Chapter 5 Conventional Duties and Liabilities of Independent Directors

5.1 Introduction

The academic literature suggests at least two distinct, but not necessarily mutually exclusive, roles: (i) independent directors may be seen as watchful monitors of promoters and management on behalf of public shareholders or (ii) independent directors may be viewed as reservoirs of strategic advice intended to aid promoters and managers in maximizing overall firm value. Historically, independent directors emerged in the United States to discharge their functions more like strategic advisors to the management of a firm. However, as complexities in the functionality and holding structures within the company developed and shareholder wealth maximization gained core focus, independent boards took on more of a monitoring role. This was complemented with tighter definitions of independence.

However, before the duties and liabilities of Independent Directors are classified in detail it is significant to have a close scrutiny of the duties and liabilities of Director in Companies Act, 1956.

5.2 Conventional Functions

On broad basis, functions of independent directors can be conveniently classified between the following two:

5.2.1 Watchdog for Shareholders

One presence of independent directors on the board largely served as a means of creating back force and deterrent to management or controlling shareholder as the case may be. The simple logic applied was that it would be fairly difficulty for management or controlling shareholder to manipulate or expropriate potential transactions of self-interest under the watchful eyes of independent directors. As has already been mentioned in the earlier parts of

177 Vikramditya S. Khanna and Shaun J. Mathew, The Role of Independent Directors In Controlled Firms in India: Preliminary Interview Evidence, Nat’l. l. Sch. of India Rev. 22, P. 35 (2010) at 45
178 For detailed discussion and understanding about the historical and theoretical emergence of independent directors see Chapter 2.
thesis study Delaware Courts have perceived and suggested that independent directors can prove to be instrumental in exercising vigilance on behalf of minority shareholders in contexts such as potential self-dealing transactions involving the controlling shareholder and the company, as well as minority freeze-out transactions proposed by the controlling shareholder. One may argue that independent director may not have the voting power to stop these types of activities; however he or she has the power to make public any wrongdoing. So that even if management or controlling shareholders initiate actions for the removal of the independent director or take other retributive measures, such actions would likely cause unwanted public scrutiny.

5.2.2 Strategic Advisor to the Board

As mentioned already, emergence of Independent directors was primarily to provide strategic advice to the board which leads to better economic performance of the company. It was believed that the expertise and experience of Independent directors will help business make wiser decisions and add value to the firm. This role cannot be denied even today and it needs to be reiterated that independent directors can strengthen the board performance by providing strategic advises and opening up areas that were not considered by the board. Whether the insider or outsider model exists, strategic advisory function remains common to both models.
5.3 Position of Indian Laws

The position of Indian Laws can be understood by taking duties prescribed in Companies Act 1956.

5.3.1 Duties Prescribed in Companies Act 1956

Duties under Companies Act has been categorised under the following heads:

5.3.1.1 Duties of Director

It may be divided under two heads:

1. Statutory Duties and
2. General Duties

5.3.1.1.1 Statutory Duties

Statutory duties are the duties and obligations imposed by the Companies Act. Important among them are:

(A) To file return of allotment- Section 75 of the Companies Act, 1956 requires a company to file with the Registrar, within a period of 30 days, a return of the allotments stating the specified particulars. Failure to file such return shall make the directors liable as ‘officer in default’. A fine up to Rs. 5000 per day till the default continues may be levied.

(B) Not to issue irredeemable preference shares or shares redeemable after 20 years- Section 80, as amended by the Amendment Act of 1996, forbids a company to issue irredeemable preference shares or preference shares redeemable beyond 20 years. Directors making any such issue may be held liable as ‘officer in default’ and may be subject to fine up to Rs. 10,000.

(C) To disclose interest - Sec. 299-300: In respect of contracts with a director, section 299 casts an obligation on a director to disclose the nature of his directors. The said section provides that in case of a proposed contract or arrangements, the required disclosure shall be made at the meeting of the Board at which the question of entering into the contract or arrangement is first taken into
consideration. In the case of any other contract or arrangement, the disclosure shall be made at the first meeting of the Board held after the director becomes interested in the contract or arrangement.

For the aforesaid purpose, a general notice given to the board by a director, to the effect and he is a director or a member of a specified body corporate or is a member of a specified firm and is to be regarded as concerned or interested in any contract or arrangement which may, after the date of the notice, be entered into with that body corporate or firm, shall be deemed to be a sufficient disclosure of concern or interest in relation to any contract or arrangement so made[Sec. 299(3)].

Any such general notice shall, however, expire at the end of the financial year in which it is given, but may be renewed for further period of one financial year at a time, by a fresh notice given in the last month of the financial year in which it would otherwise expire [Sec. 299(3)(b)].

In case of ICICI V. Parasrampuria Synthetics Ltd. it was held that if a disclosure at the beginning of each financial year has been made, that is deemed to be sufficient disclosure in terms of section 299.

No such general notice, and no renewal thereof, shall be of effect unless either it is given at a meeting of the Board, or the director concerned takes reasonable steps to secure that it is brought up and read at the first meeting of the Board after it is given.

Effect of failure to disclose Interest

1. Fine- As per sub-section (4) to section 299, every director who fails to comply with the aforesaid requirements as to disclosure of concern or interest shall be punishable with fine which may extend to Rs. 50,000.
2. Exception- Nothing in section 299 will apply to a contract or arrangement entered into or to be entered into between two companies (may be more than two also) where any of the directors of one company or two or more companies together hold or hold not more than 2% of the paid-up capital of the other company.

179 Supra note 1 pg. 578-579
180 [1998] 17 SCL 51 (Delhi)
3. Interested Directors not to participate or vote in Board’s proceedings-

Sec. 300(1) provides that no director of a company shall, as a director, take part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement.

Besides, his presence shall not count for the purpose of forming a quorum at the time of any such discussion or vote. In case he does vote, his vote shall be void. The aforesaid bar on an interested director to participate or vote at a meeting shall not apply to:

a) In case of Dr. T.M. Paul V. City Hospital \(^{181}\) it was held that, a private company which is neither a subsidiary nor a holding company of a public company;

b) A private company which is a subsidiary of a public company, in respect of any contract or arrangement entered into or to be entered into, by the private company with the holding company thereof; \(^{182}\)

c) Any contract of indemnity against any loss which the director, or any one or more of them, may suffer by reason of becoming or being sureties or a surety for the company; and

d) Any contract or arrangement entered into or to be entered into with a public company, or a private company which is a subsidiary of a public company in which the interest of the director aforesaid consist solely-

i. in his being a director of such company and the holder of not more than shares of such number or value therein as is requisite to qualify him for appointment as a director thereof, he having been nominated as such director by the company referred to in sub-section (1), or

ii. in his being a member holding not more than 2 percent of its paid up share capital; \(^{183}\)

\(^{181}\) [1999] 35 CLA 164 (Ker.)

\(^{182}\) In view of the Companies (Amendment) Act, 2000, a private company which is a subsidiary of a public company is considered as a public company and therefore the said exemption shall not be available.

\(^{183}\) Supra note 1 pg. 579-580
e) a public company, or a private company which is a subsidiary of a public company in respect of which a notification is issued under sub-section (3) to the extent specified in the notification. Sub-section (3) empowers the Central Government to fully or partially relieve the company from the prohibitions contained in sub-section (1) in public interest (i.e., desirability of promoting or establishing any trade, industry or business).

4. Cessation of office of Directorship- According to sec. 283(1)(i), an office of a director shall fall vacant in case he acts in contravention of sec. 299.

It may, however, be noted that the Companies Act does not debar a company from entering into a contract in which a director is interested. It only requires that such interest be disclosed.

In Venkatachalapati V.Guntur Mills184 it was held, where the whole body of directors is aware of the facts, a formal disclosure is not necessary.

(D)To disclose receipt of transfer of property- Sec. 319: Any money received by the directors from the transferee in connection with the transfer of the company’s property or undertaking must be disclosed to the members of the company and approved by the company in general meeting. Otherwise, the amount shall be held by the directors in trust for the company. This money may be in nature of compensation for loss of office but in essence may be on account of transfer of control of the company. But, if it is bonafide payment of damages of breach of contract, then it is protected by section 321(3). Even no director other than the managing director or whole time director can receive any such payment from the company itself.

(E)To disclose receipt of compensation from transferee of shares- Sec. 320: If the loss of office results from the transfer (under certain conditions) of all or any of the shares of the company, its directors would not receive any compensation from the transferee unless the same has been approved by the company in general meeting before the transfer takes place. If the approval is not sought or the proposal is not approved, any money received by the directors shall be held in trust for the shareholders who have sold their shares.

184 AIR 1929 Mad 353
Section 320 also provides that in pursuance of any agreement relating to any of the above transfers, if the director receive any payment from the transferee within one year before or within two years after the transfer, it shall be accounted for to the company unless the director proves that it is not by way of compensation for loss of office.\textsuperscript{185}

Section 321 further provides that of the price paid to a retiring director for his shares on the company is in excess of the price paid to other shareholders or any other valuable consideration has been given to him, it shall also be regarded as compensation and should be disclosed to the shareholders. No director can receive any such payment from the company itself.

