Harvard Law Review* 1477, 1491 (1996).

[80] WS Laufer, *Corporate Bodies and Guilty Minds: The Failure of Corporate Criminal Liability* (University of Chicago Press 2006) 47.

[81] Insolvency Act 1986 (UK), s 214.

[82] Vanessa Finch & David Milman, *Corporate Insolvency Law: Perspectives and Principles* 405–408 (3rd ed., Cambridge University Press, 2017).

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APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

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substantial harm to creditors but fall short of provable dishonesty.[83] Yeoh has argued that legal systems relying solely on a fraudulent intent standard tend to under protect creditors, particularly in situations involving financial distress where irresponsible conduct may not meet the strict threshold of fraud.[84]

The Companies Law Committee, in its 2016 Report, recognised this gap and observed that the existing framework does not adequately address certain forms of irresponsible corporate management. It recommended a reconsideration of director liability standards within the insolvency regime, particularly in relation to conduct preceding insolvency.[85] However, this recommendation has not yet been implemented. The case for reform remains compelling. The introduction of a wrongful trading standard would encourage directors to adopt a more cautious and proactive approach to financial management, including closer monitoring of the company's financial position, timely consultation with professional advisors, and earlier initiation of insolvency proceedings where necessary.[86]At the same time, any such reform must be carefully calibrated to avoid discouraging legitimate risk-taking. Appropriate safeguards, including a well-defined good faith defence and protection for directors who act on reasonable professional advice, would be essential to ensure that the provision does not unduly inhibit entrepreneurial decision-making.[87] Properly designed, a wrongful trading regime could strike a more effective balance between promoting commercial activity and safeguarding creditor interests within the Indian corporate framework.

REFORM PROPOSALS

A. A Continuous Fraudulent Trading Offence

The most pressing legislative reform lies in the introduction of a standalone criminal offence of fraudulent trading that operates independently of the winding-up trigger and remains applicable throughout the company's commercial existence. Drawing inspiration from Section 993 of the United Kingdom Companies Act 2006, such an offence should apply whenever a company's business is conducted with an intent to defraud creditors or for any other fraudulent purpose, irrespective of whether the company is solvent, insolvent, or undergoing liquidation.[88] In the Indian context, this would mark a shift from a reactive to a more preventive enforcement model, allowing authorities to intervene before financial harm becomes irreversible. At the same time, the existing civil remedy of imposing unlimited personal liability may be retained within the winding-up framework under a revised Section 339, supplemented by the power of the NCLT to grant interim reliefs such as injunctions and asset-freezing orders against individuals suspected of engaging in fraudulent trading during the company's ongoing operations.[89]

B. Rationalisation of Criminal Penalties

A related reform concerns the rationalisation of criminal penalties under Section 339(2), which currently remain inconsistent with the broader framework of corporate fraud regulation. Aligning these penalties with Section 447 of the Companies Act, 2013 would ensure both coherence and proportionality within the statute.[90] The revised provision should prescribe imprisonment ranging from one to ten years, coupled with fines proportionate to the quantum of fraud involved, rather than adhering to a rigid monetary cap. Such an approach would better reflect the gravity of

[83] Andrew Keay, "Wrongful Trading and the Liability of Directors" (2014) 35 *Company Lawyer* 123.
[84] Peter Yeoh, *Insolvency and Corporate Rescue* 178–182 (Edward Elgar, 2016).
[85] Companies Law Committee, *Report of the Companies Law Committee* (Ministry of Corporate Affairs, 2016).
[86] Roy Goode, *Principles of Corporate Insolvency Law* 670–673 (5th ed., Sweet & Maxwell, 2020).
[87] Andrew Keay, *Company Directors' Responsibilities to Creditors* 220–223 (Routledge, 2019).
[88] Paul L. Davies & Sarah Worthington, *Gower's Principles of Modern Company Law* 1032–1035 (10th ed., Sweet & Maxwell, 2016).
[89] Andrew Keay, *Company Directors' Responsibilities to Creditors* 215–218 (Routledge, 2019).
[90] Umakanth Varottil, "Corporate Governance in India: Evolution and Challenges" (2017) 12 *Indian Journal of Corporate Law* 45.

economic offences and remove the existing tendency of enforcement agencies to bypass Section 339 in favour of the more stringent general fraud provision.[91] Ultimately, a calibrated penalty structure would enhance deterrence while maintaining consistency across the statutory framework.

C. Introduction of a Wrongful Trading Standard

The absence of a wrongful trading framework in Indian law continues to represent a significant doctrinal gap. To address this, the Insolvency and Bankruptcy Code, 2016 may be amended to incorporate a provision imposing civil liability on directors who permit trading to continue when insolvent liquidation has become unavoidable, without taking reasonable steps to minimise losses to creditors.[92] This standard should combine a subjective assessment of the director's actual knowledge with an objective benchmark of what a reasonably diligent person in a similar position would have done, following the approach under Section 214 of the UK Insolvency Act 1986.[93] Importantly, a carefully structured good faith defence must be included to protect directors who relied on professional advice in circumstances of genuine commercial uncertainty.[94] Such a provision would bridge the existing gap between negligence and fraud, thereby promoting more responsible corporate conduct.

