Duties and Liabilities of DIRECTORS

Second Edition

Dr. K S Ravichandran

M Com, LLB, FCS, PhD

Foreword by

Justice N. Seshasayee

Madras High Court

BLOOMSBURY

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SECOND EDITION

Dr. K. S. Ravichandran, **M Com, LLB, FCS, PhD**

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About the author

Dr K S Ravichandran, M Com LL B, FCS, Ph D, is the founder and managing partner of KSR & Co Company Secretaries LLP, Bangalore, Chennai and Coimbatore. He is an expert in company law, securities laws and regulations; law relating to foreign exchange management and its related rules & regulations, industrial law, and environmental laws. His areas of specialization include board process, governance, audits, compliance solutions, corporate restructuring, dispute resolution, IPRs, mergers & acquisitions, corporate and individual insolvency & bankruptcy and arbitration & conciliation.

He has appeared before various regulatory authorities such ROC, RD, OL, RBI, SEBI, IRDAI, MOF and tribunals such as the National Company Law Tribunal, National Company Law Appellate Tribunal, Debts Recovery Appellate Tribunal, and Intellectual Property Appellate Tribunal.

He has addressed more than 500 conferences, seminars, and workshops and written more than 1000 articles on corporate laws. He has authored several books most recent of which are (a) Third edition of Compounding, Adjudication and Prosecution under Corporate Laws; (b) Second edition of CSR, ESG and Charitable Institutions; (c) Third edition of Related Party Transactions; and (d) Second edition of Directors – Duties and Liabilities.

His other books include (a) *A Treatise on Contraventions under Companies Act, Securities Laws and FEMA (2019);* (b) *Corporate Social Responsibility – Emerging Opportunities and Challenges in India (2016)*; (c) *A Treatise on Corporate Lending, Charges, Debts Recovery, Enforcement of Security Interest and Winding up of Companies (2006);* and (d) *The Law relating to Limited Liability Partnerships in India (2010).*

He holds a doctorate from the Department of Management, Alagappa University on Prosecution of Directors under the Company Law and Criminal Law in India and UK. He was a member of the expert sub-group constituted by MCA for studying the suggestions relating to chapters of the Companies Act, 2013. He was a member of Secretarial Standards Board of the ICSI. He served the Indian Air Force for more than nine years as a specialist in Russian Radar Systems. He holds a Diploma in Electronics and Radio Communication Engineering and a Diploma in Technology. He was a lecturer at Jawaharlal Nehru College, Pasighat, Arunachal Pradesh. Currently, he is an Independent Director of the Karur Vysya Bank Limited. He chairs the Corporate Laws Council of Assocham's Southern Regional Council.

Justice N. SESHASAYEE
Madras High Court.

FOREWORD

The directors are the conscience keepers of any company. That a company is granted the status of a person in corporate jurisprudence notwithstanding, it still requires the aid of human consciousness to navigate it in an acutely competitive commercial environment. The directors, like cricketers, may have to be adept at playing all formats of the game. Even as they shape a good innings, they are often driven to cliffhanger situations, as in a T-20 eco-system, and are compelled to take swift decisions to define the fortunes of the company. From the Competition Commission to the IBC, from SARFAESI to the Secretariats, from shareholders to taxmen, from consumers to creditors, from market uncertainties to governmental policies, there are fielders everywhere to test the ability of the company to score its runs. And the competitors bowl from all sides, alongside which will be bad lights and poor umpiring. There is neither any assurance of success in corporate decisions nor is there any insurance against failure. And, if it is a family-controlled company, there will be non-commercial, non-corporate internal pressures for the directors to negotiate with. Including Lee Iacocca, the success story of any company is written essentially in hindsight. However tall a batsman's achievements may be, his value to the team is assessed by his current form, and the directors of a company share a similarity here.

The responsibilities of the directors therefore, are too onerous. The challenges a company faces for its success and survival constantly test the directors' astuteness in decision-making and their skill in the art of scoring runs even in trying moments. They may have to phase the innings, rotate the strike the best way possible to keep the scoreboard moving, and demonstrate at most alacrity to push the short-term gains to accomplish the long-term vision of the company. The hopes of the stakeholders start and end in the corporate board rooms, and the realisation of this reality defines the level of corporate awareness which the directors ought to share.

The success of a company transcends beyond the AGM and the board rooms as it energizes the economy, promotes the circulation of money (sans money laundering), provides employment opportunities, and adds to the GDP of the nation. The corporate contribution to nation-building is not a matter of derision or political ridicule but is a facet of the brand value of the nation.

Justice N. SESHASAYEE
Madras High Court.