(F) Duty to attend Board meetings- A number of powers of the company are exercised by the Board of directors in their meetings held from time to time. Although a director may not be able to attend all the meetings but if he fails to attend three consecutive meetings or all meetings for a period of three months whichever is longer, without permission of the Board, his office shall automatically fall vacant i.e., Section 283(1)(g).

(G) To convene statutory, Annual General Meeting (AGM) and also extraordinary general meeting i.e., Sections 165, 166 & 169.

(H) To prepare and place at the AGM along with the balance sheet and profit and loss account a report on the company’s affairs including the report of the Board of Directors i.e., Section 173, 210 and 217.

(I) To authenticate and approve annual financial statement i.e., Section 215.

(J) To appoint first auditor of the company i.e., Section 224

(K) To appoint cost auditor of the company i.e., Section 233B.

(L) To make a declaration of solvency in the case of a Member’s voluntary winding up i.e., Section 488.\textsuperscript{186}

\textsuperscript{185} Supra note 1 pg. 580
\textsuperscript{186} Supra note 1 pg. 581
5.3.1.1.2 General Duties

General Duties of directors are as follows:

5.3.1.1.2.1 Duty of good faith

The directors must act in the best interest of the company. Interest of the company implies the interest of present and future members of the company on the footing that the company would be continued as a going concern.

Thus a director should not make any secret profits. He should also not exploit to his own use the corporate opportunity. In Cook V. Veeks, 187 it was observed that “men who assume complete control of a company’s business must remember that they are not at liberty to sacrifice the interest which they are bound to protect and while ostensibly acting for the company, direct in their own favour business which should properly belong to the company they represent.”

In this case there was an offer of a contract to the company. Directors who were the holders of the share of 3/4th of the votes resolved that the company has no interest in the contract and later entered into the contract by themselves. Held, the benefit of the contract belonged in equity to the company”

As regards the director selling his property to the company there would be breach of faith and he would have to account for the profit to the company if the property was acquired by him under circumstances which made it in equity the property of the company. But if the property in equity as well as in law belonged to him, there is no breach of faith. In case of Burland V. Earle, 188 the plaintiff was a director in one company and a shareholder and creditor in another company. The second company was being wound up and the plaintiff purchased the assets of the second company at a public auction in four lots. One such lot he sold to the former company (in which he was a director) at almost three times the price he had paid for it. The lower Court decided that he should account for the profit on resale to the company. But, the Privy Council overruled the decision.

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187 [1916]AC 554
188 [1902] AC 83
In case of Regal (Hastings) Ltd. V. Gulliver\textsuperscript{189} held that, if the property is acquired by a director by reason of the fact that he is a director and in the course of the exercise of the office of director, then the profit on resale of such property would belong to the company.

**5.3.1.1.2.2 Duty of care**

A director must display care in performance of work assigned to him. He is, however, not expected to display an extraordinary care but that much care only which a man or ordinary prudence would take in his own case. Justice Romer in Re City Fire Insurance Company’s case observed:

“His (director’s) duties will depend upon the nature of the company’s business, the manner in which the work of the company is distributed between the directors and other officials of the company. In discharging these duties a director must exercise some degree of skill and diligence. But he does not owe to his company the duty to take all possible care or to act with best care. Indeed, he 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. It is, therefore, perhaps another way of stating the same proposition that directors are not liable for mere errors of judgement.”

Similar view was expressed in case of Lagunas Nitrate Co. V. Lagunas Nitrate Syndicate,\textsuperscript{190} in the following words:

“ If directors act within their powers, if they act with such care as is to be reasonably expected of them having regard to their knowledge and experience and if they act honestly for the benefit of the company they discharge both their equitable as well as legal duty to the company.”

Section 201 states that a provision in the company’s Articles or in any agreement that excludes the liability of the directors for negligence, default, misfeasance, breach of duty or breach of trust, is void. The company cannot even indemnify the directors against such liability. But, if a director has been acquitted

\textsuperscript{189} [1942] 1All ER 378(HC)

\textsuperscript{190} [1899] 2Ch.392 (p.428, C.A.)
against such charges, the company may indemnify him against cost incurred in defence.

Section 633 further states that where a director may be liable in respect of the negligence, default, breach of duty, misfeasance or breach of trust but if he has acted honestly and reasonably and having regard to all the circumstances of the case, he ought fairly his liability on such terms as it may think fit. In the case of TEC Venkatesh V ROC 191 held that, the plea of a director that he was merely a non-executive independent director at the time of the issue of the prospectus by itself is not enough to grant him relief under section 633.

5.3.1.2.3 Duty not to delegate:

Director being an agent is bound by the maxim delegates non protest delegare’ which means a delegate cannot further delegate. Thus, a director must perform his function personally. A director may, however, delegate in the following cases:

(a) Where permitted by the Companies Act or Articles of the Company
(b) Having regard to the exigencies of business certain functions may be delegated to other officials of the company.192

5.3.1.2 Liabilities of Directors

The liabilities of directors may be considered under the following heads:

1. Liability to the Company
2. Liability to third parties
3. Liabilities for breach of statutory duties
4. Liability for acts of co-directors
5. Criminal Liability

191 [2007] 78 SCL 1 (AP)
192 Supra note 1 pg. 582-583
A. Liability to the Company

The liability of a director to the company may arise from:

(a) Breach of fiduciary duty

(b) Ultra vires acts

(c) Negligence

(d) Mala fide acts

(a) Breach of fiduciary duty: Where a director acts dishonestly to the interest if the company, he will be liable for breach of fiduciary duty. Most of the powers of directors are ‘power in trust’ and therefore, should be exercised in the interest of the company and not in the interest of the directors or any section of members. In case of Hogg V. Cramphorn Ltd193 where the directors, in order to forestall a take-over bid, transferred the unissued shares of the company to trustees to be held for the benefit of the employees, and an interest free loan from the company was advanced to the trustees to enable them to pay for the shares, it was held to be a wrongful exercise of the fiduciary powers of the directors.

(b) Ultra vires acts: Directors are supposed to act within the parameters of the provisions of the Companies Act, Memorandum and Articles of association, since these lay down the limits to the activities of the company and consequently to the powers of the Board of directors. Further, the power of the directors may be limited in terms of specific restrictions contained in the Articles of association. The directors shall be held personally liable for acts beyond the aforesaid limits, being ultra vires the company or the directors. Thus, where the directors pay dividends or interest out of capital i.e., except the payment under section 208 of the Act, they will be liable to indemnify the company for loss or damage suffered due to such Act.

(c) Negligence: As long as the director’s act within their powers with reasonable skill and care as expected of them as prudent businessmen, they discharge their duties to the company. But where they fail to exercise

193 [1967] Ch. 254
reasonable care, skill and diligence, they shall be deemed to have acted negligently in discharge of their duties and consequently shall be liable for any loss or damage resulting there from. However, error of judgement will not be deemed as negligence. It may be noted that the directors cannot be absolved of their liability for negligence by any provisions in the Articles i.e., Section 201.

However, the Court may grant relief to directors against such liability under section 633 of the Act.

The Madras High Court in S. Pattabhiraman V. ROC\textsuperscript{194} has held that in exercising power of the Court to grant relief under section 633(2), the Court has to see that the condition precedent to such exercise is present, i.e. the director/officer is in fact in default. Earlier in 2003, the Calcutta High Court in Tapan Kumar Chowdhury V ROC\textsuperscript{195} had laid down guiding principles of exercise of power under section 633 by the Court. These are:

1. If there is any statutory default on the part of individual while acting on behalf of a company, the court is empowered to consider the application for excusing him from such responsibility or liability.
2. While considering the application under section 633(2), the Court will have to come to the conclusion that the applicant has acted honestly and fairly and even after his honest and fair act, the default was committed for some unavoidable circumstances;
3. Non-compliance of statutory requirements by the applicant was caused due to incidents beyond his control;
4. The court is neither empowered to extend the time to hold A.G.M or to comply with the statutory requirements nor empowered to relieve the company from such responsibility.

(d) Mala fide acts: Directors are the trustees for the moneys and property of the company handled by them, as well as for exercise of the powers vested in them. If they dishonestly or in a mala fide manner, exercise their powers and perform their duties, they will be liable for breach of trust and may be required to make good the loss or damage suffered by the company by reason of such mala fide acts.

\textsuperscript{194} [2009] 96 SCL 305
\textsuperscript{195} [2009]55 CLA 80
They are also accountable to the company for any secret profits they might have made in course of performance of duties on behalf of the company.196

Director can also be held liable for their acts of ‘misfeasance’ i.e., misconduct or wilful misuse of powers. However, misconduct which is not wilful shall not amount to ‘misfeasance’. Moreover, the directors are entitled to relief against liability for breach of trust or misfeasance under section 633. In case of Aapka Bazar Ltd., (in liquidation), In re197 it was held that, when a person entitled to seek relief under section 633 is charged under Indian Penal Code (1860) the relief is not available for the charge.

In case of P.K. Nedungadi V. Malayalee Bank Ltd.198 it was held that where a director misapplies or misappropriates money or properties of the company or has been guilty of breach of trust or misfeasance, the Court may order him to repay the money or restore the property to pay compensation.