D. Deferred Prosecution Agreements

A statutory deferred prosecution agreement framework should be introduced for corporate fraud cases. Modelled on Schedule 17 of the Crime and Courts Act 2013 in England,[95] this would allow enforcement agencies to suspend criminal prosecution in exchange for the company's agreement to pay a substantial penalty, cooperate fully with investigations, disgorge any benefit obtained through the fraud, and implement specified compliance reforms within a defined timeframe. Singh has argued that the absence of a formal DPA framework represents one of the most significant gaps in India's corporate fraud enforcement toolkit, particularly in complex cases where conventional prosecution is slow and uncertain in outcome.[96]

E. Institutional Strengthening and Coordination

Substantive legislative reforms, however, cannot achieve their intended impact without corresponding improvements in institutional capacity and coordination. The National Company Law Tribunal (NCLT), in particular, requires enhanced judicial strength, specialised financial expertise, and investment in digital infrastructure capable of managing the extensive documentary evidence typically associated with complex fraud cases.[97] Equally important is the establishment of a statutory inter-agency protocol governing coordination between the SFIO, the Enforcement Directorate, SEBI, and the NCLT. Such a framework should clearly define mechanisms for information sharing, sequencing of parallel proceedings, and avoidance of jurisdictional overlap.[98] In addition, the whistleblower protection regime under the Whistle Blowers Protection Act, 2014 requires strengthening through the introduction of meaningful financial incentives and credible safeguards against retaliation.[99] As Sethi has rightly observed, even the most well-drafted legal provisions are unlikely to be effective unless supported by a robust investigative and adjudicatory infrastructure capable of enforcing them in practice.

[91] Arvind P. Mishra, "Fraud under the Companies Act, 2013: A Critical Analysis" (2021) 8 *NLIU Law Review* 112.
[92] Vanessa Finch & David Milman, *Corporate Insolvency Law: Perspectives and Principles* 412–415 (3rd ed., Cambridge University Press, 2017).
[93] Roy Goode, *Principles of Corporate Insolvency Law* 678–680 (5th ed., Sweet & Maxwell, 2020).
[94] Michael Bridge, *The Law of Insolvency* 289–292 (4th ed., Sweet & Maxwell, 2018)
[95] Crime and Courts Act 2013 (UK), sch 17.
[96] R Singh, "Deferred Prosecution Agreements: An Idea Whose Time Has Come for India" 12 *Indian Journal of Law and Technology* 113, 125 (2020).
[97] M. Rajan, "Institutional Challenges in Corporate Adjudication in India" (2019) 5 *Company Law Journal* 78.
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[99] Robert G. Brown, *Whistleblowing and Corporate Governance* 144–148 (Routledge, 2018).

INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 6 AND ISSUE 6 OF 2026

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

https://iledu.in

CONCLUSION

Section 339 of the Companies Act, 2013 is grounded in well-established principles and reflects a clear legislative intent to impose personal liability on individuals who knowingly participate in fraudulent trading. By allowing courts to lift the protection of limited liability in such cases, the provision reinforces the idea that corporate structures should not be misused as a shield for dishonest conduct.[100] Judicial interpretation of this provision has generally been cautious and balanced, requiring convincing evidence of dishonesty while also permitting inferences to be drawn from consistent patterns of conduct. At the same time, courts have maintained a clear distinction between deliberate fraud and genuine commercial failure, thereby safeguarding bona fide business decisions from undue penal consequences.[101]

Despite this strong conceptual foundation, three significant limitations reduce the practical effectiveness of Section 339. First, its application is restricted to situations where the company is undergoing winding-up, which makes the provision inherently reactive. As a result, intervention typically occurs only after substantial financial harm has already been caused, limiting the possibility of meaningful recovery for creditors.[102]Second, the relatively weak criminal penalties prescribed under Section 339(2) undermine its deterrent value and often lead enforcement authorities to rely instead on the broader and more stringent provisions of Section 447 of the Companies Act, 2013.[103] Third, the fragmented nature of enforcement spread across multiple agencies and adjudicatory bodies results in delays, jurisdictional overlaps, and inconsistent outcomes, often operating to the disadvantage of creditors seeking timely redress.[104]

In addition to these concerns, Indian corporate law does not currently recognise a wrongful trading standard. This creates a significant gap, as many instances of harmful director conduct such as reckless or imprudent management that falls short of intentional fraud do not attract personal liability. Such behaviour, while not strictly fraudulent, can nevertheless cause substantial losses to creditors, yet the legal framework does not provide an adequate civil remedy in such cases.[105]

The reforms proposed in this study seek to address these deficiencies through a combination of legislative and institutional measures. These include the introduction of a continuous fraudulent trading offence, the rationalisation of penalties to align with Section 447, the incorporation of a wrongful trading provision modelled on English law, the establishment of a deferred prosecution agreement framework, and improved coordination among enforcement institutions. Each of these reforms is independently feasible, and their combined implementation would significantly strengthen the regulatory framework. In effect, these changes would transform Section 339 from a largely symbolic provision into a more effective mechanism for deterring misconduct and protecting creditor interests. The case for reform is therefore both compelling and urgent, leaving it to the legislature to translate these proposals into action.[106]

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ISSN 2583-2344