
A HOLISTIC VIEW ON DIRECTOR'S FIDUCIARY DUTIES

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ABSTRACT

Directors have the ultimate responsibility to manage the affairs of the company. Company law provides the legal framework to prevent the directors from abusing their power while managing the affairs of the company. Director's fiduciary duties form the foundation of corporate governance. These duties encompass a wide spectrum of duties ranging from duty of loyalty to care. In this research article, the authors have examined the legal position of directors in the company. Article gives a comprehensive overview of the fiduciary duties and analyses duties of care and loyalty. Further, the authors have examined the fiduciary duties governed by the Companies Act, 2013.

INTRODUCTION

A board of directors has the ultimate responsibility to manage the affairs of the company. In order to run a company efficiently, the companies give wide discretionary powers to the board of directors.¹ The company law provides framework restraining the directors from abusing their powers. These are the duties laid on the directors of the company that provides the limits within which the directors should exercise their powers. The directors owes fiduciary duties of care and loyalty to the company and its shareholders.² These fiduciary duties of directors have evolved over a period of time through judicial interpretation by applying rules applicable on trustees. It has remained confined to common law principles until the Companies Act, 2013 gave statutory recognition to duties of directors. Directors' duties had to be determined by considering the nature of the company's business and the manner in which the work of the company was actually distributed between the directors and management.³ A director is required to exhibit the same degree of skill in the performance of his duties as may reasonably be expected of a person of his knowledge and experience.⁴ The codification of fiduciary duties of directors under section 166 of the Companies Act, 2013 was a significant development in Indian corporate governance jurisprudence by giving statutory recognition to obligations that had traditionally evolved through common law principles and judicial precedents. However, judicial interpretation continues to remain indispensable because fiduciary duties are inherently broad, flexible and incapable of exhaustive definition. The Act lays down general standards of conduct but does not provide detailed guidance regarding the manner in which these duties are to be applied in commercial situations. Therefore, the courts play a crucial role in interpreting the fiduciary obligations by balancing competing interests of shareholders, creditors, employees and other stakeholders.

LEGAL POSITION OF DIRECTORS

The legal position of director's has not been defined by the Companies Act, 2013. There have been various occasions on which the courts described directors as agents, trustee or managing partners. However, these are not as exhaustive of their powers and responsibilities.

Agents: The Company itself cannot act in its own person, it can only act through directors.

¹ Paul L. Davies and Sarah Worthington, *Gower's Principles of Modern Company Law* (10th Edition, Sweet and Maxwell 2016) 462.

² Myron M. Sheinfeld & Judy Harris Pippitt, *Fiduciary Duties of Directors of a Corporation in the Vicinity of Insolvency and After Initiation of a Bankruptcy Case* (2004) 60 (1) *Business Lawyer* 79.

³ *In re City Equitable Fire Insurance Co Ltd* (1925) Ch. 407.

⁴ Blanaid Clarke, *Duty of Care, Skill and Diligence-From Warm Baths to Hot Water* (2016) 56 *Irish Jurist* 139.

Therefore, directors are regarded as the agents of the company. It is the duty of such agents to act as best to promote the interest of the company whose affairs they are conducting. Such agents have duties of fiduciary nature to discharge.⁵ The principles of agency will apply to any transaction entered into by the directors on behalf of the company and the company will be held liable for the authorised acts of directors. An act of director which is beyond his powers but within the powers of the company can be ratified by a resolution of the company.⁶

Trustees: A trustee is a person in whom the legal ownership of the assets is vested which he administers for the benefit of another. The directors of a company are considered as trustees because they administer the assets of the company and perform duties in the interest of the company and not for their personal benefit.⁷ Most of the powers of directors are powers in trust. Directors have been held liable to make good money which they have misapplied as if they were trustees. Fiduciary obligations of director enjoins upon them the duty to act on behalf of a company with utmost good faith, utmost care and skill, due diligence and in the best interests of the company.⁸

Managing Partner: The directors have responsibility of managing the affairs of the company. Persons considering a company as large partnership believe that the directors are managing partners and shareholders are dormant partners. Directors have powers of management and act as the policy and decision making body by virtue of provision of Memorandum and Articles of the company.

Employee: Director is elected by the shareholders in general meeting of the company. He has well-defined powers and rights under the Companies Act, 2013. A director is not an employee of the company, but he may be appointed by the company under a contract of service as an employee of the company.

Therefore, it does not matter much what director are being called so long as you understand what their real position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and of all the shareholders in it. They stand in a fiduciary position towards the company in respect of their powers and capital under their control.⁹

⁵ *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461

⁶ *Bhajekar v Shinkar* (1934) 4 CompCase 298 (Mad).

⁷ *Ramaswamy Iyer v Brahmayya* (1966) 1 CompLJ 107 (Mad).

⁸ *Dale & Carrington Investment v P K Prathapan* (2004) 54 SCL 601 (SC).

⁹ *Forest of Dean Coal Mining Co., Re* (1878) 10 Ch D 450.

