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Date of Publishing: August 8, 2025

Beyond Compliance: Building Director Immunity Against Trade Wars, CBAM & Sanctions**CS RAHUL SAHASRABUDDHE**

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I. THE UNAVOIDABLE IMPERATIVE: GLOBAL VOLATILITY AS A STATUTORY DUTY

Directors treating today's volatile global economy—marked by escalating tariff conflicts, supply chain disruptions, and U.S.-China-EU trade frictions—as mere 'external factors' risk personal fines, disqualification, and **though no class action suit has yet succeeded in Indian courts**, potential liability from shareholder litigation. The statute imposes an unequivocal mandate: boards must proactively anticipate and mitigate such threats. When EU carbon tariffs or U.S. import bans can erode market capitalization overnight, geopolitics ceases to be an "act of God"—it becomes a direct assessment of director competence.

A. The Legal Anatomy of Director Liability**1. Section 166(3):** Mandates directors exercise "*reasonable care, skill, and diligence.*"

- **Interpretation:** "Reasonable care" encompasses anticipating global economic shocks substantiated by:
 - IMF warnings on trade fragmentation (2024 Global Stability Report)
 - U.S. Section 301¹ tariffs on \$300B+ Chinese goods (impacting Indian exporters)
 - EU's Carbon Border Adjustment Mechanism (CBAM²) imposing 20-35% levies by 2026
- *Consequence:* Neglecting systemic risks constitutes negligence.

2. Section 166(7)

- Penalties: Rs. 5 lakh fine per director + 5-year disqualification.
- *Case Example:* An auto parts manufacturer's board ignoring U.S. tariff threats since early 2025. If 25% duties materialize, EBITDA may drop 40%. Shareholders may sue for breaching Section 166(3).

3. SEBI LODR Regulation 30

- Requires disclosing "material events" in a timely manner.
- *Expanded Definition:* Tariff announcements, sanctions, war outbreaks, or supply chain ruptures now qualify as material.
- Downside: Penalties, trading suspension.

II. THREE DEFENSIVE STRATEGIES AGAINST LIABILITY

STRATEGY 1: SUPPLY CHAIN EXPOSURE MAPPING & CONTRACT ARCHITECTURE **Why This Matters**

- 58% of Indian manufacturing inputs rely on tariff-impacted regions (China, Russia, Taiwan)—NITI Aayog 2024.
- Unaddressed dependencies violate Section 166's³ "diligence" standard.

Action Framework

1. Supplier Audits

- Identify dependencies on sanctioned regions (e.g., Russian minerals, Taiwanese chips).
- **Contract Triggers:** Embed *"tariff escalation =10% permits contract renegotiation"* clauses.
- **Statutory Anchor:** Per SEBI LODR Reg 17(3), boards must review supply chain risks quarterly. Non-compliance risks trading suspension.

2. Contractual Shields

- *Clause Samples:*
"If tariffs on supplied goods increase by =10%, parties shall renegotiate pricing within 10 business days."
"Force Majeure covers 'trade embargoes', 'sanctions', and 'cross-border supply chain disruptions'."
- *Statutory Link:* Ensures directors fulfill Section 134(3)(n)⁴ disclosure duties for risk mitigation.

STRATEGY 2: WAR-GAMING CURRENCY & TRADE SHOCKS

The Board's Blind Spot

The rupee's depreciation to Rs. 88/\$ underscores systemic vulnerability: most Nifty 500 boards overlooked stress-testing this scenario despite Section 166(3)⁵ requiring 'skill' in foreseeing market shocks.

Execution Blueprint

1. FX Stress Testing

Integrate RBI's Rs. 92/\$ vulnerability threshold, a 15% EU CBAM levy, and 10% U.S. services tariffs into a 'Severe Shock' model. This quantifies compound exposure to synchronized currency, climate, and trade policy fractures—testing EBITDA impact, covenant breaches, and liquidity shortfalls.

2. Hedging Protocol

Align with FEMA ECB guidelines capping unhedged forex exposure and Section 177(4)⁶'s audit committee reviews. Hedge projected forex exposure for 12 months, embedding compliance into treasury strategy.

3. Real-Time Disclosure Triggers

Under SEBI LODR Reg 30, adopt 'Dynamic Materiality Thresholds'—automating market alerts if tariffs threaten (a) =5% PAT erosion or (b) loan covenant breaches.

STRATEGY 3: GEOPOLITICAL VDD FOR M&A — AVOIDING DEAL-KILLERS

1. The High-Stakes Pitfall in Modern Due Diligence

Traditional M&A due diligence often omits geopolitical-regulatory exposures (e.g., CFIUS interventions, OFAC⁷-sanctioned end customers, CBAM⁸'s competitive impacts). Such gaps breach Section 166's "reasonable skill, care, and diligence" mandate.

