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A STUDY ON THE LEGAL POSITION OF DIRECTORS

ABSTRACT

A company is considered an artificial person with a distinct legal entity. The company being an artificial person cannot take the decisions of the company on its own. The role of the Board of Directors becomes necessary eventually for the running of the company. Legal status provides a person with various rights, duties, and liabilities. The Board of Directors works as a central brain of the company and promotes plans and implements it. The Board of Directors plays multiple roles in the company which can be that of a trustee, agent, or of partner. This paper discusses the legal position of the Board of Directors in the company in terms of their rights, liabilities, and duties according to the role they perform.

Keywords- Directors, Trust, Partners, Agents

RELEVANCE OF THE STUDY

The Board of Directors is considered an integral part of the company. The BOD is the person who plans, implements it, and is liable for the output. It becomes important to understand the legal status of the BOD as it gives an overview of where and to what extent the BOD can be held liable for the actions of the company.

OBJECTIVES

The objectives of the research paper are:

1. To understand the legal position of the Directors
2. To understand the rights of the Directors
3. To understand the duties and liabilities of the Directors in the company.

RESEARCH PROBLEM

The uncertainty in the position of the Directors in the company had been a question ranging from the status of an agent, trustee, or of partner. The roles provide them with different rights, liabilities, and duties towards the company.

HYPOTHESIS

The legal status of the Directors is not clear and has changed from time to time based on the facts and circumstances.

RESEARCH METHODOLOGY

The research methodology used in this research paper is Doctrinal. The data is collected from secondary sources like articles, research papers, etc.

RESEARCH QUESTIONS

- A. What are the rights, duties and liabilities of the directors based on different legal statuses?
- B. What factors influence the determination of a breach of duty and the standard of care expected from directors?
- C. What legal mechanisms exist to address conflicts of interest within the board of directors? How effective are these mechanisms in ensuring impartial decision-making and preventing potential legal challenges?

INTRODUCTION

The legal position of the directors distinguishes from the position in terms of their liability towards the company. To understand the rights and duties of the directors it comes evident to understand in what capacity they are performing their functions. The different legal position of the director ranges from an agent, trustee, managing partner, employer, etc. To understand the scope of the liability of the directors it becomes necessary to understand the legal position they perform. The paper tries to identify the rights and liabilities of the directors based on their respective legal positions.

The directors are defined under Section 2(13) of the Companies Act, 2013 as someone appointed to the Board of a company. The Board of Directors means a group of those individuals elected by the shareholders of a company to manage the affairs of the company.¹ The directors of a company are provided with the duty of care and fiduciary relation with

¹ Companies Act, 2013

others. The company is based on the trust between the directors and the shareholders or members of a company. The duty requires the directors to perform their functions with utmost skill, care, and diligence and are responsible in case of any lack of the same. In some cases, the directors may be held liable personally liable for the acts that they have committed in pursuance of the functions performed in the company whereas in some other cases, it may not be the personal capacity of the directors for the functions as they perform the function towards the company and is protected through the concept of corporate veil.

A company means, a company formed and registered under the Companies Act, 1956 or under any of the preceding Acts². The word company is used to denote an association of persons who have associated together to conduct or to carry on a business for gain. The persons associating together will contribute some money for the conduct of the business and the amount is known as the share capital of the company. The association will be registered under the Companies Act and thereafter it will be a legal person having an artificial personality. A company is a legal person who is leaving only in the eyes of the law. It's a creation of law which lacks both body and mind. It cannot act, just like a human being. It can act only through some human agency. Directors are those persons through whom the company acts and does business. They are collectively known as the Board of Directors. Board of Directors is the brain and the only brain of the company which is the body, and the company can do act only through the board of directors. A director is a person who has control over the direction, conduct, management, or superintendence of the affairs of the company. Only an individual can be appointed as a director. An association or a firm cannot be appointed as director of a company.³

CHAPTER II: Legal Positions of a Director

- **Directors as Agents**

The directors of a company may be regarded as the agent of the company as they are under the rules, regulations, and byelaws of the company under the Article of Association and can only perform the function in a limited capacity and no one can perform any functions other than the objects that are mentioned under the Memorandum of Association. There exists a principal-agent relationship between the directors and the company limiting the powers and rights of the directors.

