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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

THE STAKEHOLDER APPROACH TOWARDS DIRECTORS' DUTIES UNDER COMPANY LAW: A COMPARATIVE ANALYSIS INDIAN

AUTHORED BY - AKHILESH PATRO

ABSTRACT

Recognizing that common law does not cast any general duty upon directors towards non- shareholder constituencies, legislatures have sought to formulate a tolerable solution to what they perceive as a gap in existing common law. The British Parliament engaged in one such legislative intervention by adopting the "enlightened shareholder value" ("ESV") model through section 172 of the UK Companies Act 2006 (the "2006 Act"). This requires directors to have regard to non-shareholder interests *as a means* of enhancing shareholder value over the long term. Another approach was taken by the Indian Parliament through section 166(2) of the Companies Act, 2013 (the "2013 Act"), which appears at first glance to cast a duty on directors to treat non-shareholder interests as an end in itself. In other words, section 166(2) follows the pluralist approach by placing all interests (whether of shareholders or other stakeholders) on par without creating any hierarchy and as being valid in their own right.

In this article, we examine the nature and content of the duty cast under section 166(2) of the 2013 Act in India. In doing so, we also draw on the experiences from similar debates in other jurisdictions, principally the United Kingdom (UK). Our principal thesis is that while section 166(2) of the 2013 Act at a superficial level extensively encompasses the interests of non-shareholder constituencies in the context of directors' duties and textually adheres to the pluralist approach, a detailed analysis based on an interpretation of the section and the possible difficulties that may arise in its implementation substantially restrict the rights of stakeholders in Indian companies. This makes the Indian situation not altogether different from the ESV model followed in the UK.

KEY WORDS: Directors' duties, company law, shareholders, stakeholders, enlightened shareholder value, India, United Kingdom

INTRODUCTION

An existential (but problematic) question in company law relates to the very purpose for which companies are incorporated and managed. Are companies to be run solely for the purpose of maximizing the profits of the shareholders? Does the law insist upon protecting – or even recognizing – interests of non-shareholder constituencies? Do the directors of a company owe any duties to act in the interests of anyone other than shareholders? Theoretically speaking, these thorny questions have been the subject matter of rival claims. On the one hand, the shareholder theory visualizes the shareholders as owners of the firms, thereby requiring companies to be run in a manner that maximizes their value. On the other hand, the stakeholder theory adopts a broader perspective and requires companies to be managed on a sustainable and inclusive basis so as to consider the interests of non-shareholder constituencies such as employees, creditors, consumers, environment and the community in general. It is generally believed that while Anglo- American jurisdictions tend to be shareholder centric in nature, other jurisdictions in Europe and Asia embrace the stakeholder theory to varying degrees.[1]

This debate plays out more specifically in the context of duties owed by directors of companies. In common law, although directors legally owe their duties to the company (being a separate legal personality) and are required to act in the best interests of the company, this effectively means that in a solvent company they are to consider the interests of the members as a whole (as opposed to individual members).[2] Indeed, common law has often recognized that the directors of a company may have duties relating to non-shareholder constituencies in specific contexts. For instance, directors of a company have a duty to consider the interests of creditors during insolvency.[3] Although the matter is not devoid of controversy, it is arguable that while the directors do not owe a duty to

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[1] For a discussion of the competing theories and the relevant literature, see Andrew Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' (2010) 9 Rich J Global L & Bus 249; Sarah Kiarie, 'At crossroads: shareholder value, stakeholder value and enlightened shareholder value: Which road should the United Kingdom take?' (2006) 17 ICCLR 329.

[2] This principle was effectively summed up by the UK Company Law Review Steering Group when it said, while considering a possible statutory formulation of a duty to promote the success of the company: "*... what is in view is not the individual interests of members, but their interests as members of an association with the purposes and the mutual arrangements embodies in the constitution...*" Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (Department of Trade & Industry, 2000), para 3.51.

[3] For a duty to consider the interests of creditors, see generally, *Liquidator of West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30; *Facia Footwear Ltd (In Administration) v Hinchliffe* [1998] 1 BCLC 218; *Re Pantone 485 Ltd* [2002] 1 BCLC 266; *Gwyer v London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153; [2002] EWHC 2748; *Re MDA Investment Management Ltd* [2004] BPIR 75; [2003] EWHC 227 (Ch).

the company's creditors, in discharging their duty to an insolvent company they ought to keep in mind the interests of the creditors, which displace shareholders' interests at that stage.[4]

THE BACKGROUND: SHAREHOLDERS AND STAKEHOLDERS

An underlying theory behind the company law of most common law jurisdictions is that the managerial powers of the board arise out of delegation from the shareholders.[5] This delegation is now also seen as having constitutional – and not just agency – character; yet, the role of directors was traditionally seen as promoting the interests of the shareholders.[6] The question of whether that is all there is to the role of directors has risen to prominence recently. Should directors consider only shareholder interests, or should they also consider 'stakeholder' interests? The question is not a new one,[7] yet modern developments and attempts at legislative reformulations in recent years have thrust it into prime focus.

