



LexArticle

June 12, 2014, New Delhi, INDIA

Directors' general duties under the Companies Act 2013

If you have questions or would like additional information on the material covered in this Newsletter, please contact the authors:

-By: Alfred Adebare, Of Counsel
(aadebare@lexcounsel.in)

LexCounsel, Law Offices C-10,
Gulmohar Park New Delhi 110 049,
INDIA. Tel.:+91.11.4166.2861
Fax:+91.11.4166.2862

Recommended by:

Directors' general duties under the Companies Act 2013

A note outlining the general duties of directors set out in section 166 in chapter XI of the Companies Act 2013 ("2013 Act"). All references to sections are to sections of the 2013 Act. Section 166 in chapter XI came into force on 1 April 2014. This note covers duties owed by a director, in his capacity as director, to the company and does not cover other duties under the 2013 Act.

Background

The erstwhile Companies Act 1956 contains no statement at all of statutory duties of directors, and until 1 April 2014, acts of directors were usually reviewed in the context of their powers in terms of section 291 of the Companies Act, 1956 (and other applicable laws), and their established roles under common law as laid down in several judicial precedents. Section 166 is, therefore, the first time in Indian company law in which duties have been statutorily specified for directors. Section 166 appears to have codified certain common law and equitable duties of directors which evolved over time. In summary, the general duties of directors [appointed to the board of directors] under the 2013 Act are:

1. To act in accordance with the articles of the company, in other words, to act within powers.
2. To act in good faith in order to promote the objects of the company for the benefit of its members as a whole.
3. To exercise due and reasonable care, skill and diligence and independent judgment.

CHAMBERS
ASIA



4. To avoid conflicts of interest.
5. To avoid undue gain or advantage either to himself or relatives, partners or associates.
6. Not to assign his office.

From a glance, directors' general duties in section 166 are largely derived from common law rules and equitable principles. Some of the duties specified in section 166 correlate to statutory duties of directors under the UK Companies Act 2006 (sections 171 – 177), however, unlike the UK Act, which specifically states that the statutory duties of directors are based on certain common law rules and equitable principles as they apply in relation to directors, and would be interpreted and applied in the same way as those common law rules and equitable principles, the 2013 Act specifies no such thing, begging the question, how will the statutory duties specified in section 166 be interpreted in India? Indian courts will most likely interpret and apply the statutory duties specified in section 166, in accordance with established common law rules and equitable principles.

Common law and equitable principles

Common law is that body of law developed by judges based on customs and decisions of courts (as opposed to statutes adopted through the legislative process). Equity emerged to mitigate the rigours of common law, allowing courts to use their discretion and apply justice in accordance with natural law. Under common law and equity, director's duties are largely derived from the law of agency and trusts, and a large body of precedents imposed duties on directors accordingly.

In *Albert Judah Judah vs. Rampada Gupta and Another*, Justice P.C. Mallick of the High Court of Calcutta, citing Lord Selbourne in *Great Eastern Railway Company vs. Turner*, stated that the two fold character of directors (as trustees and agents) have been well expressed: "The directors are the mere trustees or agents of the company; trustees of the company's money and property; agents in the transactions which they enter into on behalf of the company."

Under the law of trusts, courts imposed fiduciary duties on directors; while under the law of agency, they imposed duties of skill, care and diligence on directors.

Fiduciary duties

The exemplar of a fiduciary is sometimes said to be a trustee and earlier on in the development of fiduciary law, directors were considered to be an obvious extension, given the power they have to deal with company property. The trusteeship of directors extends not merely to the property of the company, but also to the moneys of the

company, trade secrets and other items of intellectual property, the existence or particulars of which may be within the personal knowledge of the directors.

In *Chavalier I.I. Iyyappan and Another vs. The Dharmodayam Company*, the Supreme Court of India stated that “it is now impossible to dispute the proposition that the directors are in some sense, trustees - a proposition which has been established by a long series of cases.”

In *Superintendent and Remembrancer of Legal Affairs vs. Akhil Bandu Guha and Others*, the High Court of Calcutta held that the directors of joint stock companies stand in a fiduciary capacity with regard to the capital under their control, and are in the position of trustees.

In *Albert Judah Judah supra*, Justice Mallick stated that “it is clear that the directors are trustees in a very limited sense. They are liable as trustees for breach of trust, if they misapplied the funds or committed breach of byelaws.”

It would thus appear that the notion of a fiduciary relationship of directors established in Indian judicial precedents has traditionally been one of “status”. It is out of this relationship that strands of fiduciary duties – the “good faith duty”, the “no conflict of interest duty” and the “no undue benefit or advantage duty” – which are now crystallised in the 2013 Act, arose.