DIRECTOR'S FIDUCIARY DUTIES

A person in fiduciary position must not make a profit out of his trust.¹⁰ This is a part of broader rule according to which a trustee must not place himself in a position where his duty and his interest may conflict. It is an inflexible rule of a court of equity.¹¹ All directors of company are subject to the fiduciary obligation irrespective of the nature of their relationship with the company.¹² The fiduciary duties of directors are governed by the Companies Act, 2013.

A director should avoid a conflict of interests and is prohibited from profiting from his office. The no-conflict rule requires a fiduciary to avoid situations in which his personal interest and his duty conflict. On the other hand, no-profit rule renders a fiduciary liable to account for any gain which he obtained as a result of taking advantage of his fiduciary position.¹³ The conservative formulation focusses on the fiduciary obligation as the exaction of loyalty from the corporate fiduciary. On following this rule, a company will be free from speculating the loyalty and fair-dealing of director's, and as a consequence the monitoring costs will reduce. Therefore, primacy should be given to maintaining the integrity of fiduciary-company relationship. However, the application of such rule ignores the legitimate interests of director's as an individual as the application of and corresponding liability under this rule depends neither on an examination of circumstances surrounding the alleged breach nor on the equities of the case.¹⁴ A director acting against the interests of the company will be held liable for breach of fiduciary duty.¹⁵ Directors failing to exercise reasonable care, skill and diligence shall be deemed to have acted negligently in discharge of their duties to the company and shall be liable for any loss or damage resulting therefrom. If the directors exercise powers vested in them in a *mala fide* manner, then they will be liable for breach of trust and may be required to make good the loss suffered by the company due to such mala fide acts. They are accountable to company for any secret profits made in course of performance of their duties for the company. A director misappropriating properties of the company will be guilty of breach of trust and he may be asked to restore the property or to pay compensation.¹⁶

Duty of Care

The duty of care requires directors to exercise the degree of care that an ordinarily careful and

¹⁰ *Phipps v Boardman* [1967] 2 AC 46.

¹¹ *Bray v Ford* (1896) AC 44.

¹² Pearlie Koh, The Director's Fiduciary Obligations (2003) 62 (1) Cambridge Law Journal 42.

¹³ Pearlie Koh, Once a Director, Always a Fiduciary? (2003) 62 (2) Cambridge Law Journal 403.

¹⁴ Pearlie Koh, Once a Director, Always a Fiduciary? (2003) 62 (2) Cambridge Law Journal 403.

¹⁵ *Hogg v Cramphorn* (1967) Ch. 254.

¹⁶ *P.K. Nedungadi v Malayalee Bank Ltd* AIR 1971 SC 829.

prudent men would use in similar circumstances.¹⁷ While exercising their duty of care, directors must take informed decisions and use reasonable diligence in gathering information and considering material information.¹⁸ Only a systematic failure of the directors to exercise oversight will establish the lack of good faith that is a necessary condition for liability.¹⁹ Such a test of liability is quite high. A director is required to exercise reasonable care in the performance of his duties with respect to the use of his knowledge and experience. It is not necessary that every action of a director should result in benefits to the company irrespective of their intention. If in spite of exercise of reasonable care, damage has been caused to the company due to error in judgment, the director shall not be held responsible for the same.²⁰ If in discharge of their responsibility, directors had placed blind faith and reliance on a dishonest manager, they would be considered guilty for not acting reasonably and also they could be considered as having acted dishonestly.²¹

Duty of Loyalty

The duty of loyalty requires the directors of a company to act in the best interests of the company and its shareholders. The interest of company includes the interest of present and future members of the company. Directors must refrain from engaging in self-dealing by not seizing an opportunity of the company or receiving an improper personal benefit from the company.²² Directors must deal fairly with the company and its shareholders and should not make secret profits. As the director has a fiduciary relationship with company, he is restrained from entering into any contract with the company which may be in conflict with his own interest.²³ Further, a director is not expected to retain the profits he has made due to the opportunities which have come to him by virtue of his appointment as a director in the company, even if he has acted in complete probity.²⁴ If a director retains gains made by him out of transactions entered into by him on behalf of the company, the profits earned actually belong to the company and not to the director.²⁵

¹⁷ *Graham v Allis-Chalmers Mfg. Co* 188 A.2d 125 (Del. 1963).

¹⁸ *Brehm v Eisner* 746 A.2d 244 (Del. 2000).

¹⁹ *In re Caremark International Inc. Derivate Litigation* 698 A.2d 959 (Del. Ch. 1996).

²⁰ *In re Brazilian Rubber Plantation and Estates Ltd* (1911) 1 Ch. 425.

²¹ *In re Union Bank of Allahabad* AIR 1925 All 519

²² Myron M. Sheinfeld & Judy Harris Pippitt, *Fiduciary Duties of Directors of a Corporation in the Vicinity of Insolvency and After Initiation of a Bankruptcy Case* (2004) 60 (1) *Business Lawyer* 79.