To be sure, the shareholder primacy approach does not mean that directors must refrain from considering the interests of other stakeholders: directors are not prevented from taking into account the interests of other stakeholders, as long as they do this as a means to the end of maximizing shareholder wealth in the long term. Prior to the codification of directors' duties, company law in both India and the UK did recognize stakeholder interests to varying extents.

Beginning with India, at the time of independence the colonial law was unequivocal in its zeal to protect shareholders so as to enable companies to attract capital.[8] Corporate law did not play any role at all in taking cognizance of the interests of non-shareholder constituencies. This position continued immediately following independence, but the change in philosophy began taking shape in

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[4] *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187; *Yukong Line Ltd v Rendsburg Investments Corporation (No. 2)* [1998] 1 WLR 294.

[5] Reinier Kraakman, et al, *The Anatomy of Corporate Law* (Oxford: Oxford University Press, 2nd ed, 2009), 12- 14.

[6] See generally, for a broad outline, Paul Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors', Inaugural W.E. Hearn Lecture, University of Melbourne Law School (2005). Davies also clarifies that directors' duties to act in "the interests of the company" identifies the company with one or more groups of people who, in the case of a solvent company, ought to be its members (or shareholders). Paul Davies,

[7] The question was in a sense central to the Berle-Dodd debate that occurred decades ago. AA Berle, Jr, 'Corporate Powers as Powers in Trust' (1931) 44 Harv L Rev 1049; E Merrick Dodd, Jr, 'For Whom are Corporate Managers Trustees?', (1932) 45 Harv L Rev 1145 (with Berle arguing that companies must have responsibilities only to shareholders, and Dodd arguing that companies must be responsible for other constituencies such as employees, customers and the general public).

[8] Varottil, 'The Evolution of Corporate Law in Post-Colonial India'.

the 1960s with amendments to the Companies Act, 1956 (the predecessor of the 2013 legislation).[9] Consistent with the country's journey through years of socialism, the role of company law in India has extended beyond the mere protection of shareholders.[10] It encompasses the protection of employees, creditors, consumers and society. For instance, employees obtained certain special rights under company law, such as preferential payment for dues in case of winding up of a company,[11] and also the right to be heard in case of significant proceedings involving a company such as in a scheme of arrangement (merger, demerger or other corporate restructuring)[12] or in a winding up[13] of the company.

THE LANGUAGE AND LEGISLATIVE INTENT: BREAKING DOWN THE STATUTORY DUTIES

Starting with the statutory reforms in India, section 166(2) of the 2013 Act reads:

A director of a company 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, the community and for the protection of environment.

The journey of this provision from its original draft form to the finally enacted version is itself illuminating. The genesis of this provision can be found in Clause 147(2) of the Companies Bill, 2008, which remained unchanged in the Companies Bill, 2009. The clause in these Bills was based on the recommendations of the Irani Committee Report.[14] The provision as originally inserted did

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[9] Ibid.

[10] See Tarun Khanna & Krishna Palepu, 'Globalization and Convergence in Corporate Governance: Evidence from Infosys and the Indian Software Industry' (2004) 35 J Int'l Bus Studies 484 (laying out the debate in the context of protection of employees using the stakeholder theory).

[11] Companies Act, 1956, s. 529-A.

[12] Companies Act 1956, s. 391. See *In Re, River Steam Navigation Co. Ltd* (1967) 2 Comp LJ 106 (Cal.) (holding that in considering any scheme proposed, the Court will also consider its effects on workers or employees); *In Re Hathisingh Manufacturing Co. Ltd*(1976) 46 Comp Cas 59 (Guj) and *Bhartiya Kamgar Sena v Geoffrey Manners & Co Ltd* (1992) 73 Comp Cas 122 (Bom) (approving the proposition that while sanctioning a scheme of arrangement the court should consider not merely the interests of the shareholders and creditors but also the wider interests of the workmen and of the community).