2. Director Safeguards and Proactive Compliance Measures

For targets facing trade barriers (e.g., 60% U.S. tariffs on Mexican imports), demand tariff-adjusted

valuations (min. 30% discount). Screen OFAC-sanctioned suppliers and use indemnity escrows. Disclose CBAM-driven margin erosion (e.g., 40% on steel) via SEBI LODR Reg 30 within 24 hours.

3. **Implementing Validation Due Diligence (VDD)**

VDD supplements financial checks with real-time geopolitical/regulatory threat analysis (e.g., Critical Technology Audits). It validates regulatory survivability—essential for cross-border deals amid trade fragmentation.

III. BROAD ACTION PLAN

Step 1: Conduct a Comprehensive Volatility Gap Audit

Initiate a *Volatility Gap Audit* quantifying exposure to: (1) 5+ high-risk tariff regimes, (2) suppliers linked to sanctions/war zones, (3) unhedged forex positions. Statutorily append the Gap Report to the Board's Report under *Section 134(3)(n)*.

Step 2: Reconfigure Board Governance Structures

- Embed "*geopolitical risk oversight*" in Audit Committee charters (*Section 177*).
- Mandate Risk Committee quarterly stress tests (*SEBI LODR Regulation 21*).
- Retrain directors via certified workshops or appoint consultants.
- Document volatility responses in minutes to demonstrate *Section 166* compliance.

Step 3: Deploy Automated Early-Warning Systems

Integrate AI tools for real-time threat monitoring. Use API⁹ driven automation to convert risk alerts into SEBI LODR Reg 30-compliant disclosures in a timely manner.

IV. THE ULTIMATE ACCOUNTABILITY: DATA OR DISQUALIFICATION

When shareholders litigate over unmitigated tariff losses, MCA-21 filings won't suffice. Courts demand proof of proactive governance—not passive compliance. Section 166 converts global volatility into a director competency test.

Compliance Commandments

1. Meticulous Documentation of Board Deliberations

Record all Section 166 "skill and diligence" discussions on trade wars in board or committee meeting minutes.

2. Precision in Market Disclosures

Replace generic "monitoring global risks" with granularity: "*The board simulated a 15% EU CBAM impact on Project Aurangabad, identifying 17% PAT erosion.*"

3. Independent Director Competency Upgrade

Per Section 149(6), independent directors (IDs) must demonstrate trade law, sanctions screening, and forex management skills. Retrain non-compliant IDs or replace via Nomination Committee. Document Independent Directors' technical contributions in minutes.

CONCLUSION: GOVERNANCE AS THE CORPORATE IMMUNE SYSTEM

Governance functions as the corporate immune system against volatility, not a symbolic ritual. Directors prioritizing routine filings over strategic foresight invite fines, disqualification, and reputational ruin under the Companies Act. Echoing U.S. Deputy AG Paul McNulty's warning: '*If you don't like compliance, try noncompliance.*' Resilience demands:

- (1) Hardwiring geopolitical risk into committee charters,
- (2) Rigorously stress-testing tariff/war fallout, and

- (3) Documenting defensive actions in board minutes. Forge this immunity today—or confront liability tomorrow.

The ultimate test under Section 166 reduces to one pivotal question: Did the board deploy *every reasonable measure* to protect against foreseeable threats? In 2025, 'reasonable' unequivocally mandates anticipating trade wars—not dismissing them.

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1. Section 301 is a **unilateral enforcement tool** enabling the U.S. to pressure trading partners. (<https://www.congress.gov/crs-product/IF11346>)

2. CBAM - Carbon Border Adjustment Mechanism. it's an EU regulation aimed at preventing carbon leakage by imposing a carbon price on imports of certain goods.

3. **Companies Act 2013:**

Duties of directors.

166. (1) Subject to the provisions of this Act, a director of a company shall act in accordance with the articles of the company.

(2) A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

(3) A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

(4) A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

(5) A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

(6) A director of a company shall not assign his office and any assignment⁷¹ so made shall be void.

(7) If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

4. **Companies Act 2013**

Sec 134 (3) (n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company

5. **Companies Act 2013**

Sec 166 (3) (n) A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

6. **Companies Act 2013**

Sec 177(4) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall *inter alia*, include.....

7. Office of Foreign Assets Control, which is part of the U.S. Treasury Department.

8. CBAM - Carbon Border Adjustment Mechanism. it's an EU regulation aimed at preventing carbon leakage by imposing a carbon price on imports of certain goods.

9. API (Application Programming Interface) is a digital intermediary that enables different software systems to communicate and share data with each other.