Violation of mandatory provisions of the Companies Act: The Madras High Court in Farouk Jain V BIFR199 has held that where violation of statutory provisions including mandatory provisions takes place, the discretionary powers of the court under section 633 cannot be exercised in favour of the defaulters. T.K. Seshadri V ROC200 however when no material is on record to show that the person i.e., directors against whom prosecution has been launched were incharge of day–today affairs of the company or were in the know of the default, they should be relieved from the prosecution under section 633 – specially when prosecution was not launched against all concerned.

196 Supra note 1 pg. 584
197 [2007] 76 SCL 128 (Raj)
198 AIR 1971 SC 829
199 [2002] 38 SCL 95
200 [2004] 54 SCL 118 (Mad.)
2. Liability to third parties:

The discussion on liabilities of directors towards third parties may be grouped as under:

1. Liability under the provisions of the Companies Act, 1956
2. Liability for breach of warranty of authority.

1) Liability under the Companies Act:

The directors shall be personally liable to the third parties, inter alia, under the following provisions of the Companies Act 1956:

(i) Prospectus

Failure to state any particulars as per the requirements of section 56 and Schedule II of the Act or mis-statement of facts in a prospectus renders a director liable for damages to the third party. Section 62 provides that a director shall be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damages he may have sustained by reason of any untrue or misleading statement included therein. He may, however, escape liability where he proves his innocence.

(ii) With regard to allotment

Directors may also incur personal liability for:

(a) Irregular allotment, i.e., allotment before minimum subscription is received (Section 69), or without filing a copy of the statement in lieu of prospectus (Section 70)- [Section 71 (3)] – Under section 71 (3) , if any director of a company knowingly contravenes or wilfully authorises or permits the contravention of any of the provisions of section 69 or 70 with respect to allotment, he shall be liable to compensate the company and the allottee respectively for any loss, damages or costs which the company or the allottee may have sustained or incurred thereby. However, proceedings to recover any such loss, damages or costs must be commenced before the expiry of two years from the date of the allotment.
(b) **For failure to repay application monies in case of minimum subscription having not been received:** Under section 69 (5) in case monies are not repaid within 130 days from the date of the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of six percent per annum from the expiry of 130th day. However, a director shall not be so liable if he proves that the default in repayment of money was not due to any misconduct or negligence on his part.\(^{201}\)

(c) **For failure to repay application monies when application for listing of securities is not made or is refused:** Under section 73(2) where the permission for listing of the shares of a company has not been applied or such permission having been applied for, has not been granted, the company shall forthwith repay without interest all monies received from applicants in pursuance of the prospectus, and, if any such money is not repaid within eight days after the company becomes liable to repay, the company and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at such rate, not less than four percent and not more than fifteen percent, as may be prescribed, having regard to the length of the period of delay in making the repayment of such money (presently fifteen percent straight).

**(iii) Unlimited Liability**

Directors will also be held personally liable to the third parties where their liability is made unlimited in pursuance of section 322 i.e., vide Memorandum or section 323 i.e., vide alterations of Memorandum by passing special resolution. By virtue of section 322, the Memorandum of a company may make the liability of any or all directors, or manager unlimited. In that case, the directors, manager and the member who proposes a person for appointment as director or manager must add to the proposal for appointment a statement that the liability of the person holding the office will be unlimited. Notice in writing to the effect that the liability of the person will be unlimited must be given to him by the following or one of the

\(^{201}\) Supra note 1 pg. 585
following persons, namely, the promoters, the directors, the managers and officers of the company before he accepts the appointment.

Further, in case of a limited liability company, the company may, if authorised by its articles, by passing special resolution alter its Memorandum so as to render the liability of its directors or of any director or manager unlimited. But the alteration making the liability of the director or directors or manager unlimited will be effective only if the concerned officer consents to his liability being made unlimited. This alteration also, unless specifically consented to by any or all the directors will not have any effect until the expiry of the current term of office.

(iv) Fraudulent trading

Directors may also be made personally liable for the debts or liabilities of a company by an order of the Court i.e., now tribunal under section 542. Such an order shall be made by the Court i.e., now tribunal where the directors have been found guilty of fraudulent trading. Section 542(1), in this regard, provides that if in the course of the winding up of a company, it appears that any business of the company has been carried on, with intent to defraud creditors of the company or any other person, or of any fraudulent purpose, the Court i.e., now Tribunal, on the application of the Official Liquidator, or the liquidator or any creditor or contributory of the company, may if it thinks it proper so to do, declare that any persons who were knowingly parties to the carrying on business in the manner aforesaid shall be personally responsible without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court i.e., now Tribunal may direct.

Further, sub-section (3) of section 542 provides that every person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to fifty thousand rupees, or with both. 202

2) Liability for breach of warranty

Directors are supposed to function within the scope of their authority. Thus, where they transact any business in respect of matters, ultra vires the

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202 Supra note 1 pg. 586
company or ultra vires the articles, they may be proceeded against personally for any loss sustained by any third party. 203

3) Liability for breach of statutory duties

The Companies Act, 1956 imposes numerous statutory duties on the directors under various sections of the Act. Default in compliance of these duties attract penal consequences. The various statutory penalties with directors may incur by reason of non-compliance with the requirements of the Companies Act are referred to in their appropriate places.

4) Liabilities for acts of co-directors

A director is the agent of the company except for matters to be dealt with by the company in general meeting and not of the other members of the Board. Accordingly, nothing done by the Board can impose liability on a director who did not participate in the Board’s action or did not know about it. To incur liability he must either be a party to the wrongful act or later acquiesce i.e., consent to it. In case of Dovey V. Cory 204 held, the absence of a director from meeting of the Board does not make him liable for the fraudulent act of a co-director on the ground that he ought to have discovered the fraud except where he had the knowledge or he was a party to confirm that action.

In case of Ramskill V. Edwards 205 where a director is made liable for the acts of a co-director, he is entitled to contribution from the other directors or co-directors who were a party to the wrongful act. However, where the director seeking contribution alone benefited from the wrongful act, he is not entitled to contribution.

5) Criminal Liability

Apart from civil liability under the Act or under the common law, directors of a company may also incur criminal liability under common law, as well as under the Companies Act, and other statutes. 206

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203 Id at pg. 586-587
204 [1901] AC 477
205 [1885] 31 Ch.D 100
206 Supra note 1 pg. 587
5.4. Powers of Directors

5.4.1 General Powers of the Board of Directors

Sec. 291 subject to the provisions of the Act, the Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do.

However, the Board cannot exercise any power or do any act or thing which is directed or required, whether by the Companies Act or any other Act or by the Memorandum of Association or Articles of the Company or otherwise, to be exercised or done by the company in general meeting.

In exercising the aforesaid powers or doing any of the aforesaid acts or things, the Board will be subject to the provisions contained in that behalf in the Companies Act or any other Act, or in the Memorandum of Association or Articles of the Company, or in any regulations not consistent therewith and duly made there under, including regulations made by the company in general meeting.

Thus, the Board may exercise all powers of the company and can do all such acts and things that the company can do except those which are specifically provided to be exercised or done by the company in a general meeting. But the exercise of such powers of the Board shall be in conformity with the provisions of the Companies Act or any other Act and Memorandum, Articles, and resolutions of the company passed in general meeting.

It is therefore clear that the powers of a company in respect of all matters are to be exercised by the Board of directors except where these are reserved for exercise by company in general meeting.\(^{207}\)

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\(^{207}\) Supra note 1pg. 563
In Nibro Ltd. V. National Insurance Co. Ltd., the Delhi High Court observed as follows:

“**It is well settled that under section 291 except where express provisions is made that the powers of a company in respect of a particular matter are to be exercised by the Company in general meeting; in all other cases the Board of Directors is entitled to exercise all its powers.**”

### 5.4.2 Powers of the individual directors

Section 291 provides for general powers of the Board of Directors. In other words, it is the collective wisdom of the directors which has been conferred the privilege of managing the affairs of the company. However, unless the Act or the articles otherwise provide, the decisions of the Board are required to be the majority decisions only. Individual directors do not have any general powers. They shall have only such powers as are vested in them by the Memorandum or Articles or otherwise by the Board of Directors. Thus, unless a power of institute suit is specifically conferred on a particular director, he has no authority to institute a suit on behalf of the company.

In Shubh Shanti Services Ltd. V. Manjula S. Agarwalla held, any director acting individually has no power to act on behalf of the company in respect of any matter except to the extent to which any power or powers of the Board have been delegated to him by the Board within the limit permitted by the Companies Act or any other law. The position of the Chairman of the Board of directors is not substantially different from an individual director.

A mode or manner of exercise of Board’s power:

Section 292(1) of the Companies Act, 1956 provides that the Board of directors of a company shall exercise the following powers on behalf of the

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208 [1991] 70 Comp. Cas. 388 (Delhi)
209 Id.
210 [2005]60 SCL 280 (SC)
company and it shall do so only by means of resolution passed at meetings of the Board:

(a) The power to make calls on shareholders in respect of money unpaid on their shares;

(aa) The power to buy-back its shares under section 77A,\(^{211}\)

(b) The power to issue debentures;

(c) The power to borrow moneys\(^{212}\) otherwise than on debentures. However, a banking company can borrow from other banking companies or from the Reserve Bank of India, the State Bank of India or any other bank established by or under any Act [Explanation 1 to section 292(1)].