A rider may have to be added here. While corporate success is an unmistakable paradigm in corporate governance, there is a duty to incorporate the highest standards of ethical fidelity to it, and it rests with the directors. CSR may be the taxman's forced-enticement to compel the company to share a fraction of its profit with the society, but the duty to care for others does not stop there. Presently, IBC offers the greatest temptation to kill the operational creditors, but the directors ought to remember that the company that strategizes to destroy an operational creditor through the shrewd use of the IBC might itself become a victim of another's strategy. What may appear perfectly legal may still injure fairness expected in commerce. The laws of karma are unsparing. A decision to promote a company may be an individual choice, but once promoted, a company becomes an entity within the legal system. It is therefore, important that the directors play a disciplined game consistent with laws and regulations, for none forced anyone to promote a company. It is a test of character on which rests the long term fortunes of a company.

The author has done a commendable job in capturing the quintessential responsibilities of the directors with a focus on their liabilities with illustrative case studies. His efforts deserve to be appreciated. It is satisfying to note that the first edition of this book has been a success which is obvious from the fact that the second edition of the book is due to hit the stores in less than two years. I place on record my appreciation and congratulations to the author for his efforts. May this book serve all.

Preface to the second edition

With immense satisfaction and a profound commitment to professional responsibility, I am delighted to present to you the second edition of my book on "Duties and Liabilities of Directors." Having been a practitioner in the field of corporate governance for more than three decades, I can say with perfect aplomb that this subject is dear to my heart and this endeavour marks a significant milestone in the ongoing journey from the inaugural edition to the current iteration, in shaping my understanding of the intricate landscape of corporate governance.

In presenting this second edition, my intent is not merely to provide information but to contribute to the ongoing dialogue surrounding the duties and liabilities of directors, ultimately fostering a culture of governance excellence in the corporate world. This edition aims to elevate the current discourse on the responsibilities and liabilities inherent in the role of directors.

The second edition emerges as a response to the imperatives of a dynamic and ever-evolving business environment and increasing role played by the corporate sector. The evolution of each chapter has been a meticulous process, aiming not only to update but to enrich the narrative with the latest developments in corporate law and governance.

One of the chapters of this book, undertakes a thorough exploration into various types of directorships, number of directorships, equipping readers with a comprehensive account of the procedural and compliance requirements under the Companies Act, 2013 as well as the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

As this edition is going to print, as recommended by an Expert Committee constituted by the Securities and Exchange Board of India (SEBI), SEBI is considering an amendment to certain aspects of corporate governance. The Expert Committee was constituted by SEBI on August 24, 2023 under the Chairmanship of Shri S.K. Mohanty for facilitating ease of doing business and harmonization of the provisions of ICDR and LODR Regulations ("Expert Committee" or "Committee"). The proposal includes counting only memberships and chairmanships of audit committees. Therefore, the ceiling on number of committees in which a director may be a member or chairman would be reckoned only in relation to such positions in audit committees in listed entities.

Duties and Liabilities of directors form the most important aspect of this book. Three chapters have been dedicated to discuss in detail all the aspects of these two subjects with a separate chapter explaining the role to be played by independent directors. Acknowledging the heightened regulatory scrutiny on independent directors,

it offers readers a profound understanding of the specialized responsibilities they shoulder in shaping corporate governance. The chapter on "duties of directors" lays emphasis on the duty to act in good faith, duty to protect company interests, and the upper most duty to disclose potential conflicts.

When it comes to liabilities, the most important aspect of discussion on this topic is the extent of liability of non-executive directors in general and independent directors in particular. A chapter of this book explains the need to ensure that there is a clear and visible distinction in the management structure between persons responsible for the management of the affairs of the company and non-executive directors. In short, the aim of the revised chapter on liabilities of directors is to emphasize on the point that (a) directors are liable for their acts of commissions and omissions; (b) directors are liable for offences and frauds; (c) directors are protected by business judgment rule so long as they are able to establish that they have acted in good faith; and (d) non-executive and independent directors are not ordinarily made liable unless law specifically introduces vicarious liability upon them or if facts prove that the contraventions had occurred with their consent or connivance.

Decisions at Boards and Board committees are collectively made; and most of the time, Boards strive to arrive at unanimous decisions. A chapter of this book explains the concept of collective responsibilities of directors. A close reading of the obligations imposed on the Board of Directors under the Companies Act, 2013 as well as the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 would show that in India, Directors of Companies are collectively duty bound to assess risks that could threaten the sustainability of the business model that their company is pursuing.

A post by Martin Lipton and William Savitt in Harward Law School Forum on Corporate Governance https://corpgov.law.harvard.edu/2019/09/19/directors-duties-in-an-evolving-risk-and-governance-landscape/ states "Corporate boards are obligated to identify and address these risks as part of their essential fiduciary duty to protect the long-term value of the corporation itself. Attentive directors are already grappling with immediate environmental business risks, as climate change, soil erosion, and rising sea levels disrupt commercial relationships and supply chains".

