Code of conduct for directors' duties

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An appointment to the board of dynamic Indian companies is not an enviable function. It comes with great responsibility and significant duties while exercising powers on behalf of the company.

Directors' duties can be placed in three categories: Statutory, fiduciary, and as an agent and trustee of the corporation.

While the principles of agency apply to a large extent in their relationship with the company, a director has to use such skill as may reasonably be expected from a person of his knowledge and experience.

Further, every Indian company is governed according to the provisions of the Companies Act, 1956, and must adhere to its charter documents.

Company loyalty

Under Indian law, a director's fiduciary duties require him to exercise his powers and position diligently, with care, loyalty and in good faith for the benefit of the company as a whole and not for his own benefit or for the benefit of a section of the shareholders, even if the section represents the majority of shareholders.

Moreover, according to section 5(g) of the act, if a company does not have a managing director, whole-time director, or manager in case of any default, the directors of the company are treated as "officers-in-default" and are liable for monetary and penal sanctions.

Most legislation in India invariably includes a section which defines the vicarious liability of directors for offences committed by the corporation.

It is also important to remember that the duties of the directors extend beyond the act and the directors have to comply with various other statutes as well, encompassing economic, employment, environmental, industrial, and welfare issues.

Legitimate business

Specifically, a director cannot make a secret profit out of his position, and if he receives a secret profit from a third party without the consent of the company, he is under an obligation to refund such profit to the company.

The directors also have a duty to ensure that the company's funds are used for legitimate business purposes. If the funds are misused then the directors will be personally liable to restore them. In other words, a director will be liable as a trustee for breach of trust if he misapplies the funds or commits a breach of the charter documents.

Indian jurisprudence holds directors not merely as agents but, to some extent, in the capacity of trustees of the company's property.

Tax payments

Further, under Indian tax laws if a private company is dissolved and the tax assessed cannot be recovered, then the directors of a private company can be held liable for the payment of such tax, provided the non-recovery is attributable to gross neglect, or breach of duty.

Indian environment law provides for the protection of the environment, and lays down guidelines regarding the handling of hazardous substances and emission norms for industrial undertakings. Any violation of the statutory provisions amounts to an offence making the directors liable.

Apart from the various statutory duties, fiduciary duties emanate from general common law principles developed and evolved by the courts over a period of time. These duties are general in nature and based on the courts' interpretation of what amounts to fair and reasonable behaviour.

Conflicts of interest

The expectation is that the directors do not put themselves in a position in which an individual's personal interest conflicts with the duties to the company.

The fiduciary duties are, however, owed to the company and not to shareholders. Duties to the latter arise only in special situations.

Where a director acts contrary to the interests of the company, he will be liable for breach of his fiduciary duty.

Reasonable care

By the same token, Indian jurisprudence has consistently maintained that the directors will not be liable if they act honestly for the benefit of the company, within the confines of their powers and with such care as can be reasonably expected of them.

In practical terms, it is difficult to provide a precise description of the anticipated standard of care and diligence.

In such cases, the courts decide based on the nature and size of the company, and depending upon the facts of each case.

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