(d) The power to invest funds of the company. This power shall however be subject to the provisions of section 293 and 372A.

(e) The power to make loans. Again this power is subject to the provisions contained in sections 295 and 372A.

The Board may, however, by a resolution passed at a meeting delegate to any committee of directors, managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, a principal officer of its branch, the powers specified in clauses (c), (d) and (e) above on such conditions as the Board may prescribe [first proviso to section 292(1)].

Board’s power to delegate functions under (d) and (e) is restricted to making loans and investments only to/ in non-corporate entities and wholly owned subsidiaries as inter-corporate loans, investments etc. are governed by the specific provisions of section 372A of the Act.

\(^{211}\) As per the Companies (Amendment) Act, 2001.

\(^{212}\) The acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of money on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of moneys or, as the case may be, making of loans by a banking company within the meaning of section 292(1) [second proviso to section 292(1)].
Further, sub-section (5) of section 292 provides that the company in general meeting may impose any restrictions and conditions on the exercise by the Board of any of the powers specified above.

Besides the powers specified in section 292 there are certain other powers also which can be exercised only at the meeting of the Board:

1. The power of filing casual vacancies in the Board [Section 262].
2. Sanctioning of a contract in which a director is interested [Section 297].
3. The power to recommend the rate of dividend to be declared by the company at the Annual General Meeting, subject to the approval by the shareholders.
4. The powers to make political contribution [Section 293A].

In the following cases not only that the powers be exercised at the Board’s meeting but also that every director present and entitled to vote must consent thereto:

1. The power to appoint a person as managing director or manager who is holding either office in another company [sections 316 and 386].
2. The power to give loan to, or invest in any shares of, any other body corporate [section 372A].

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213 Supra note 1 pg. 566
5.4.3 Power of the directors to institute a suit on behalf of the company

In Furruccio Sias V. Jai Manga Ram Mukhi,\(^{214}\) the Court observed that it is a necessary requirement that there be proper authority by resolution of the Board of directors, or there has to be a power of attorney authorising institution of the suit on behalf of the corporation, or there has to be power conferred by the articles of association of a corporation, in a particular officer, to institute suits on behalf of the corporation.

5.4.4 Powers of the Board to institute legal proceedings

In Herbertsons Ltd. V Kishore Rajaram Chhabaria,\(^{215}\) it was held that initiating legal proceedings is within the independent powers of the Board. Further, not only the Act but all other statutes dealing with incorporated companies, whether criminal or civil, always recognise the Board of Directors as one responsible for conducting the affairs of a company. Therefore, as a general proposition, majority shareholders cannot impugn the decision of the Board of institute judicial proceedings.

Restrictions on powers of directors: Section 293 of the Companies Act, 1956 provides that the Board of Directors of a public company or a private company which is subsidiary of a public company cannot exercise the following powers without the consent of all the shareholders in general meeting:

1. Sell, lease or otherwise dispose of the whole, substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole or substantially the whole, of any such undertaking.

2. Remit or give time for the repayment of any debt due by a director except in the case of renewal or of continuance of an advance made by a banking company to its directors in the ordinary course of business.

\(^{214}\) [1998] 93 Comp. Cas.750 (Delhi)

\(^{215}\) [1999] 97 Comp. Cas. 429 (CLB-New Delhi)
3. Invest, otherwise than in trust securities, the amount of compensation received by the company in respect of compulsory acquisition of any property or fixed assets of the company.

4. Borrow monies exceeding the aggregate of the paid-up capital of the company and its free reserves. ‘Borrowing’ does not include temporary loans\(^{216}\) obtained from the company’s banker in the ordinary course of business.

5. Contribute in any year, to charitable and other funds not directly relating to the business of the company or the welfare of its employees any amount exceeding Rs. 50,000 or five per cent of its average net profits of the last three financial years, whichever is higher.\(^{217}\)

### 5.4.5 Director Identification Number

#### 5.4.5.1 Application for allotment of Director Identification Number

266 A: Every- (a) individual, intending to be appointed as director of a company; or (b) director of a company appointed before the commencement of the Companies (Amendment) Act, 2006, shall make an application for allotment of Director Identification Number to the Central Government in such form, and manner (including electronic form) along with such fee, as may be prescribed: Provided that every director, appointed before the commencement of the Companies (Amendment) Act, 2006, shall make, within sixty days of the commencement of the said Act, such application to the Central Government: Provided further that every applicant, who has made an application under this section for allotment of Director Identification Number, may be appointed as a director in a company, or, hold office as director in a company till such time such applicant has been allotted Director Identification Number.

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\(^{216}\) The expression ‘temporary loans’ means loans repayable on demand or within six months from the date of the loan such as short-term cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character. But, the expression does not include loans raised for the purpose of financing expenditure of capital nature.

\(^{217}\) Supra note 1 pg.567-568
5.4.5.2 Allotment of Director Identification Number

Sec. 266B the Central Government shall, within one month from the receipt of the application under section 266A, allot a Director Identification Number to an applicant, in such manner as may be prescribed.

5.4.5.3 Prohibition to obtain more than one Director Identification Number

266C no individual, who had already been allotted a Director Identification Number under section 266B, shall apply, obtain or possess another Director Identification Number.

5.4.5.4 Obligation of director to intimate Director Identification Number to concerned company or companies

266D every existing director shall, within one month of the receipt of Director Identification Number from the Central Government, intimate his Director Identification Number to the company or all companies wherein he is a director.

5.4.5.5 Obligation of company to inform Director Identification Number to Registrar

266E(1) Every company shall, within one week of the receipt of intimation under section 266D, furnish the Director Identification Number of all its directors to the Registrar or any other officer or authority as may be specified by the Central Government. (2) Every intimation under sub-section (1) shall be furnished in such form and manner as may be prescribed.
5.4.5.6 Obligation to indicate Director Identification Number

266F every person or company, while furnishing any return, information or particulars as are required to be furnished under this Act, shall quote the Director Identification Number in such return, information or particulars in case such return, information or particulars relate to the director or contain any reference of the director.

5.4.5.7 Penalty for contravention of provisions of section 266A or section 266C or section 266D or section 266E [266G]

If any individual or director, referred to in section 266A or section 266C or section 266D or a company referred to in section 266E, contravenes any of the provisions of those sections, every such individual or director or the company, as the case may be, who or which, is in default, shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which the contravention continues.

Explanation. For the purposes of sections 266A, 266B, 266C, 266D, 266E and 266F, the Director Identification Number means an identification number which the Central Government may allot to any individual, intending to be appointed as director or to any existing directors of a company, for the purpose of his identification as such.218

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5.5. Register of Directors

The first important register to be maintained is known as the Register of Directors. Every Company has to keep at its registered office a register of its Directors, managing director, managing agents, secretaries and treasurers, manager and secretary. The register is to contain the following particulars:

1. The full name of the director etc. with father’s name and address; if a married woman, her husband’s name; nationality of origin; his business or other occupations; particulars of any office held by him in any country; his date of birth

2. In case any of the above offices is held by a body corporate, its corporate name and registered office and the details specified in clause (1) (above) of each of its directors; if the same body corporate holds office in some other companies the particulars of each such office.

3. In case any of the above offices is held by a firm, the name of the firm should be given and also the details specified in clause (1) (above) of each partner in the firm; and if the firm hold office in other companies, the particulars of each such office.

4. If any directors have been nominated by a body corporate, the name of such company should be given and the particulars of each of its directors.

5. If any directors have been nominated by a firm, the particulars of such firm should be given.

A duplicate copy in the prescribed form of the contents of the register should be sent to the Registrar within thirty days of the appointment of first directors. When any change occurs in the managerial personnel a notification of the change should be sent within thirty days from the date of the change.

Shareholders have the right to inspect the register without any charge and any member of the public on payment of one rupee for each inspection. The articles or general meeting of shareholders may impose reasonable restrictions on hours of inspection, but they should not be less than two on each day.

Directors have also been obliged at the pain of penalty to inform the company of any change that occurs in their position and which ought to be specified in the register.
The Registrar of Companies is also under an obligation to maintain register for recording information in this respect received from different companies. Such register is also open to public inspection on the payment of prescribed fees.

5.6 Register of director’s shareholdings

Sec. 307 again for information of shareholders and general public, companies are required to maintain a register of the director’s shareholding. The number of shares or debentures held by each director should be specified showing also his holdings in the company’s subsidiaries and the company’s holding company and other subsidiaries of the same holding company. The register must also give details of the shares held “in trust for him or of which he has any right to become the holder on payment or not.” A director may, however, insist that the nature and extent of his interest over the shares should also be recorded. Where by reason of any transaction entered into by a director, any shares or debentures have to be recorded in the register or omitted from it. The register must show the date of and consideration for the transaction.

The register is open to the inspection of members subject to reasonable restrictions which may be imposed by the company. But during the period of fourteen days before and three days after an annual general meeting the register must remain open to the inspection of shareholders during any business hours not less than two hours in each day. Where the right of inspection is not allowed, the Central Government or Tribunal may by order compel an immediate inspection of the register.