I have attempted to add value by presenting a few case studies which will provide valuable insights into the state of corporate governance and the manner in which directors have acted in real situations in different companies and jurisdictions.

The second edition is a thoroughly revised edition, presenting greater clarity on several critical aspects of the theme of this book. It is my sincere belief that this edition will serve as an invaluable resource for directors, legal professionals, and corporate leaders alike, fostering a heightened understanding of the evolving landscape in which they operate.

I record a special note of gratitude for Shri Justice N Seshasayee for graciously contributing a foreword to this edition, thereby adding a distinguished touch to the book. Amidst his busy schedule, he spared a lot of his time to go through the second edition and made enquiries about what revisions/additions have been made in this edition before penning his foreword in style. His involvement is truly an honour, and I am privileged to have had his encouragement and support.

Particularly, he said – "While corporate success is an unmistakable paradigm in corporate governance, there is a duty to incorporate the highest standards of ethical fidelity to it, and it rests with the directors".

It is with great appreciation that I extend my thanks to Ms Nikita Gupta and Mr. Toby Thomas, whose encouragement served as the catalyst from the inception of this venture. I thank the publishers for their support. I am deeply grateful for their unwavering dedication.

I place on record that I would be failing in my duty if I do not mention the support given to me by my family members, friends, and colleagues.

As this book reaches a wider audience, it is my sincere hope that it continues to serve as an indispensable resource for directors, professionals, academicians, and students alike. I am eager to receive your feedback, observations, and suggestions to ksr@ksrandco.in, as they are integral to the ongoing evolution of this work. Your insights will undoubtedly contribute to making future editions even more comprehensive and insightful.

Place: Coimbatore

April 2024 DR K S Ravichandran

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Chapter 1

Types of directors, appointment and cessation of directors

1.1 FIRST DIRECTORS

Every person who is appointed as a director is a director. Section 2(34) of the *Companies Act, 2013* itself says a "director" means a director appointed to the board of a company. Board of directors or the "Board", in relation to a company, means the collective body of directors of the company. The Companies Act, 2013 envisages that there is a Board of Directors from the date of incorporation itself.

In the articles of association, certain persons are usually named as the first directors of a company. From the language contained on the above lines in section 7 of the *Companies Act, 2013*, it is clear that it is not necessary or mandatory for the articles to name a few persons as directors. Section 149 requires at least two directors to be there on the board for a private company and three directors in the case of a public company. If the articles of association do not name any persons as first directors, section 152(1) of the *Companies Act, 2013* declares that 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. It is therefore clear that first directors are named even before the incorporation of a company.

If a company is formed by two subscribers neither of whom is a natural person, and, if the articles of association do not mention the name of anyone as first directors, there is no guidance under the *Companies Act, 2013* to meet such a situation. However, firstly it is a highly hypothetical situation and secondly from the manner in which the incorporation documents have been structured and required to be electronically filled and filed, it will be clear that filling up and uploading the forms

for incorporation of a company without naming not less than the prescribed minimum number of natural persons as directors, will not be possible.

Section 152(1) states that the first directors of a company will hold office until the directors are duly appointed by the members in terms of section 152 of the *Companies Act, 2013*. The language of section 152(1) does not insist on appointment of directors at the first annual general meeting or at any extra-ordinary general meeting within a specified period. It simply says first directors shall continue to be directors until the directors are duly appointed in terms of section 152 of the *Companies Act, 2013*.

Table F of Schedule I to the *Companies Act, 2013* contains the model regulations for companies with share capital. Regulation 60 of Table F says the number of directors and names of the first directors shall be determined in writing by the subscribers to the memorandum, or a majority of them. It is a different issue that Table F will apply only after the incorporation of a company. Section 5(6) of the *Companies Act, 2013* says that the articles of a company shall be in the respective forms specified in Tables F, G, H, I and J in Schedule I as may be applicable to such company. The use of the words "shall be" denotes that these model regulations would apply compulsorily. Section 5(7) clarifies that a company may adopt any or all of the regulations contained in the model articles applicable to such company. Thus, from a reading of regulation 60 of Table F and section 152(1) of the *Companies Act, 2013*, it is clear that first directors are chosen by the subscribers to the memorandum of association of a company, whether it is a private or public company and they shall continue to be in office until directors are appointed in terms of section 152 of the *Companies Act, 2013*.

While on the subject of first directors, it will be useful to note that while filing forms for incorporating a company, a declaration is also required to be filed by every person who has subscribed to the memorandum of association of the company proposed to be formed and by every person named as the first directors, if any, in the articles to the effect that he/she is not convicted of any offence in connection with the promotion, formation or management of any company, and that he/she has not been found guilty of any fraud or misfeasance or any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the registrar for the registration of the company contain information that is correct and complete and true to the best of his/her knowledge and belief.

