

Directors duties and liabilities under the  
Companies Act, 2013





*A director is “bound to take such precautions and show such diligence in their office as a prudent man of business would exercise in the management of his own affairs.” – Trustees of the Orange River Land & Asbestos Company vs King (1892)*

The reference may be very old but it still beautifully summarizes the duties of the Director of a company in a simple sentence.

### **Director under the Companies Act 2013**

The Companies Act, 2013 (“**Act**”) has spearheaded a new era of corporate governance, by increasing the roles and responsibilities of the board of directors (“**Board**”), protecting shareholders' interests, bringing in a disclosure based regime and built in deterrence through self-regulation. The Act has introduced several measures which have the effect of considerably enhancing the duties and liabilities of directors and imposition of stringent penal provisions in case of breach of any statutory provisions. With the enactment of the Act, the duties of a director have been codified. The Act introduces terms such as, 'reasonable care', 'independent judgment' and 'reasonable and due care'.

The term “director” has been defined under Section 2(34) of the Act to mean a director appointed to the Board of directors of a company. The Act provides for different categories of directors including, whole time directors, managing directors, independent directors, nominee directors, alternate directors and women directors. The Act for the first time recognizes the concept of an independent director. The term ‘independent director’ means a director other than a managing director or a whole time director or a nominee director and who fulfills certain other criteria (such as relevant expertise, experience, integrity etc.). Also, there is a new requirement under the Act to mandatorily appoint atleast one woman director for certain companies meeting the prescribed thresholds.

### **Duties and liabilities of a director of a company**

The following duties and liabilities have been imposed on the directors of companies under **section 166 of the Act**:

- A director of a company shall act in accordance with the Articles of Association (AOA) of the company which govern the internal functioning of the company and include matters such as procedure for transfer of shares, convening the general meetings, payment of dividend.
- A director of the company shall act in good faith, in order to promote the objects of the company, for the benefits of the company as a whole, and in the best interests of the shareholders, the community and for the protection of environment.
- A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- A director of a company 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.



- A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives<sup>1</sup>, 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. Therefore, in case any contract is being entered between the company and (i) the director; or (ii) any other body corporate where the director has an interest, directly or indirectly (*through relatives*), the director should disclose the nature of his interest in the board meeting.
- A director of a company shall not assign his office and any assignment so made shall be void.

The duties set out above are not exhaustive. Apart from the duties set out in section 166 of the Act, a director, amongst other obligations, is responsible for the following fiduciary obligations:

- The Board needs to lay the financial statements for approval and adoption at the annual general meeting of the shareholders.
- The directors are responsible for devising proper systems to ensure compliance with the provisions of all applicable laws and to ensure that such systems are adequate and are operating effectively.
- The director should ensure that the company, in which he is a director, files the financial statement and the annual return every year with the Ministry of Corporate Affairs (“MCA”). If default is made by any company (*in which a person is a director*) in filing the financial statement and annual return for a period of continuous 3 (three) financial years, the concerned director cannot act as a director of other companies for a period of 5 (five) years from the date of default. Further, his existing directorships in other companies will automatically cease on account of the default.
- The director should ensure that the company where he is a director repays all the deposits, redeem the debentures, pay the interest thereon, wherever applicable and pay the dividend within a period of one (1) year once they become due.
- The director shall not disclose any price sensitive information, unless such disclosure is expressly approved by the board or required by law. Further, a director shall not take undue advantage from the price sensitive information of which he is aware by virtue of being a director.

### Concept of ‘officer in default’

The Act contains the concept of an '**officer who is in default**' for the purposes of affixing liability on such person in respect of any contravention of the provisions of the Act by the company. The ambit of 'officer who is in default' is quite wide and includes, inter alia-

a whole-time director (WTD);

- key managerial personnel (which includes: a Chief Executive Officer, Managing Director or manager, Company Secretary, WTD, Chief Financial Officer or and any other officer as prescribed);
- where no key managerial personnel is provided such director(s) as specified by Board and who consent in writing, or all the directors if no director specified;

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<sup>1</sup> “**relative**” includes (1) Father (including step-father); (2) Mother (including step mother); (3) Son (including step son); (4) Son’s wife; (5) Daughter; (6) Daughter’s husband; (7) Brother (includes the step-brother); (8) Sister (including the step-sister).



- any person (under the immediate authority of the Board or any key managerial personnel) charged with responsibilities like maintenance or distribution of accounts/records who actively participates in/permits/fails to take active steps to prevent any default; or
- every director, in respect of contravention of any provision of the Act, aware of such contravention by virtue of receipt by him of any Board proceedings or participation in the same without objecting, or where such contravention takes place with his consent or connivance.

Additionally, an independent director shall be held liable only in respect of such acts of omission or commission by company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

### **Conclusion**

From a bare reading of the Act, it is understood that the role of a director in a company is an important and crucial one. For ensuring smooth functioning of the company, the company must, through sessions and seminars, create awareness for its directors of their role, responsibilities and duties towards the company and its shareholders. It is pertinent for a director to act diligently and in best interest, by self-awareness, reading all documentation carefully (*before signing*) and complying with all the applicable laws. A director has to not only comply with the duties mentioned in the Act but also with the duties mentioned in other statutes.

Since it is such a vital and onerous role, the directors must understand and as protection, must cautiously negotiate the director indemnification clauses in shareholder and director agreements. Any properly negotiated indemnity clause should cover directors for indemnification from any proceedings brought by a third party for both costs of fighting the case and liabilities incurred.

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