² Sec 3(i) of the Companies Act, 1956

³ Adv Vishnus, "Positions of Director in a company"

In *Ferguson v. Wilson*⁴ the court clearly recognised that directors are in the eyes of law, agents of the company. It was held that, the company has no person; it can act only through directors and the case is, as regards those directors, merely the ordinary case of a principal and agent. When the directors contract in the name, and on behalf of the company, it is the company which is liable on it and not the directors.⁵

In *Elkington & Co. v. Hurter*⁶, where the plaintiff supplied certain goods to a company through its chairman, who promised to issue him a debenture for the price, but never did so and company went into liquidation, he was held not liable to the plaintiff. Similarly, a director was held to be personally not liable in a suit against a private chit fund company. Attachment of the property of the director was held to be not permissible⁷.

Like agents, directors have to disclose their personal interest, if any, in any transaction of the company. In *Ray Cylinders & Containers v. Hindustan General Industries Ltd*⁸, held that, the directors are the agents of the institution and not of its individual members, except when that relationship arises due to the special facts of the case. Also granted permission to file a suit against a company was not allowed to be treated as permission against directors as well.⁹

- **Directors as Trustees**

Directors are the trustees of the company's money, property and their powers and such must account for all the moneys over which they exercise control and shall refund any moneys improperly paid away and shall exercise their powers honestly in the interest of the company and all the shareholders, and not their own sectional interest. The directors of a company are trustees for the company, and for reference to their power of applying funds of the company and for misuse of the power they could be rendered liable as trustees and on their death, cause of action survives against their legal representatives.¹⁰ Directors are those persons selected to manage the affairs of the company for the benefit of shareholders. It is an office of trust, which if they undertake, it is their duty to perform fully and entirely. This peculiar nature of their

⁴ (1866) 2Ch App 77: 15 LT 230

⁵ Adv Vishnus, "Positions of Director in a company"

⁶ (1892) 2 Ch 452

⁷ *Kuriakos v. PVK Group Industries*, (2002) 111 Comp Cas 826 Ker

⁸ 2001) 103 Comp Case 161 Del

⁹ Ibid

¹⁰ *Ramaswamy Iyer v. Brahmayya & Co*, [1966] 1 Comp LJ 107

office is one of the reasons why the directors have been described as trustees. In the real sense, the directors are not trustees. A trustee is the legal owner of the trust property and contracts in his own name. On the other hand, the director is a paid agent or officer of the company and contracts for the company¹¹. In fact, the directors are commercial men managing a trading concern for the benefit of themselves and of all the shareholders in it.

The principle of liability was laid down in 1902 in *Percival v. Wright* and still holds ground as a basic proposition. In this case, the court held that directors have no duty toward individual shareholders. From this it is very clear that the directors are trustees to the company and not of individual shareholders. The principle of the case was reiterated in *Peskin v. Anderson*¹². Ordinarily, the directors are not agents or trustees of members or shareholders and owe no fiduciary duties to them¹³.

However, we have to take the decision of *Allen v. Hyatt*¹⁴. It was held that the directors are trustees of the profit for the benefit of the shareholders. They cannot always act under the impression that they owe no duty to the individual shareholders. But it is no doubt that the primary duty of the director is to the company. But in such circumstances where the directors act as agents for the shareholders, the latter would be liable to the purchasers of their shares for any fraudulent misrepresentation made by the directors during negotiations.¹⁵

- **Directors as Managing Partners**

One of the major functions of a company's directors is that they represent the will and wants of the shareholders. They are notably known to act in the place of the shareholders and their goals. Due to the same reason, they tend to have a lot of vast powers. Their functions have a proprietary nature. This makes them the managing partner of the company.¹⁶

- **Directors as Organs of Corporate Body**

The organic theory of corporate life "treats certain officials as organs of the company, for whose action the company is held liable just as a natural person is for the action of his limbs¹⁷. Thus, modern directors are more than mere agents or trustees. The Board is also correctly

¹¹ *Smith v. Anderson*, (1880) 15 Ch D 247 at p 275

¹² [2000] 2 BCLC 1

¹³ *Ibid*

¹⁴ 1914) 30 TLR 444

¹⁵ *Ibid*

¹⁶ Legal position of directors of a Company, 26 April 2023

¹⁷ *Gopal Khaitan v. State*, AIR 1969 Cal 132, 138

recognized to be a primary organ of the company. Directors and managers represent the directing mind or will of the company and control what it does.¹⁸