1.2 RETIRING DIRECTORS

Section 152(2) of the *Companies Act, 2013* stipulates that, unless otherwise expressly stated, every director shall be appointed by the company in a general meeting. Section 152(6) requires that not less than two-thirds of directors of a public company should

be appointed at a general meeting and the office of such directors must be liable to be determined by retirement of directors by rotation. Retirement of directors as per section 152(6) of the *Companies Act, 2013* shall happen at every annual general meeting including the first one which is held next after the date of the general meeting at which the first directors are appointed in accordance with clauses (a) and (b) of section 152(6).

Since, section 152(6) itself states that it applies only to public companies, the concept of retirement of directors by rotation does not apply to private companies, unless the articles of association of such companies provide for retirement.

While Section 152(2) would apply to all companies, section 152(6) applies only to public companies. Therefore, it is necessary to read section 152(2) in conjunction with section 152(6). As already stated, section 152(6) of the *Companies Act, 2013* requires not less than two-thirds of directors of a public company to be directors liable to retire by rotation and they shall be appointed by the members at a general meeting of the company. The remaining directors (other than those falling under the "not less than two-thirds" who are "liable to retire by rotation") of a public company should also be appointed only at a general meeting, unless the articles of association of such companies provide otherwise. Even if the articles of association of public companies do not contain any regulation on this subject, the remaining directors of public companies shall be appointed at a general meeting only. It is only when the articles of association of a public company has any express provision that dispenses with the appointment of the remaining directors at a general meeting, such directors need not necessarily be appointed at a general meeting.

In the case of both private and public companies, the first annual general meeting shall be held within a period of nine months from the date of closing of the first financial year of the company. Section 2(41) of the *Companies Act, 2013* makes it clear that the financial year means the period ending on the 31st day of March every year. Where the company has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the next calendar year will be the first financial year of such a company. For example, if the date of incorporation of a company is 01st January 2023, the first financial year shall end on 31st March 2024.

Therefore, if, between the date of incorporation and the first annual general meeting, no other general meeting had been held, it will be the first annual general meeting of the company at which first directors and other directors will have to be appointed by shareholders.

Pursuant to clause (c) of sub-section (6) of section 152, at the first annual general meeting of a public company held after the date of the general meeting at which the first directors are appointed in accordance with clauses (a) and (b) of sub-section (6) of section 152 and at every subsequent annual general meeting, one-third of the directors who are liable to retire by rotation, shall retire. If such number is neither

three nor a multiple of three, then, the number nearest to one-third shall retire from office.

Please note that independent directors are not liable to retire by rotation on account of section 149(13) of the *Companies Act, 2013*. Similarly, pursuant to rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014, Small Shareholders Director too is not liable to retire by rotation. Since independent directors and Small Shareholders Directors are not liable to retire by rotation, only the remaining strength of the board of directors shall be considered for the purpose of reckoning those who are liable to retire and those who are the remaining directors for the purpose of section 152(6) of the *Companies Act, 2013* excluding therefrom those who have not yet been appointed at a general meeting at all.

Where directors who are liable to retire at an annual general meeting continue in office due to delay or default in holding the annual general meeting, courts have consistently held that directors cannot take advantage of their own default. In Palmer's Company Precedents, as quoted by Madras High Court in *A Ananthalakshmi Ammal and Another* v *The Indian Trades and Investments Limited and another*, AIR1953 Mad 467

> *"Where the directors of a company are invested by the regulations with certain powers, the authority thus conferred is to be read subject to the general rules applicable to the exercise by directors of the powers vested in them, and in particular to the rule that the directors are to exercise the powers for the benefit of the company and in the true interests of the company and according to the best of their Judgment, for they stand in a fiduciary position, and must act accordingly."*

In this case, the Madras High Court held that the directors who would have retired had the annual general meeting been held on or before the due date, will vacate their office and cannot continue to remain in office after the last date for the holding of the annual general meeting.

In an interesting situation, the Madras High Court, in *B. Ramachandra Adityan* v *Tamilnadu Mercantile Bank*, decided on 26 November, 2009 held that

> *"where the default in not holding the annual general meeting cannot be attributed to the directors, the said proposition cannot be applied. In Section 256(1) [this section corresponds to Section 152(6) and (7)] merely makes a Director who is liable to retire, to bow out of office, at the Annual General Meetings. The Act by itself does not speak of the liability to retire on the last day for holding the meeting. It is only by way of purposive interpretation to Section 256 and to prevent the mischief that is possible, that the Courts have interpreted Section 256 to mean that a Director shall retire on the last date for holding the meeting. Therefore, it is the very same purposive interpretation that should be invoked to extraordinary cases of this nature, where the Directors have not assumed office even for a single*