[13] Companies Act, 1956, s. 443.See *National Textile Workers' Union v Ramakrishnan (P.R.)*A.I.R. 1983 SC 75 (holding that a court can hear the employee if it determines the employee should be heard to administer justice).

[14] Report of the Expert Committee on Company Law, May 2005 ("Irani Committee Report). Available at: http://reports.mca.gov.in/Reports/23-Irani%20committee%20report%20of%20the%20expert%20committee%20on%20Company%20law,2005.pdf.

not make reference to non-shareholder constituencies. The Irani Committee Report did not categorically indicate that the intent at that time was anything other than a codification of existing common law; at the same time, the Committee did make a reference to the duties of directors to the interest of employees and potentially other stakeholders. After finding that international practice (especially the UK) considers a wide spectrum of directors' duties, the Irani Committee Report in the relevant part states:[15]

18.3 Certain basic duties should be spelt out in the Act itself such as

- *(a) duty of care and diligence;*
- *(b) exercise of powers in good faith, i.e., discharge of duties in the best interest of the company, no improper use of position and information to gain an advantage for themselves or someone else;*
- *(c) duty to have regard to the interest of the employees, etc.*

Interestingly, the Committee does not appear to have spelt out in detail as to which stakeholders other than the employees would benefit from the duty. Further, the Committee did mention that there was a duty of exercise of powers in good faith in the best interest of the company. At the same time, the duty recommended with respect to employees and other possible stakeholders was not one of acting in good faith to promote their interests: it was simply a duty to 'have regard to the interest of the employees, etc.' In the event, Clause 147 of the 2008 and 2009 Bills did not spell out specifically any duty in relation to non-shareholder interests. Clause 147(2) simply stated:

A director of a company 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 interest of the company.

The introduction of the phrase "*a director … shall act … in the best interest of its employees, the community and the environment…*" can be traced to the corresponding provision in the Companies Bill, 2011 (which eventually took shape in the form of the2013 Act).

[15] Irani Committee Report, Part 3, Chapter IV – Management and Board Governance, Duties and Responsibilities of Directors, paras 18.1 – 18.3, pp. 43 – 44

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The 2011 Bill is the result of deliberations by a Parliamentary Standing Committee on Finance, and the rationale for the introduction of this phrase can be gleaned from the Standing Committee Report.[16] The Standing Committee noted that the Institute of Company Secretaries of India ("ICSI"), the professional body regulating company secretaries, had recommended that a specific reference be inserted for a duty of directors towards shareholders, employees, environment and community.[17]

This suggestion was forwarded to the Ministry of Corporate Affairs. The Ministry accepted the suggestion; in addition to accepting the suggestion, the Ministry also noted that an appropriate provision was required to be made by way of an enabling clause allowing directors to consider non-shareholder interests particularly in view of the proposed voluntary CSR norms also sought to be introduced.[18] The Ministry therefore recommended the insertion of the clause as it presently stands. It needs to be clarified that the Ministry does not appear to have considered the clause merely as an enabling provision for CSR norms; in other words, the Ministry appears to have considered the provision as something more than simply enabling directors to consider non- shareholder interests. This is evident from at least two factors: first, the specific wordings were inserted on the suggestion of the Ministry, which could easily have chosen different wordings if the intent was a mere enabling provision (for example, "having regard to" stakeholder interests); secondly, the Ministry did make reference to 'enabling' CSR, but also specifically accepted the recommendations of the ICSI. The ICSI had clearly envisaged the clause as being in the nature of a positive duty on the directors, *requiring* directors to consider stakeholder interests and not merely as being in the nature of an enabling provision *allowing* directors to do so. The Ministry's recommendation was seconded by the Standing Committee, which noted:[19]

The Committee welcome the proposed changes with regard to the duties of a director to promote the objects of the company in the best interests of its employees, the community and the environment as well, particularly in the backdrop of Corporate Social Responsibility, which is proposed to be included in this statute…

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[16] Twenty-first Report, Standing Committee on Finance (2009-2010) (Fifteenth Lok Sabha), The Companies Bill, 2009 (Ministry of Corporate Affairs), Lok Sabha Secretariat, New Delhi, August 31, 2010. Available at:http://www.prsindia.org/uploads/media/Companies%20Bill%202009.pdf.
[17] Ibid, para. 11.77.
[18] Ibid, para. 11.78.
[19] Ibid, para 11.80.