Directors as Agents

As a company cannot itself act in its own person, for it has no person; it can only act through directors and the case is, as regards the directors, merely the ordinary case of principal and agent, for whenever an agent is liable the directors would be liable. In *Albert Judah Judah supra*, Justice Mallick cited with approval the court’s observation in *Ferguson v. Wilson* that directors are agents of the company. Consequently, where directors enter into contracts on behalf of the company, it is the company and not the directors, who are liable thereunder. In *Aberdeen Ry vs. Blaikie*, Lord Cranworth stated in his judgment that a company can only act by agents and it is the duty of those agents so to act as best to promote the interest of the company whose affairs they are conducting. Like agents, directors are expected to display a degree of care, skill and diligence in the exercise of their power and functions on behalf of the company as is expected from men of their position. Again, from the common law principle of directors as agents arose the duty of promoting the interest of the company, and duty of care, skill and diligence.

However, directors are not always treated as agents of the company. The High Court of Calcutta has held that the question as to whether one or two directors or the entire board of directors acted as agents would depend on the evidence and would have to be determined after a careful consideration of the facts and circumstances of the case – refer *Syham Sundar Jalan vs. State*. Also, if a director commits a fraud on the company his knowledge of such fraud cannot be attributed to the company – refer *V.K.R.S.T Firm v. Official Liquidator, Oriental Investment Trust*.

Equitable principles

In applying general equitable principles to [common law] duties of directors, English courts (refer Romer J, in *City Equitable Fire Insurance Co.*) laid down the following three propositions:

- (1) a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. This element of subjectivity means that a director is to be held to his own, subjective standard of ability, knowledge and experience, and not that of the reasonable man.

Later, a general standard of care, which was expressed as being both objective and subjective, was re-stated by later decisions of English courts, as being that of a reasonably diligent person having the knowledge, skill and experience both of a person carrying out that director's functions and of that person himself. This may find acceptance in Indian courts with respect to independent directors who are required to possess appropriate skills, experience and knowledge in one or more fields (including of finance) related to the company's business.

- (2) A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so.

In a modern approach, this may be relevant when assessing the duties of non-executive directors. However, where non-executive directors are appointed because of their particular skills or qualifications, those will be taken into account by a court in assessing their duties.

- (3) In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

Other rules that have emerged are: (1) that directors must act in good faith in what they believe to be the best interests of the company; (2) that they must not exercise the powers conferred upon them for purposes different from those for which they were conferred; (3) that they must not fetter their discretion as to how they shall act; and (4) that, without the informed consent of the company, they must not place themselves in a position in which their personal interests or duties to other persons are liable to conflict with their duties to the company."

Duty owed to company

Unlike the UK Companies Act 2006, which specifies that the duties specified in sections 171 – 177 are owed by a director of a company to the company, the 2013 Act is silent on who the duties specified in section 166 are owed. However, in view of the legal relationship between the directors and the company, it is safe to assume that the

duties are owed to the company. This would not prejudice or preclude, in special circumstances, additional duties owed by directors to the shareholders arising from a special factual relationship.

Consequences of breach

The 2013 Act states that breach by a director of the provisions of section 166 is punishable with a minimum fine of Rs. 100,000 (which may also extend to Rs. 500,000). There is, however, no specified process or procedure in which the company may bring an action against erring directors for an alleged breach of any of the duties of directors in section 166. It is presently not clear if a shareholder can bring a derivative action in respect of an alleged breach of duty by a director of his/her duties under section 166 (though the National Company Law Tribunal to be constituted under section 408 would have all powers of a civil court under the Code of Civil Procedure, 1908, for purposes of the 2013 Act). It is, however, possible for a shareholder to bring an application for relief under section 241 (yet to be notified into effect) if the alleged breach of duties of the directors becomes prejudicial to the interest of such shareholder or the company or public interest. A company may exempt its directors from liability (by way of indemnity or otherwise by way of directors and officers insurance) in connection with any breach of duty in relation to the company as the 2013 Act does not specifically prohibit such exemptions.

Feedback

Disclaimer: LexCounsel provides this e-update on a complimentary basis solely for informational purposes. It is not intended to constitute, and should not be taken as, legal advice, or a communication intended to solicit or establish any attorney-client relationship between LexCounsel and the reader(s). LexCounsel shall not have any obligations or liabilities towards any acts or omission of any reader(s) consequent to any information contained in this e-newsletter. The readers are advised to consult competent professionals in their own judgment before acting on the basis of any information provided hereby.