

## **DUTIES AND LIABILITY OF DIRECTORS – AN INDIAN LAWS PERSPECTIVE**

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1. The Indian government has decided to replace almost six decades old company law governing the companies in India, i.e., the Companies Act, 1956 (“**CA1956**”) by new law, viz., the Companies Act, 2012 (“**CA2012**”). The CA2012 has already been passed by lower house of the Indian Parliament and approval of upper house of Indian Parliament is pending to become the CA2012 a law. The Indian Government has attempted to make the provisions of the CA2012 in line with company law of the developed countries in view of the global economy and changed social-economic environment. This article has made an attempt to analyse and compare the duties/liabilities of the directors of Indian Companies and indemnity to the directors by companies under the CA1956 and the CA2012.
  
2. **DUTIES/LIABILITY OF DIRECTORS, AND INDEMNIFICATION BY COMPANIES, UNDER THE CA1956**
  - 2.1 The CA1956 has not codified the law relating to duties of directors but in all cases all directors must ensure compliance with the provisions of the CA1956 and other applicable laws. Further, under the CA1956 the directors of Indian companies are subject to common law duties. Thus, a director has fiduciary duty towards the company.
  
  - 2.2 As per s.5 of the CA1956, for violation of the provisions of the CA1956 the managing director/ whole time director (director who is in whole time employment of the company) / manager (who is so appointment in accordance with the provisions of the CA1956) and the company secretary, if any, are responsible in first instance. In the absence of aforesaid categories of officers, prosecutions should be against all other directors of the company unless the directors have authorised any other person to make compliance with that provisions of the CA1956 and such person has accepted any such authorisation. The Master Circular No. 1/2011 dated 29 July 2011 of the Ministry of Corporate Affairs, Government of India (“**MCA**”) consolidating the provisions relating to prosecution of directors under the CA1956 has clarified that Registrar of Companies should take extra care in examining the cases where following directors are also identified as ‘officer who is in default’ under s.5 of the CA1956:
    - (a) For listed companies (companies of which shares are listed at Indian stock exchange), Securities and Exchange Board of India requires nomination of certain Directors designated as Independent Directors.
    - (b) For public sector undertakings, respective Government nominates directors on behalf of the respective Government.
    - (c) Various public sector financial institutions, financial institutions and banks having participation in equity of a company also nominate directors to the board of such companies.

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- (d) Directors nominated by the Government under s.408 of the CA1956.

The MCA has also directed the Registrar of Companies that none of the above directors shall be held liable for any act of omission or commission by the company or by any officer of the company which constitute a breach or violation of any provision of the CA1956 which occurred without his knowledge attributable through board process and without his consent or connivance or where he has acted diligently in the board process. The MCA did however not say that such directors should not be prosecuted at all and rightly so. Consequently, all the directors of a company may be liable for any violation of CA1956 unless they prove that they acted diligently and violation took place without their consent / knowledge / connivance.

- 2.3 It is pertinent to note that s.201 of the CA1956 restricts a company to indemnify its directors. According to s.201 of the CA1956 a company can indemnify its directors of any liability incurred by him in defending civil or criminal proceedings only if he is acquitted or discharged. Except as aforesaid, s.201 of the CA1956 renders void all the provisions in the company's constitution or in any agreement indemnifying a director against any liability that would attach to him in respect of any breach of duty or trust or negligence. It is noted that if premium of D&O policy to protect the directors is paid by a company, then also directors will be covered by s.201 of the CA1956 and may not be entitled to benefit of D&O policy.

### 3. **DUTIES/LIABILITY OF DIRECTORS, AND INDEMNIFICATION BY COMPANIES, UNDER THE CA2012**

- 3.1 The CA2012 has like other modern laws codified the duties of the director of Indian companies. The proposed s.166 of the CA2012 mention the duties of the director as under:

- (a) A director shall act in accordance its constitution document, i.e., articles of association.
- (b) A director shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.
- (c) A director shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- (d) A director 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.
- (e) A director 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.

- 3.2 The CA2012 has widened the definition of the 'officer who is in default' to include key managerial personnel (chief executive officer and chief financial officer) and

shadow directors. Interestingly, the CA2012 has proposed that every Indian company must have at least one director who stayed in India for a total period of not less than 182 days in the previous calendar year. Notably, the CA1956 has no such provision and this proposed change will require the resident Indian director to be more careful as he will be first one to be caught in case of violation by an Indian company.

- 3.3 The CA2012 has no provision corresponding to s.201 of the CA1956 meaning thereby that there is no restriction on the companies to indemnify its directors under the CA2012. The only reference to the provisions of indemnity to directors is given in s.197 of the CA2012 stating that the premium paid on insurance policy shall be treated as part of the remuneration of the officers only if such officer is found guilty.

#### 4. **COMPARISON BETWEEN OLD AND PROPOSED NEW LAW RELATING TO DIRECTORS**

- 4.1 It is noted that the CA2012 has deleted the phrase “or any other Act” existing in first proviso to s.291 of the CA1956 dealing with the powers of the board in corresponding new s.179 of the CA2012. According to a ruling of the Indian apex court, the existence of the aforesaid phrase in the CA1956 required the board of director to comply with other applicable laws while they exercise any power on behalf of the company. Though it is unclear whether the board of directors is liable to comply with other applicable laws but the deletion of above phrase makes it clear that the directors cannot be prosecuted under the CA20012 for non-compliance with the provisions of any law other than the CA2012. It would be an irony that the company law that gives the board authority to exercise the power on behalf of a company does not requires the board to comply with the provisions of other applicable laws while they exercise such a power on behalf of a company.

- 4.2 Though the CA2012 has however widened the definition of the ‘officer who is in default’ to include key managerial personnel (chief executive officer and chief financial officer) and shadow directors, but unlike old definition in the CA1956 that includes ‘all the following officers’, the new definition says ‘any of the following officers’ and thus apparently absolving the liability of other officers of the Company.

- 4.3 It is noted that despite increasing instances of frauds and violation by the companies, the CA2012 has radically changed the provisions of indemnity to directors by the companies as now there is no restriction on companies to indemnify its directors. This change will perhaps make the CA2012 the only law in the world not restricting the company to indemnify its directors.

#### 5. **LIABILITY OF DIRECTORS OF PRIVATE COMPANIES UNDER THE INCOME TAX ACT, 1961**

While discussing the liabilities of the directors under Indian laws, the provisions of s.179 of the Income Tax Act, 1961 (“**ITA1961**”) are also noticeable. S.179 of the

ITA1961 is applicable only to private companies. The liability of the directors of a private company for the payment of tax due from the company is made joint and several if tax cannot be recovered from the company. This section however enables a director to establish that the non-recovery of tax is not attributable to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of a company to avoid such a liability. The burden to establish this rests on the director concerned and only if the burden is discharged that director can be exempted from the tax liability of a company imposed on him by s.179 of the ITA1961.

6. **CONCLUDING REMARK:** The CA2012 though discussed for more than four years appears to be a part of reform agenda of the Indian Government. A number of measures to protect the investors' interest have been incorporated in the CA2012 but the Indian government has offered more to the directors and companies as a number of provisions favourable to the companies and its directors are being incorporated in the CA2012 by diluting the existing legal provisions. It might also be possible that though the CA2012 has been passed by the lower house of Indian Parliament, it is amended by the upper house of the Indian Parliament and then sent back to the lower house of the Indian Parliament's approval again.
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