This discussion indicates that the language of section 166(2) was a well-considered one and inserted to cast a positive duty on directors; and was not merely an enabling provision as such. The legislative policy seems to be specifically to adopt the pluralist model; and the language chosen thus seems to deliberately shy away from the ESV model.[20] The Committee's concluding remark on this issue reproduced earlier is of some interest: the Committee seems to read the clause as casting a duty to act in good faith for the promotion of the objects of the company in the interest of the shareholders and other stakeholders. Thus, the duty is seen as one of good faith to promote the objects of the company. The objects of the company are to be promoted in the best interest of the shareholders and other stakeholders. Thus, there is no independent duty to the stakeholders.

The plain language of section 166(2) however could be construed as meaning that there is a duty to act in good faith,

a) in order to promote the objects of the company for the benefit of its members as a whole, and
b) in the best interests of the company, its employees, the shareholders, the community and for the protection of environment. In other words, the text of section 166(2) seems to leave open the interpretation that there are two duties of good faith; first, to act in good faith in order to promote the objects for the benefit of the members as a whole, and secondly, in addition, to act in good faith in the best interests of stakeholders. The Standing Committee however seems to have considered the clause as resulting in a duty to act in good faith to promote the objects of the company in the interests of the company and all stakeholders.

On the Committee's view, there is no independent duty to act in the best interests of the stakeholders: the duty is simply one of promoting the objects. The objects are to be promoted in the best interests of the company as well as the stakeholders. It is not clear that the Committee's view is borne out by the language of the clause; in particular, the clause seems to be distinctly in two parts. This is clear

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[20] It is also interesting to note that around the time the Standing Committee was deliberating upon these issues, business associations in India were also moving towards a pluralist approach. Illustratively, one may consider the recommendations of the Murthy Committee constituted by NASSCOM, a premier trade body of the Indian IT/BPO industry. The Committee was constituted to make recommendations in the aftermath of the Satyam
scandal which had emerged by then; where a leading Indian IT company had admitted to large-scale irregularities. The Murthy Committee also leans towards a pluralist approach towards directors' duties; and in exploring the interests of non-shareholder parties, it considers not just stakeholders such as employees and customers, but also vendors and even competitors. NASCOMM, *Corporate Governance and Ethics Report* (2010), available at: http://survey.nasscom.in/sites/default/files/upload/66719/Corporate_Governance_Report.pdf.

from the separate references to '…*for the benefit of its members as a whole*' and '*and in the best interest of the company…*' The Commmittee's view will make one of those parts redundant. The point is not merely linguistic: whether there is one single duty or two separate duties will be of relevance in attempting to analyse how to resolve conflicts between the interests of shareholders and stakeholders.[21] It will also be of relevance in determining the nature and content of the duties and the types of conduct which will satisfy the thresholds set by the clause. We return to these aspects later. The relevance of these discussions becomes clearer from an examination of the corresponding English provision. The debates in the UK point ultimately to a choice by Parliament in the 2006 Act to adopt the ESV model rather than the pluralist approach. We now briefly examine the relevant debates at the time of enactment of the 2006 Act in the UK, before comparing the language of section 166(2) of the 2013 Act with the language of section 172 of the 2006 Act. We also briefly examine the significance of another provision in the 2006 Act specifying to whom the relevant duties in section 172 are owed. In particular, section 170(1) of the 2006 Act clearly states that the duties are owed to the company.

Finally, in comparing the position in India and the UK, we have already seen that Indian law does not adopt the 'have regard to' approach or a hierarchical approach (that puts shareholder interest on top), but rather casts a positive duty on directors to cater to the interests of shareholders and other stakeholders in equal measure. Nor is there is a specific provision in India clarifying that the duty is owed to the company, leaving open the question of whether there is an enforceable right given to any of the stakeholders to bring an action for breach of duty. However, in the UK, shareholder interests continue to be paramount, and it is clear that directors owe their duties only to the company (and not directly to shareholders or other stakeholders). At first blush, the textual analyses of the statutory provisions in India and the UK suggest a great deal of disparity in the treatment of stakeholders as beneficiaries of directors' duties. While India appears to have adopted the pluralist approach (that was expressly rejected in the UK), the UK has expressly resorted to the ESV model (that India seems to have distanced itself from). On that count, India seems to have granted better protection to stakeholders in comparison with the UK.

[21] The point that there may be two duties does not detract from the proposition, discussed later, that both the duties are of good faith.