The state of mind of these managers is the state of mind of the company and is treated by law as such. The practical effects of these rules are that the directors' personal fault in the business of the company becomes the "fault of the company"; their reason to believe is attributed to the company and the intention to occupy premises as expressed by their conduct is the intention of the company.¹⁹

- **Directors as Employees**

Directors are professionals who manage the company for the benefit of themselves and for the benefit of the shareholders. However, if a director accepts employment in the same company under a separate contract of service, then, in addition to the directorship, he is also treated as an employee or servant of the company. In other words, when the director is appointed as a whole-time employee of the company, then that director shall be considered an employee director or whole-time director.²⁰

ILLUSTRATION: Gunalan is a director of a company who has also taken extra charge to act as a manager of the company. But as per the contract of service as a manager, he is entitled to receive remuneration. Hence, he is a director who also happens to be an employee of the company.²¹

- **Directors as officers**

"**Officer**" includes any director, manager or key managerial personnel, or any person in accordance with the directions or instructions of the Board of Directors or any one or more of the directors who are or are accustomed to acting. Therefore, Director is treated as an officer of a company. Sometimes, they may be also liable for punishments in the form of penalties, under the Companies Act, when the provisions of the Act are not strictly complied with.²²

Collective Duties of Directors: Directors as a part of Board perform certain duties collectively. The following are some of those duties exercised collectively: -

¹⁸ Ibid

¹⁹ Ibid

²⁰ Legal Position of Director, Company Management

²¹ Ibid

²² Ibid

- (i) Approval of annual accounts and authentication of annual accounts
- (ii) Directors report to shareholders highlighting performance of the company, transfers to reserves, investment of surplus funds, borrowings
- (iii) Appointment of First Auditors
- (iv) Issuance of Notice and Holding of Board meetings and shareholders meetings
- (v) Passing of resolutions at board meetings or by circulation.²³

General duties of Directors:

- (i) Structuring or new policy to reach the objectives of a company.
- (ii) Delegating power to any committee if the Articles Permits for well being of the company
- (iii) Issuing instructions to employees for implementation of policy to review company's progress.
- (iv) Appointing their subordinates like Managing director, Manager, Secretary and other employees.
- (v) Acting in accordance with the Articles of the company
- (vi) Act in Good faith in order to promote the objects of the company
- (vii) Perform duties with due and reasonable care and diligence.²⁴

CHAPTER III: FACTORS INFLUENCING THE BREACH OF DUTY TO TAKE CARE

There are various factors that influence the breach of duty to take care as if the directors perform their functions which are outside of the jurisdiction or the capacity of the MOA or AOA of the company. If the directors are not working in a proper manner and breaking the trust of the people who are linked with the company on the basis of the fiduciary relation then the directors are liable for breach of the duty to take care and legal actions for the same can be implemented. So, reasonable course of action is very much required for the proper functioning

²³ Ibid

²⁴ Ibid

of the company and also to protect the interests of the company, directors, and others who are linked with the working of the company.

If there is a breach of duty the person can sue the other for the same as it is evident that the Judiciary has been active in protecting the rights of the people from time to time. For the proper corporate governance, compliance and risk management, direct accountability, Shareholder protection, shareholder management, Board effectiveness etc.

CHAPTER IV: CONCLUSION

In conclusion, the legal position of the board of directors holds significant importance in the realm of corporate governance. This study has highlighted several key aspects that contribute to understanding the legal framework surrounding board members' rights, responsibilities, and liabilities. The duty of care and fiduciary responsibilities of board members are crucial elements in ensuring effective decision-making and protecting the interests of the company and its shareholders. Clear guidelines and standards for exercising this duty, along with the level of care expected from directors, can help mitigate conflicts and legal disputes. Legal liability remains a significant consideration for board members. Being aware of potential personal liabilities and understanding the legal ramifications of their actions or omissions helps directors exercise prudence and fulfil their fiduciary duties responsibly.

In conclusion, studying the legal position of the board of directors provides valuable insights into corporate governance practices, director accountability, shareholder protection, stakeholder management, and board effectiveness. By addressing the research questions and considering the relevant legal aspects, organizations can strengthen their governance structures, mitigate legal risks, and ensure compliance with applicable laws and regulations.

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