²³ *Fateh Chand v Hindsons (Patiala) Ltd* (1956) 27 Comp Cas 340 (Pun)

²⁴ *Regal (Hastings) Limited v Gulliver* (1942) 1 All ER 378

²⁵ *Boston Deep Fishing & Ice Company v Ansell* (1888) All ER 65 (CA)

FIDUCIARY DUTIES UNDER THE COMPANIES ACT 2013

In line with the practices which are followed internationally, the J.J. Irani Committee recommended that it is necessary to expressly provide the duties of directors considering that they stand in the fiduciary position in relation to the company and therefore should be aware of their duties under the law. The Companies Act, 2013 explicitly provides the duties of directors under section 166. 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, and the community and for the protection of environment.²⁶ It states that the director shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.²⁷ Further, it provides that 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.²⁸ A director shall not achieve any undue gain or advantage 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.²⁹ Directors owe a fiduciary obligation to the company and its shareholders which makes it imperative that they should provide a complete and full disclosure on all matters relating to the company and its shareholders.³⁰ The directors must conform to the probity and their conduct should always be beyond suspicion.³¹ Where a director fails to perform any of the duties which have been set out above, he shall be liable to a penalty by way of fine which shall not be less than rupees one lakh, but may extend to rupees five lakhs.³²

In *Rajeev Saumitra v Neetu Singh*³³, a director of private company started a competing business to that of company. The Delhi High Court held that she had violated her fiduciary duties and was guilty of breach of section 166 of the Companies Act, 2013. The court, further, directed her to pay the undue gain already made by her to the company.

In *Dale and Carrington Invt (P) Ltd v. P.K.Prathapan*,³⁴ where the directors failed to act in the manner specified in a matter of issue of rights shares to the shareholders of the company, the

²⁶ The Companies Act 2013, s 166(2).

²⁷ The Companies Act 2013, s 166(3).

²⁸ The Companies Act 2013, s 166(4).

²⁹ The Companies Act 2013, s 166(5).

³⁰ A. Ramaiya, Guide to the Companies Act (19th edition LexisNexis 2020).

³¹ *Kamal Kumar Dutta v. Ruby General Hospital* (2006) 7 SCC 613.

³² The Companies Act 2013, s 166(7).

³³ MANU/DE/0201/2016.

³⁴ AIR 2005 SC 1624.

Supreme Court held that directors were liable for breach of trust for mis-utilisation of funds and assets of the company.

In *D.C. Mehta v. Jogeshwar Prasad*,³⁵ where a director has acted in good faith holding bona fide the true and reasonable belief that he has acted in the interest of company, the Patna High Court held that he shall not be liable for being guilty of breach of trust if in the process of promoting the interest of company he is also promoting his own interest.

In *Nanalal Zaver v. Bombay Life Assurance Co. Ltd.*,³⁶ where the directors exercise their powers for the benefit of the company and in the process they promote their own interest, they are not guilty of any breach of their duties. The Supreme Court stated that “merely because in promoting the interests of the company they also promote their own interests it cannot be held that they have not acted bona fide”.

In *M.K. Ranjitsinh v. Union of India*,³⁷ the Supreme Court observed that a director’s primary duty was to maximise wealth of shareholders. However, this narrow view was dismantled by section 166 (2) of the Companies Act, 2013 imposing broader fiduciary duty. Now, directors are legally mandated to act in good faith for the “best interests of the company, its employees, the shareholders, the community and for the protection of environment.” A combination of private interest and public interest is ordained under section 166(2) of the Act.³⁸

CONCLUSION

Directors are subject to fiduciary duties because loyalty and trust are ideals of behaviour that are difficult to demand and to monitor. They must behave honourable toward those to whom they owe fiduciary duties. The purpose of fiduciary duties is to discourage directors from putting their personal interests ahead of their duties to company. To fulfil their fiduciary duties of care and loyalty, the directors must have the courage to ask tough questions while facilitating a positive atmosphere of pursuing the best interests of company. Practicality and inquiry must equally dominate a director’s oversight of the affairs of the company. Fiduciary duties of director encompasses a wide spectrum of duties. Director can, by adopting a holistic view, navigate through the legal framework and promote board efficiency. The evolution from shareholder-orientated approach to stakeholder-oriented approach under section 166 of the Companies Act, 2013 reflects a shift in Indian corporate governance. Directors are not expected

³⁵ (1976) Comp Cas 671 (Pat).

³⁶ AIR 1950 SC 172.

³⁷ 2025 INSC 1472.

³⁸ Tata Consultancy Services Ltd. v. Cyrus Investments Pvt Ltd, 2021 INSC 217.

merely to maximise the wealth of shareholders but are required to balance commercial objectives with social responsibility, environmental protection and larger public interest. The legal framework of fiduciary duties seeks to harmonise corporate interests with larger public interests, thereby strengthening accountability, governance and corporate sustainability.