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However, if we were to dig deeper into the legalities of the enforcement of directors' duties and other operational matters regarding the assertion of rights by stakeholders, an altogether different picture emerges. Despite the textual disparity between Indian and English law in the directors' duties to uphold stakeholder interests, we find that a deeper analysis suggests that the two regimes are not entirely far apart. Several issues relating to the inability of stakeholders to assert their rights and take advantage of a seemingly beneficial regime brings the law in India somewhat closer to English law than it appears at the outset. We examine these matters in the following section.

THE PROBLEMS: POTENTIAL ISSUES ARISING IN IMPLEMENTATION

The scope and effectiveness of section 166 of the 2013 Act in India ought to be really tested in its functioning and implementation. In doing so, it is clear that a number of problems emerge. Stakeholder interests are not as wide-ranging as the text of the provisions would suggest. This is because stakeholders are devoid of remedies in case directors breach their duty to act in their interests. The common remedies of derivative action and class action are available only to shareholders and not to other stakeholders. Moreover, the nature of the directors' duties themselves is fuzzy and incapable of clear enforcement. The pluralistic approach towards the stakeholder theory reveals several shortcomings that make section 166 operate more by way of rhetoric than legally enforceable rights to stakeholders. To that extent, section 166 of the 2013 Act in India does no better in protecting stakeholder interests than section 172 of the 2006 Act in the UK, thereby reducing the dissimilarities in the operation of the two provisions.

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The Lack of Enforcement Powers

The first question that confronts us on a plain reading of section 166 is: to whom are these duties owed? How are they enforceable? A rather straightforward argument would be one based on a literal meaning of the words used. The argument would be that section 166 states in terms that the directors must act in good faith to promote the objects of the company, and must also act in good faith in the best interests of the stakeholders. Thus, section 166 casts a specific obligation to act in good faith in the best interests of the stakeholders. This, coupled with the omission of a provision similar to the English section 170(1) (that clarifies that the duties are owed to the company), suggests that duties

are owed to each individual stakeholder too. It could then be further argued that as the duty is owed to the stakeholders, there would be nothing to bar a civil claim raised by the stakeholders, for instance.

We respectfully submit that such an argument would be entirely misconceived. We support our position by beginning with a brief discussion on duties and remedies under general law, and then proceed to consider the remedies of stakeholders under company law.The answer to the question of whether a statutory provision gives rise to a civil action depends "*on a consideration of the whole Act and the circumstances, including the pre-existing law, in which it was enacted…*"[22]If one were to examine the section 166 from this angle, it is evident that the provisions cannot be realistically interpreted to give a right of action to all stakeholders.

First, the text is not all that clear. As we noted in the previous section, the Standing Committee in its concluding remarks seems to have read the clause in a different manner: the committee mentions that the duty is one of promoting the objects of the company, and stakeholder interests are to be necessarily taken into account in promoting the objects. The duty is however still only of promoting the objects.

Secondly, the categories of stakeholders mentioned in the clause are fairly vague; and at least in respect of some categories, it is clear that there is no 'injured party' except the larger public interest. For instance, the only easily ascertainable category of stakeholders is 'employees'.[23] It is evident that Parliament could not have intended that a right to sue accrues independently to stakeholders as vague as 'the community' and 'the environment'. Generally speaking, the editors of Winfield note, "*… where there is no [limited, identifiable] class, it is inherently unlikely that Parliament would have intended a duty, sounding in damages, to the public as a whole in the absence of plain*

[22] *Cutler v. Wandsworth Stadium* [1949] AC 3398 at 407.

[23] Companies Act, 2013. 'Creditors' as a category of stakeholders are conspicuous by their absence in the statutory provision, and hence are not stated beneficiaries thereof. In the UK too, while section 172(1) of the 2006 does not expressly include creditors as a beneficiary of the provision, section 172(3) preserves the interests of creditors under general law (which presumably encompasses insolvency law). French, et al, *Mayson, French & Ryan on Company Law* (Oxford University Press, 2014), p. 483.

words…”[24]

Thirdly, any such wide understanding of to whom the duty is owed would throw much of the modern law of negligence into disarray. The law of negligence identifies three approaches to the question of determination of ‘duty of care’. The first is the “tripartite test”: (i) is the harm foreseeable? (ii) is there sufficient proximity between the parties? and (iii) would the imposition of a duty of care be fair, just and reasonable?[25] The second approach involves asking whether there is an “assumption of responsibility”.[26] Third, there is an incremental approach of expanding the categories of duty of care by drawing analogies from existing, settled categories.[27] It is evident that none of these approaches readily accommodates a broad idea of a duty of care to all stakeholders. It would be a rather surprising result if section 166 were then to be interpreted as brushing away at a stroke the entire basis of the modern law on when there is a duty of care in tort.

