

# Codification of Directors' Duties: Is Common Law Excluded?

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## Background

Hitherto, directors had negligible guidance under company law as regards their duties and liabilities. The preexisting Companies Act, 1956 (the **1956 Act**) did not explicitly stipulate directors' duties, which made it necessary to fall back on common law principles (to be articulated by courts while delivering specific decisions). The statutory uncertainty was compounded by the absence of significant cases of director duties and liabilities before Indian courts.

This somewhat unsatisfactory situation has been mended in the Companies Act, 2013 (the **2013 Act**), which is rather explicit about directors' duties (somewhat similar to the codification of directors' duties under the UK Companies Act of 2006, section 172). The new provisions not only provide greater certainty to directors regarding their conduct, but also enable the beneficiaries as well as courts and regulators to judge the discharge of directors' duties more objectively.

The duties of directors are set forth in section 166 of the 2013 Act, and are principally as follows:

- To act in accordance with the articles of association of the company;
- To act in good faith to promote the objects of the company;
- To act in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment;
- To exercise duties with due and reasonable care, skill and diligence and to exercise independent judgment;
- To not be involved in a situation of direct or indirect conflict with the interests of the company; and
- To not achieve any undue gain or advantage.

These duties can broadly be classified into two:

- (i) duty of care, skill and diligence; and
- (ii) fiduciary duties.

The duty of care, skill and diligence requires directors to devote the requisite time and attention to affairs of the company, pursue issues that may arise through "red flags" and take decisions that do not expose the company to unnecessary risks. Fiduciary duties, on the other hand, require the directors to put the interests of the company ahead of their own personal interests. Rules that prevent conflict of interest and self-dealing on the part of directors are integral to this set of duties.

Section 166 also provides for the consequences of breach of these duties. Sub-section (5) provides for civil liability that requires a breaching director to return any undue gain or advantage received as a result of such breach. Sub-section (7) is a penal provision that imposes a fine of Rs. 1 lac to Rs. 5 lac (i.e. rupees 0.1 million to 0.5 million) on directors who have contravened the section.

## Comparative Position

The effort to codify directors' duties is not altogether novel, as it has been undertaken in other common law jurisdictions such as the UK and Singapore. However, in one significant respect, the Indian codification exercise is different from the UK and Singapore. Under the 2013 Act in India, there is no provision that reserves the application of common law following codification. Contrastingly, both in the UK and in Singapore, the applicability of common law has been preserved to the extent that it can be utilized to interpret the statutory provisions relating to directors' duties.

The following provisions in the UK Companies Act of 2006 are relevant:

### **Section 170 Scope and nature of general duties**

[...]

(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.

(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.

(emphasis added)

The relevant provision in the Singapore Companies Act (Cap. 50, Rev. Ed. 2006) is as follows:

### **S. 157 As to the duty and liability of officers**

[...]

(4) This section is in addition to and not in derogation of any other written law or rule of law relating to the duty or liability of directors or officers of a company.

In stark contrast, the 2013 Act in India does not carry a similar provision explaining whether the principles of common law are applicable (or excluded) in the interpretation of the directors' duties as codified in common law. This would give rise to an interpretational issue as discussed below. While this issue is somewhat technical in nature from a jurisprudential standpoint, it could turn out to be a reality once cases relating to directors' duties under section 166 of the 2013 Act come up for litigation before the courts.

The legislative history appears to be silent regarding the rationale for the manner in which section 166 has been drafted. Furthermore, this specific issue has also not received the attention of the Parliamentary Standing Committee on Finance that extensively reviewed the Companies Bill prior to its enactment.

### **Issue**

*Whether section 166 of the Companies Act, 2013 is exhaustive regarding duties or company directors, or whether directors are also bound by common law duties (that are either in addition to the statutory duties or that can be used to interpret or explicate the statutory duties)?*

### **Options**

Similar to a [format previously followed on this Blog](#), I propose to refrain from expressing any preferences or stating arguments on this issue. Instead, I set out two possible views along with some rationale for each, and invite readers to post their comments on these or other possible views or arguments on the issue.

Option 1: Section 166 is exhaustive of directors' duties and is a complete code.

According to this view, the codification exercise is exhaustive, and directors' duties must be determined solely by the language of the statutory provision. It leaves no room for the application of common law.

This option emerges from a plain and simple textual interpretation. It is also consistent with the objective of codification, which is to introduce certainty and clarity. If directors are nevertheless subjected to common law principles, the codification exercise might be rendered redundant (at least partially). Moreover, unlike the company law statutes in countries such as the UK and Singapore, there is no express provision that preserves the use of common law either in addition to the statutory duties or by way of an aid to interpret the statutory provisions.

*Option 2: Section 166 is only a partial codification of directors' duties, and the principles of common law are preserved through implication and operate in addition to the statutory provisions or to at least aid in their interpretation.*

In this dispensation, the codification in the 2013 Act is incomplete as the statutory provisions lay down only the broad and basic principles, and do not provide the details as to how the duties must be discharged by the directors. Moreover, it is not possible for the statute to envisage all possible situations in which directors must discharge their duties and also the manner in which they are to do so. Those details are to be determined by the courts based on the facts and circumstances of each case, which is where common law comes into the picture.

Furthermore, if common law were not resorted to, the remedies would be inadequate as well apart from the substantive duties themselves. For example, Mihir has elaborately discussed in an [earlier post](#), the statutory remedy for breach of directors' duties is only a return of profits or undue gains. This is only a personal remedy, and there is no provision for proprietary remedies such as constructive trust. Moreover, staying with personal remedies, there could be scenarios where a director has not received a gain but the company has suffered a loss. In that case, without resorting to common law, it is not possible for the company to recover such losses from the director by way of damages or compensation. Therefore, any inability to import principles of common law will substantially diminish the scope of remedies for breaches of directors' duties.

Finally, and more specifically, the 2013 Act does not have a section corresponding to section 170 (3) of the UK Companies Act of 2006 (extracted above) which specifically states that the duties in section 166 (are based on common law rules and equitable principles and) shall have effect in place of such rules and principles. In other words, there is no express provision to state that the statutory duties replace the common law duties.

Readers' comments are welcome.

*(The motivation for this post arose from immensely helpful discussions with (i) Shinoj Koshy, Ashwin Bishnoi and Arjya Majumdar on the sidelines of the [International Conference on Trade, Investment and Corporate Governance: Law and Policy in India and China](#), and (ii) the students in the intensive course on "Corporate Governance" held in April 2014 at the National Law School of India University, Bangalore. As might be evident, those discussions remain inconclusive, and a search for the yet elusive answer continues!)*