For the purpose of this section the word “director” would include any person in accordance with whose directions the company’s board is accustomed to act, and also any other company whose board is accustomed to act accordingly to the directions of a director, or if such director holds one-third of the voting strength in that company. Entries in the register have also to be made about the shareholding of managing agents, secretaries and treasurers and managers, if the company has any. Directors are obliged to make necessary disclosures to enable the company to prepare the register.
5.7 Register of contracts, companies and firms in which directors are interested

Sec. 301: A company has also to maintain a register of such contracts in which a director is interested and of contracts with such companies or firms in which a director is interested. This register is to contain the particulars regarding the date of the contract, the names of the parties, important terms and conditions of the contract, the date on which it was put before the board and the names of directors who were neutral or voted for or against the contract.\(^{219}\)

5.8 Loans to Directors

Section 295 provides that, without obtaining prior approval of the Central Government, a company (hereinafter referred as ‘lending company’ for the purposes of section 295) cannot give, directly or indirectly, any loan given any guarantee or provide any security for any loan taken or given by:

(a) Any director of the lending company or of a company which is it holding company or any partner or relative of such director;
(b) Any firm in which any such director or relative is a partner;
(c) Any private company of which any such director is a director or member;
(d) Anybody corporate at a general meeting of which does not less than twenty-five percent of the total voting power may be exercised or controlled by any such director, or by two or more such directors together, or
(e) Anybody corporate, the Board of Directors, managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors of the lending company.

Exemptions- Above restrictions, however, do not apply to any loan made, guarantee given or security provided by:

\(^{219}\) Supra note 2 pg. 344-346
i. a private company (unless it is subsidiary of a public company);
ii. a banking company;
iii. a holding company in respect of any loan given by it to its subsidiary or any guarantee given or security provided by a holding company in respect of any loan given to subsidiary;
iv. leasing or hire purchase transaction, as the same is not a loan; and
v. loans and advances to a trust in which one or more directors are trustees.\textsuperscript{220}

In case of Re Bank of Commerce Ltd.\textsuperscript{221} held, there is no prohibition against a banking company lending money to concerns of which a director of the bank is also a director.

5.9 Position of Promoter, Directors and Independent Directors in Companies Act 2013

5.9.1 Promoter

Sec.2 (69) “Promoter” means a person-

(a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
(b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity;\textsuperscript{222}

\textsuperscript{220} Supra note 1 pg. 590
\textsuperscript{221} [1947] C.W.N 662
\textsuperscript{222} http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf pg. 9 (last visited 12\textsuperscript{th} Jan 14)
5.9.2 Manner of selection of independent directors and maintenance of databank of independent directors

Sec. 150  (1) Subject to the provisions contained in sub-section (5) of section 149, an independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors, maintained by anybody, institute or association, as may be notified by the Central Government, having expertise in creation and maintenance of such data bank and put on their website for the use by the company making the appointment of such directors:
Provided that responsibility of exercising due diligence before selecting a person from the data bank referred to above, as an independent director shall lie with the company making such appointment.

(2) The appointment of independent director shall be approved by the company in general meeting as provided in sub-section (2) of section 152 and the explanatory statement annexed to the notice of the general meeting called to consider the said appointment shall indicate the justification for choosing the appointee for appointment as independent director.

(3) The data bank referred to in sub-section (1), shall create and maintain data of persons willing to act as independent director in accordance with such rules as may be prescribed.

(4) The Central Government may prescribe the manner and procedure of selection of independent directors who fulfil the qualifications and requirements specified under section 149.
5.9.3 Appointment of director elected by Small shareholders

Sec. 151 a listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

Explanation.—for the purposes of this section “small shareholders” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

5.9.4 Appointment of directors

Sec. 152 (1) Where no provision is made in the articles of a company for the appointment of the first director, the subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed and in case of a One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section.

(2) Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting.

(3) No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number under section 154.

(4) Every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number and a declaration that he is not disqualified to become a director under this Act.

(5) A person appointed as a director shall not act as a director unless he gives his consent to hold the office as director and such consent has been filed with the Registrar within thirty days of his appointment in such manner as may be prescribed:

Provided that in the case of appointment of an independent director in the general meeting, an explanatory statement for such appointment, annexed to the
notice for the general meeting, shall include a statement that in the opinion of the Board, he
fulfils the conditions specified in this Act for such an appointment.

(6) (a) Unless the articles provide for the retirement of all directors at every annual
general meeting, not less than two-thirds of the total number of directors of a
public company shall—

(i) be persons whose period of office is liable to determination by retirement of
directors by rotation; and

(ii) save as otherwise expressly provided in this Act, be appointed by the
company in general meeting.

(b) The remaining directors in the case of any such company shall, in default of,
and subject to any regulations in the articles of the company, also be appointed by
the company in general meeting.

(c) At the first annual general meeting of a public company held next after the date
of the general meeting at which the first directors are appointed in accordance with
clauses (a) and (b) and at every subsequent annual general meeting, one-third of
such of the directors for the time being as are liable to retire by rotation, or if their
number is neither three nor a multiple of three, then, the number nearest to one-
third, shall retire from office.

(d) The directors to retire by rotation at every annual general meeting shall be
those who have been longest in office since their last appointment, but as between
persons who became directors on the same day, those who are to retire shall, in
default of and subject to any agreement among themselves, be determined by lot.

(e) At the annual general meeting at which a director retires as aforesaid, the
company may fill up the vacancy by appointing the retiring director or some other
person thereto.

Explanation.—For the purposes of this sub-section, “total number of directors”
shall not include independent directors, whether appointed under this Act or any
other law for the time being in force, on the Board of a company.

(7) (a) If the vacancy of the retiring director is not so filled-up and the meeting has
not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till
the same day in the next week, at the same time and place, or if that day is a
national holiday, till the next succeeding day which is not a holiday, at the same
time and place.

(b) If at the adjourned meeting also, the vacancy of the retiring director is not
filled up and that meeting also has not expressly resolved not to fill the vacancy,
the retiring director shall be deemed to have been re-appointed at the adjourned
meeting, unless—

(i) at that meeting or at the previous meeting a resolution for the re-appointment of
such director has been put to the meeting and lost;

(ii) the retiring director has, by a notice in writing addressed to the company or its
Board of directors, expressed his unwillingness to be so re-appointed;

(iii) he is not qualified or is disqualified for appointment;

(iv) a resolution, whether special or ordinary, is required for his appointment or re-
appointment by virtue of any provisions of this Act; or

(v) section 162 is applicable to the case.

Explanation.—For the purposes of this section and section 160, the expression
“retiring director” means a director retiring by rotation. 223

5.9.5 Application for allotment of Director Identification Number

Sec.153: Every individual intending to be appointed as director of a
company shall make an application for allotment of Director Identification
Number to the Central Government in such form and manner and along with such
fees as may be prescribed.

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5.9.6 Allotment of Director Identification Number

Sec. 154: The Central Government shall, within one month from the receipt of the application under section 153, allot a Director Identification Number to an applicant in such manner as may be prescribed.

5.9.7 Prohibition to obtain more than one Director Identification Number

Sec. 155: No individual, who has already been allotted a Director Identification Number under section 154, shall apply for, obtain or possess another Director Identification Number.

5.9.8 Director to intimate Director Identification Number

Sec. 156: Every existing director shall, within one month of the receipt of Director Identification Number from the Central Government, intimate his Director Identification Number to the company or all companies wherein he is a director.

5.9.9 Company to inform Director Identification Number to Registrar

Sec. 157 (1) Every company shall, within fifteen days of the receipt of intimation under section 156, furnish the Director Identification Number of all its directors to the Registrar or any other officer or authority as may be specified by the Central Government with such fees as may be prescribed or with such additional fees as may be prescribed within the time specified under section 403 and every such intimation shall be furnished in such form and manner as may be prescribed.

(2) If a company fails to furnish Director Identification Number under sub-section (1), before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees and every officer of the
company who is in default shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

**5.9.10 Obligation to indicate Director Identification Number**

Sec.158: Every person or company, while furnishing any return, information or particulars as are required to be furnished under this Act, shall mention the Director Identification Number in such return, information or particulars in case such return, information or particulars relate to the director or contain any reference of any director.

**5.9.11 Punishment for contravention**

Sec. 159: If any individual or director of a company, contravenes any of the provisions of section 152, section 155 and section 156, such individual or director of the company shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to fifty thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which the contravention continues.
5.9.12. Right of persons other than retiring directors to stand for directorship

Sec. 160 (1) A person who is not a retiring director in terms of section 152 shall, subject to the provisions of this Act, be eligible for appointment to the office of a director at any general meeting, if he, or some member intending to propose him as a director, has, not less than fourteen days before the meeting, left at the registered office of the company, a notice in writing under his hand signifying his candidature as a director or, as the case may be, the intention of such member to propose him as a candidate for that office, along with the deposit of one lakh rupees or such higher amount as may be prescribed which shall be refunded to such person or, as the case may be, to the member, if the person proposed gets elected as a director or gets more than twenty-five per cent. of total valid votes cast either on show of hands or on poll on such resolution.

(2) The company shall inform its members of the candidature of a person for the office of director under sub-section (1) in such manner as may be prescribed.

5.9.13 Appointment of additional director, alternate director and nominee director

Sec. 161 (1) The articles of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director in a general meeting, as an additional director at any time who shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

(2) The Board of Directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint a person, not being a person holding any alternate directorship for any other director in the company, to act as an alternate director for a director during his absence for a period of not less than three months from India:
Provided that no person shall be appointed as an alternate director for an independent director unless he is qualified to be appointed as an independent director under the provisions of this Act:

Provided further that an alternate director shall not hold office for a period longer than that permissible to the director in whose place he has been appointed and shall vacate the office if and when the director in whose place he has been appointed returns to India:

Provided also that if the term of office of the original director is determined before he so returns to India, any provision for the automatic re-appointment of retiring directors in default of another appointment shall apply to the original, and not to the alternate director.

(3) Subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company.

(4) In the case of a public company, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board:

Provided that any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.²²⁴

5.9.14 Appointment of directors to be voted individually

Sec. 162 (1) At a general meeting of a company, a motion for the appointment of two or more persons as directors of the company by a single resolution shall not be moved unless a proposal to move such a motion has first been agreed to at the meeting without any vote being cast against it.

(2) A resolution moved in contravention of sub-section (1) shall be void, whether or not any objection was taken when it was moved.

(3) A motion for approving a person for appointment, or for nominating a person for appointment as a director, shall be treated as a motion for his appointment.

5.9.15 Option to adopt principle of proportional representation for appointment of directors

Sec. 163: Notwithstanding anything contained in this Act, the articles of a company may provide for the appointment of not less than two-thirds of the total number of the directors of a company in accordance with the principle of proportional representation, whether by the single transferable vote or by a system of cumulative voting or otherwise and such appointments may be made once in every three years and casual vacancies of such directors shall be filled as provided in sub-section (4) of section 161.

5.9.16 Disqualifications for appointment of director

Sec.164 (1) A person shall not be eligible for appointment as a director of a company, if —

(a) he is of unsound mind and stands so declared by a competent court;

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to
imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence:

Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company:

(e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

(f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;

(g) he has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years; or

(h) he has not complied with sub-section (3) of section 152.

(2) No person who is or has been a director of a company which—

(a) has not filed financial statements or annual returns for any continuous period of three financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

(3) A private company may by its articles provide for any disqualifications for appointment as a director in addition to those specified in sub-sections (1) and (2):

Provided that the disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) shall not take effect—

(i) for thirty days from the date of conviction or order of disqualification;

(ii) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed off; or
(iii) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed off.

5.9.17 Number of directorships

Sec. 165 (1) No person, after the commencement of this Act, shall hold office as a director, including any alternate directorship, in more than twenty companies at the same time:
Provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten.

Explanation.—For reckoning the limit of public companies in which a person can be appointed as director, directorship in private companies that are either holding or subsidiary company of a public company shall be included.

(2) Subject to the provisions of sub-section (1), the members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as directors.

(3) Any person holding office as director in companies more than the limits as specified in sub-section (1), immediately before the commencement of this Act shall, within a period of one year from such commencement,—

(a) choose not more than the specified limit of those companies, as companies in which he wishes to continue to hold the office of director;
(b) resign his office as director in the other remaining companies; and
(c) intimate the choice made by him under clause (a), to each of the companies in which he was holding the office of director before such commencement and to the Registrar having jurisdiction in respect of each such company.

(4) Any resignation made in pursuance of clause (b) of sub-section (3) shall become effective immediately on the despatch thereof to the company concerned.

(5) No such person shall act as director in more than the specified number of companies,—
(a) after despatching the resignation of his office as director or non-
executive director thereof, in pursuance of clause (b) of sub-section (3); or
(b) after the expiry of one year from the commencement of this Act,
whichever is earlier.

(6) If a person accepts an appointment as a director in contravention of sub-section
(1), he shall be punishable with fine which shall not be less than five thousand
rupees but which may extend to twenty-five thousand rupees for every day after
the first during which the contravention continues.²²⁵

5.9.18 Duties of directors

Sec.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, and 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 assignment 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.

5.9.19 Vacation of office of director

Sec. 167(1) The office of a director shall become vacant in case—

(a) he incurs any of the disqualifications specified in section 164;
(b) he absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board;
(c) he acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;
(d) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184;
(e) he becomes disqualified by an order of a court or the Tribunal;
(f) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months:

Provided that the office shall be vacated by the director even if he has filed an appeal against the order of such court;

(g) he is removed in pursuance of the provisions of this Act;

(h) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

(2) If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified in subsection(1), he shall be punishable with imprisonment for a term
which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

(3) Where all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

(4) A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified in sub-section (1).

5.9.20 Resignation of director

Sec.168 (1) A director may resign from his office by giving a notice in writing to the company and the Board shall on receipt of such notice take note of the same and the company shall intimate the Registrar in such manner, within such time and in such form as may be prescribed and shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company:

Provided that a director shall also forward a copy of his resignation along with detailed reasons for the resignation to the Registrar within thirty days of resignation in such manner as may be prescribed.

(2) The resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later:

Provided that the director who has resigned shall be liable even after his resignation for the offences which occurred during his tenure.

(3) Where all the directors of a company resign from their offices, or vacate their offices under section 167, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in general meeting.
5.9.21 Removal of directors

Sec. 169 (1) A company may, by ordinary resolution, remove a director, not being a director appointed by the Tribunal under section 242, before the expiry of the period of his office after giving him a reasonable opportunity of being heard:

Provided that nothing contained in this sub-section shall apply where the company has availed itself of the option given to it under section 163 to appoint not less than two thirds of the total number of directors according to the principle of proportional representation.

(2) A special notice shall be required of any resolution, to remove a director under this section, or to appoint somebody in place of a director so removed, at the meeting at which he is removed.

(3) On receipt of notice of a resolution to remove a director under this section, the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting.

(4) Where notice has been given of a resolution to remove a director under this section and the director concerned makes with respect thereto representation in writing to the company and requests its notification to members of the company, the company shall, if the time permits it to do so,—

(a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and

(b) send a copy of the representation to every member of the company to whom notice of the meeting is sent (whether before or after receipt of the representation by the company), and if a copy of the representation is not sent as aforesaid due to insufficient time or for the company’s default, the director may without prejudice to his right to be heard orally require that the representation shall be read out at the meeting:

Provided that copy of the representation need not be sent out and the representation need not be read out at the meeting if, on the application either of the company or of any other person who claims to be aggrieved, the Tribunal is
satisfied that the rights conferred by this sub-section are being abused to secure needless publicity for defamatory matter; and the Tribunal may order the company’s costs on the application to be paid in whole or in part by the director notwithstanding that he is not a party to it.

(5) A vacancy created by the removal of a director under this section may, if he had been appointed by the company in general meeting or by the Board, be filled by the appointment of another director in his place at the meeting at which he is removed, provided special notice of the intended appointment has been given under sub-section (2).

(6) A director so appointed shall hold office till the date up to which his predecessor would have held office if he had not been removed.

(7) If the vacancy is not filled under sub-section (5), it may be filled as a casual vacancy in accordance with the provisions of this Act:

Provided that the director who was removed from office shall not be re-appointed as a director by the Board of Directors.

(8) Nothing in this section shall be taken—

   (a) as depriving a person removed under this section of any compensation or damages payable to him in respect of the termination of his appointment as director as per the terms of contract or terms of his appointment as director, or of any other appointment terminating with that as director; or
   (b) as derogating from any power to remove a director under other provisions of this Act.
5.9.22 Register of directors and key managerial personnel and their shareholding

Sec.170 (1) Every company shall keep at its registered office a register containing such particulars of its directors and key managerial personnel as may be prescribed, which shall include the details of securities held by each of them in the company or its holding, subsidiary, subsidiary of company’s holding company or associate companies.

(2) A return containing such particulars and documents as may be prescribed, of the directors and the key managerial personnel shall be filed with the Registrar within thirty days from the appointment of every director and key managerial personnel, as the case may be, and within thirty days of any change taking place.

5.9.23 Members’ right to inspect

Sec.171 (1) The register kept under sub-section (1) of section 170,—

(a) shall be open for inspection during business hours and the members shall have a right to take extracts there from and copies thereof, on a request by the members, be provided to them free of cost within thirty days; and

(b) shall also be kept open for inspection at every annual general meeting of the company and shall be made accessible to any person attending the meeting.

(2) If any inspection as provided in clause (a) of sub-section (1) is refused, or if any copy required under that clause is not sent within thirty days from the date of receipt of such request, the Registrar shall on an application made to him order immediate inspection and supply of copies required there under.
5.9.24 Punishment

Sec. 172: If a company contravenes any of the provisions of this Chapter and for which no specific punishment is provided therein, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.\textsuperscript{226}

\textsuperscript{226} http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf pg 98-102 (last visited on 12th Jan, 14)
5.10 Duties Prescribed in Clause 49 of Listing Agreement

Clause 49 sets out some duties for directors, including reviewing company efforts to comply with all applicable laws and laying down a general code of conduct. However, Clause 49 imposes the most specific requirements for independent directors who also serve on the audit committee. Specific duties for audit committee members include overseeing the financial reporting process, matters related to the appointment of the statutory auditor, reviewing financial statements with management before submitting them to the board, reviewing the internal control systems, reviewing internal investigations on suspected fraud, reviewing the whistle blower mechanism (if any), reviewing disclosure on use of proceeds from public issuance of securities, reviewing disclosures on related party transactions, and other related matters. The aforementioned is not intended to be an exhaustive list of independent directors’ responsibilities, but simply an indication of the breadth of their tasks.

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228 See, Clause 49, Article II (D), Article IV (A) & (D) of the Listing Agreement.
5.11 Liabilities

Violations of Clause 49 could result in the de-listing of the firm under the Stock Exchange Listing Agreement. Moreover, violations of the listing agreements could generate both financial penalties imposed by government and criminal sanctions for directors under the Securities Contract (Regulation) Act 1956.

Although not yet imposed on any directors in India, the prospect of these higher sanctions is likely to serve as a signal that more serious enforcement is an increasing possibility.229

Outside of Clause 49, there are a number of provisions that can be used to impose liability on directors. These include provisions targeted at directors and other general provisions for which directors may be prosecuted or otherwise pursued (this is not meant to be an exhaustive list):

1. The Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003, contains various prohibitions on manipulative, fraudulent and unfair trade practices in securities (section 4), and a prohibition on dealing in securities in a fraudulent manner or using any manipulative or deceptive device (or scheme to defraud or deceit, etc.) in connection with the purchase or sale of securities (section 3).


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230 Both the Securities Contract (Regulation) Act, 1956 [Hereinafter “SCR Act”] and the Securities and Exchange Board of India Act, 1992 [Hereinafter “SEBI Act”] also provide for penalties when firms fail to address investor grievances sent to them by SEBI or a stock exchange (§ 23C, the SCR Act and § 15C, the SEBI Act).
3. Sections 62 and 63 of the Indian Companies Act, 1956, could hold directors liable for certain misstatements in a prospectus to raise capital. There are also sanctions that SEBI can impose for similar behavior under the Takeover Code.231

4. Provisions of the Indian Penal Code (IPC) that cover breach of trust (section 406) and theft and cheating (section 420).

A number of the above can be criminal violations and hence may trigger arrests and, potentially, convictions for directors. However, private rights of action for securities fraud are not presently available in India.232

While Indian statues and regulatory bodies have relatively clear mandate for executive directors as such, what is expected of the independent directors still remains vague. Consequently there exists a possibility of independent directors falling within the broader ambit of liabilities prescribed under several regulatory and related statutes but they are not told in first place what breaches will hold them accountable. For this purpose it may be worthwhile on how US judiciary has been reading and interpreting duties of independent directors and this may prove to be helpful to extend similar duties to directors in India.

231 See, § 45(5) and 45(6), SEC. and Exch. Bd. of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (SEBI Takeover Code).
### 5.12 Comparison between appointment and qualification of directors

The comparison between appointment and qualification of directors are:

<table>
<thead>
<tr>
<th>Points of Comparison</th>
<th>Companies Act, 2013</th>
<th>Companies Act, 1956</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td><strong>Appointment of Directors</strong></td>
<td></td>
<td></td>
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<tr>
<td><strong>Compulsory appointment of woman director</strong></td>
<td>Such class or classes of companies as may be prescribed shall have a woman director.</td>
<td>No such requirement in the 1956 Act.</td>
</tr>
<tr>
<td><strong>At least 1 director who stayed in India for 182 days or more</strong></td>
<td>Every company shall have at least one of the directors who has stayed in India for 182 days or more in the previous calendar year.</td>
<td>No such requirement in the 1956 Act.</td>
</tr>
<tr>
<td><strong>Independent Director</strong></td>
<td>Listed public company shall have at least one-third of the total number of directors as independent directors. The Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies. An independent director shall not be entitled to stock options. He shall not be entitled to any remuneration other than sitting fees,</td>
<td>No such requirement in the 1956 Act.</td>
</tr>
</tbody>
</table>

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233 A Comparative Study of Companies Act 2013 & Companies Act 1956 by Taxmann’s – The Institute of Companies Secretaries of India See pg.3.86-3.93, Sections 149 to 172 of the 2013 Act/ Corresponding to Sections 202, 252 to 257, 260, 262 to 266G, 274 to 276, 278, 279,283, 284,303,304,307,312,313,and 388 of the 1956 Act
<table>
<thead>
<tr>
<th><strong>reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maximum number of directors</strong></td>
</tr>
<tr>
<td><strong>Limitation of liability of non-executive directors and independent directors</strong></td>
</tr>
<tr>
<td><strong>No such requirement for private company.</strong></td>
</tr>
<tr>
<td><strong>No such provisions in the 1956 Act.</strong></td>
</tr>
<tr>
<td><strong>Declaration by person proposed to be appointed as director</strong></td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td><strong>Board’s opinion as to whether IDs fulfil the conditions specified for appointment as IDs</strong></td>
</tr>
<tr>
<td><strong>Determining the 2/3rds of directors of public company liable to retire by rotation</strong></td>
</tr>
<tr>
<td><strong>Time limit for furnishing DIN to ROC</strong></td>
</tr>
</tbody>
</table>
| Rights of person other than retiring directors to stand for directorship | • Section 160 of the 2013 Act applies to all companies  
• Section 160 provides for refund of deposit even if candidate gets more than 25% of total votes cast.  
• Under section 160 deposit is Rs. 1,00,000 or such higher amount prescribed under the Rules. | • Section 257 of the 1956 Act was applicable only to public companies  
• Section 257 provided for refund of deposit only if candidate got elected as a director.  
• The deposit under section 257 was Rs. 500. |
|---|---|---|
| Alternate Directors | • Section 161 of the 2013 Act provides that Board of Directors, may, appoint a person, to act as an alternate director for a director during his absence from India for a period of not less than three months.  
• Section 161 requires that person appointed as alternate director should not be a person holding any alternate directorship for any other director in the company. The 1956 Act contained no such requirement. | • Section 313 of the 1956 Act empowered the Board of Directors to appoint a person, to act as an alternate director for a director (‘the original director’) during his absence for a period of not less than three months from the State in which meetings of the Board are ordinarily held. |
<p>| <strong>Nominee Directors</strong> | Section 161 of the 2013 Act provides that subject to the articles, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement by the Central Government or State Government by virtue of its shareholding in a Government Company. | No such provisions in the 1956 Act. |
| <strong>Additional Director</strong> | Section 161(1) of the 2013 Act provides that the Board of Directors shall not appoint a person who fails to get appointed as a director in a general meeting as an additional director | No such provision. |</p>
<table>
<thead>
<tr>
<th>Appointment of directors to be voted individually</th>
<th>Disqualification of Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Section 162 of 2013 Act applies to all companies</td>
<td>▪ The 2013 Act permanently debars from directorship of a company any person who is convicted of any offence and sentenced to imprisonment of 7 years or more.</td>
</tr>
<tr>
<td>▪ Section 263 of the 1956 Act provided that where a resolution so moved is passed, no provision for the automatic re-appointment of the director retiring by rotation in default of another appointment shall apply. The 2013 Act omits this provision.</td>
<td>▪ Section 164 of the 2013 Act contains the following two new grounds for disqualifying a person from directorships of companies which were not there in section 274 of the 1956 Act:</td>
</tr>
<tr>
<td>▪ No such provisions in 1956 Act.</td>
<td>a) he has been convicted</td>
</tr>
</tbody>
</table>
of the offence dealing with related party transactions at any time during the last preceding five years;  

b) he has not obtained Director Identification Number.  

| Disqualifications of directors if company commits specified defaults | ▪ Under section 164(2) of the 2013 Act, it does not matter whether the defaulting company is a public company or not.  
▪ Any person who is a director of such a defaulting company shall be disqualified to be reappointed as a director of that company or appointed in other company for a period of five years from the date of the specified default.  

| Under the 1956 Act, a person was disqualified from directorships of he was a director of a defaulting public company which had committed either of the specified defaults. |

| Exclusion of certain directorships for computing limit on maximum directorships | The 2013 Act omits these exclusions. |

| Section 278 of the 1956 Act provided for exclusion of certain directorships for the purpose of computing the limit on number of directorships. |
| Limits on maximum number of directorships | • Maximum number of directorships that an individual can hold including alternate directorships is 20 of which not more than 10 can be public companies.  
• General meeting by special resolution can specify lesser number than 20/10 companies. No such provision in 1956 Act. | • 15 directorships. |

| Duties of Director | Duties of Directors | Spelt out in section 166 of the 2013 based on case laws. | Not spelt out. |

| Vacation of office of director for failing/ceasing to hold share qualification | No longer a ground for vacation of office under the 2013 Act.[It may be noted that provisions related to share qualification in section 270 of the 1956 Act are omitted from the 2013 Act]. | Failure to obtain within the time specified, or at any time thereafter ceasing to hold, the share qualification, if any, required of him by the articles of the company was a ground for vacation of office under the 1956 Act. |
| Vacation of office of director if he absents himself at Board meeting | Section 167 of the 2013 Act provides that if the director absents himself from all the meetings of the Board of Directors held during a period of 12 months with or without seeking leave of absence of the Board, his office shall become vacant.  
Section 167 of the 2013 Act is much more liberal in the sense that it requires director to attend at least one board meeting during a period of 12 months.  
However, section 283 of the 1956 Act authorised the Board to sanction a director’s absence for any period of time which is not possible now under section 167 of the 2013 Act. | Section 283 of the 1956 Act provided that a director’s office shall become vacant if he absents himself from three consecutive meetings of the Board of directors, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board. |
| Where all directors of company vacates their offices | Section 167 of the 2013 Act provides that where all the directors of a company vacates their offices, the promoter or, in his absence, the | The 1956 Act never expressly provides for this situation. |
Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

<table>
<thead>
<tr>
<th>Resignation of Directors</th>
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<tr>
<td><strong>Resignation of Director</strong></td>
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<table>
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<tr>
<th>Register, etc., of Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Return containing such particulars and documents as may be prescribed, of the directors and the key managerial personnel</strong></td>
</tr>
</tbody>
</table>
5.13 Judicial determination of Independent Directors duties

Directors of companies have long been understood to owe duties of care, loyalty, and good faith to the corporation. However when it comes to family run companies it is all together a different ballgame. It is here that position of independent directors in much more precarious the case laws that are being discussed in the paragraphs that follow comprise prime importance for the insider model prevalent in India. This is specifically so because the cases deal with such companies that were belonging to family business.

An interesting instance of Dow Jones sale to News Corp is worth examination. Dow Jones Co., a popular American publishing and financial information firm, publicly traded but privately controlled by the Bancroft family. News Corp. Offered to buy all shares of Dow Jones for $60 per share. During deliberations of the Bancroft family over whether to sell Dow Jones Co. to News Corp., the trustee for a family trust holding 9.1% of the voting power in Dow Jones demanded that News Corp. pay a premium of 10-20% per share for the class of stock held by family members, and if necessary lower to $58 the amount to be paid to public shareholders. Dow Jones’s board indicated that it would not support any deal that treated family shares differently from nonfamily shares, even if no sale were the consequence. This could be stated as a very good example of what and how the board’s conduct ought to be in such family owned companies.

Recently the Delaware Supreme Court was presented with an opportunity to clarify and specify content and character of the duty of good faith in In re The Walt Disney Co. Derivative Litigation. The Delaware court divided the range of directors’ duties into three categories, emphasizing the negative (acting in bad faith) as a way of defining the positive (acting in good faith). Accordingly when the director’s conduct is “motivated by an actual intent to do harm” to the

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235 See Matthew Karnitschnig et al., Bancroft Wrangling Intensifies, WALL ST. J., July 28, 2007
236 In re The Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006).
237 Id.
corporation, it is a conduct in bad faith. This is one end of the range. At the opposite end of the range lies conduct involving only a failure to use due care, “taken solely by reason of gross negligence and without any malevolent intent.”

Thus a negligent conduct is not a conduct in bad faith because statutory provisions differentiate between bad faith and a failure to act with due care. In the middle of the range is conduct that consists of an intentional (as opposed to a careless) disregard of duties or responsibilities, which would, in the court’s assessment, constitute conduct in bad faith.

In Stone v. Ritter, the court held that a failure to act in good faith does not result, “ipso facto, in the direct imposition of fiduciary liability.” Instead, failing to act in good faith may result in liability because the duty to act in good faith is a subsidiary element of a directors’ “fundamental duty of loyalty.” Stone thus makes explicit that a director’s duty of loyalty reaches more widely than transactions with the corporation in which the director has an individual and direct pecuniary interest. It also ties liability under the “good faith” rubric to conduct performed with scienter.

In re Tyson Foods, Inc. Consolidated Shareholder Litigation plaintiffs had alleged improper related party transactions between Tyson and its founder, Don Tyson, and members of his family, as well as procedures by which Tyson’s Board of Directors reviewed related party transactions. The complaint had also alleged misconduct in connection with the granting of stock options to officers and directors of Tyson.

Applying the aforementioned formulations, the court held that directors on Tyson’s compensation committee would have breached their duties of loyalty and good faith if, as alleged, they awarded options knowing the shares to be worth more than the strike price while purporting to make the awards in compliance with

238 Id.
240 Id. at 370 (quoting Guttman v. Huang, 832 A.2d 492, 506 n.34 (Del. Ch. 2003))
241 See Desimone v. Barrows, 924 A.2d 908, 935 (Del. Ch. 2007) (noting that Stone reinforced a “scienter-based standard”).
a stockholder-approved plan requiring options to have a market-value strike price.\textsuperscript{243}

Thus, bad faith may also be presumed when they are in complicity with controlling shareholders in reciprocal patterns of self-dealing. A director acts in bad faith, although the director receives no personal benefit, when the director knowingly deceives the corporation’s shareholders.

One such interesting matter can be witnessed in the recent Hollinger International, Inc. (Hollinger) fraud by its then-controlling shareholder, Conrad M. Black. Hollinger International Inc. (“HII”) is a global newspaper publisher with English-language newspapers in the United States, Great Britain, and Israel. Majority shareholder of HII was Hollinger Inc., a Canadian public company that owned 30.3% of the equity and 72.6% of the voting shares of HII. Hollinger Inc. in turn was held by Ravelston Corporation Limited (RCL) through Argus Corporation Ltd. (Argus). Conrad M Black owned 65% of RCL.\textsuperscript{244} To simplify the holding structure can be elaborated as follows:

\begin{center}
\begin{tikzpicture}[scale=0.8,auto,>=latex, node distance=2cm, every node/.style={align=center}]
    \node[rectangle] (HII) {Hollinger International Inc. (HII)};
    \node[rectangle, above of=HII] (HI) {Hollinger Inc.};
    \node[rectangle, above of=HI] (RCL) {Ravelston Corporation Ltd. (RCL)};
    \node[ellipse, right of=RCL, node distance=4cm] (Black) {Conrad M. Black};

    \draw[->] (RCL) -- (HI);
    \draw[->] (HI) -- (HII);
    \draw[->] (Black) -- (RCL);

\end{tikzpicture}
\end{center}

\textsuperscript{243} The settlement approved by the Delaware court requires extensive changes in Tyson's corporate governance.
\textsuperscript{244} \url{http://www.scribd.com/doc/19822999/HOLLINGER} (last visited on 23 Feb, 2014)
Conrad also served as Hollinger’s chairman and CEO. Conrad’s wife, Barbara Amiel, was a member of Hollinger’s board and its Vice President, Editorial.245 From 1999 through 2003, she received over $1.1 million in salary and bonus payments from Hollinger, but an internal investigation found that she performed “no meaningful work” in return.246 Besides they extractions included excessive cash compensation, undisclosed private side-payments, several other misuse of perquisites.

However what consist interest for purpose of our study is the performance of Hollinger’s board. In a subsequent internal review it was found that Hollinger’s board evidenced “consistent inaction” during the extractive sprees of Conrad and his managerial allies.247 The Audit Committee, which was charged with reviewing the transactions between Ravels ton and Hollinger through which Hollinger paid Ravelston for Conrad’s managerial services, asked no questions about components of the management fees and never inquired about the rationale for the noncompete fees to be paid to Conrad Black and other individual officers.248 Many members of the board had additional ties to the Blacks and to Hollinger that may help explain their quiescence. Some directors socialized with the Blacks,249 while Hollinger made generous donations to cultural and other non-profit organizations associated with several directors.250 The outside director who was a member of the board’s Executive Committee also served as the well-compensated CEO of a Hollinger subsidiary engaged in private equity investing.251

246 Id. at 143-44. The committee’s report characterized her description of her work as a vice-president as “nothing more than euphemisms for ordinary activities such as reading the newspaper, having lunch, and chatting with her husband about current events,” and the salary and bonus as payments she would not have received but for her marriage to Conrad Black. Id. at 145.
247 Supra note 245, at 31.
248 Id. at 32, 35.
249 Id. at 423. Social ties between an outside director and a controlling shareholder do not by themselves rebut the presumption that the director can act independently in assessing claims against the shareholder. Beam ex rel Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1051-52 (Del. 2004).
250 Supra note 245, at 423.
251 Supra note 245 , at 483.
5.14 Conclusion

The case laws discussed above, brings to fore the fact that role of independent directors and standards of independence assumes much more vitality in the context of family firm. It can be observed that even in jurisdictions such as US where outsider model of governance is widespread with family firms forming a marginal group, the problems posed are highly complex.

An independent director’s position is such situation is highly paradoxical because on one hand he/she is expected to maintain an “outsider” stance in terms of the family he runs business and also the overall management and on the other hand such distance may jeopardize the director’s effectiveness, either because the director is excluded from the company’s patterns of information-sharing and decision-making or because the director, perceived as an “outsider,” lacks powers of persuasion. Whatever the complexity of situation, the Delaware courts’ decisions are highly appreciable given the fact that statutory and regulatory mandates may not address such issues.

Especially considering Indian corporate sector scenario and duties and expectations from independent directors therein, Delaware Court’s parameters may have high persuasive value. The next chapter will examine recent family controlled corporate fraud of Satyam and analyse the how independent directors could further evolve themselves. In this process the latest Company Act 2013 will also be analysed to examine whether the framework provided will expand and help independent directors in performing their job effectively.