Finally, there is nothing particularly odd or incoherent with saying that the law casts a duty that is owed by the directors to one person (the company), which involves taking into consideration the interests of third persons (stakeholders). Company law itself provides for a similar case: duties owed by the directors to consider the interests of existing creditors.[28] Insofar as existing creditors are concerned, duties are owed to them through the company. The creditors’ interests are protected by proceedings in the name of the company to which ratification by the shareholders is no defence.[29] Thus, no individual creditor can bring any claim against the company: proceedings are brought in the name of the company itself. This is analogous to the principle whereby, ordinarily, shareholders cannot bring a claim in respect of the company’s losses against a third party: the claim must be brought by the company. To that extent, section 166 is consistent with English law whereby in case of a breach

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[24] WVH Rogers, *Winfield & Jolowicz on Tort*(18th ed, Sweet & Maxwell, 2010), p. 387. They give the example of *Mid Kent Holdings v General Utilities* [1997] 1 WLR 14, where a literal interpretation of section 93A the (UK) Fair Trading Act 1973 would have led to what is termed as an ‘extraordinary’ result “…*of allowing any of the whole population to bring proceedings to enforce an undertaking to the Minister…*” It is submitted that an interpretation of section 166 giving a cause of action to members of the ‘community’ would be no less extraordinary.
[25] *Caparo Industries v Dickman* [1990] 2 AC 605
[26] *Customs & Excise Commissioners v Barclays* [2006] UKHL 28.
[27] *Winfield & Jolowicz on Tort* (2010), p. 161
[28] Lord Templeman’s statement in *Winkworth v Edward Baron Development Co.* [1986] 1 WLR 1512 that a company owes a duty to future and present creditors to preserve its assets, is presumably limited to the context of a company which is unlikely to remain solvent. See Goode, *Principles of Corporate Insolvency* (3rd ed, Sweet & Maxwell, 2005), p. 522.
[29] *Miller v. Bain* [2002] 1 BCLC 266; DD Prentice, ‘Creditors Interests and Directors Duties’ (1990) 10 OJLS 275.

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of directors' duties, it is only the company that is entitled to bring an action, and neither shareholders nor other stakeholders can directly seek remedies against the directors.[30]

Thus, conceptually, there is nothing extraordinary with saying that the duties under section 166 are owed to the *company*. This is a well-established principle of company law,[31] and section 166 does nothing to alter that position. This still leaves open the point of enforcement. Insofar as creditors' interests are concerned, that aspect becomes relevant mainly during insolvency, and the liquidator is empowered to bring the necessary proceedings in the name of the company. [32]Shareholders enjoy the benefit of bringing a derivative action in exceptional cases. But how can the law ensure that stakeholder interests are protected? If the company is the one that can bring an action, but refuses to do so (which is especially likely in a case where the interests of the majority shareholder and the stakeholders are in conflict), what is the value to be attached to the pluralist approach?[33] Here, we examine two possible actions under Indian law that may be brought by persons other than the company (operating through the board of directors). We begin with class actions (that have been statutorily recognized under the 2013 Act) and then consider derivative actions (that, although not statutorily recognized, are possible under common law).

Scope of the Directors' Duties

We now turn to the content of the duty itself. The words used by Parliament suggest that the duty on directors is to '…*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,*

[30] An extensive body of literature affirms this point in the context of section 172 of the 2006 Act in the UK. This is more so because section 170(3) expressly states that directors' duties are owed to the company. Kiarie, 'At crossroads', p. 331; Tate, 'Section 172 CA 2006'; Andrew Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' (2010), available at http://ssrn.com/abstract=1662411, p. 13;Martin Gelter & Genevieve Helleringer, 'Lift Not the Painted Veil! To Whom are Directors' Duties Really Owed?' [2015] Ill L Rev 1069, at p. 1095; Lynch, 'Section 172', p. 200; Ahmed Al-Hawamdeh, et al, 'The interpretation of the director's duty under section 172 Companies Act 2006: insights from complexity theory' [2013] JBL 417, at p. 420.

[31] In *Percival v Wright* [1902] 2 Ch421 it was established that directors owed their duties to the company and not directly to shareholders.

[32] It must be pointed out that loss suffered by individual creditors is not recoverable directly. Analogous to principles barring direct claims by shareholders in respect of breaches to the company, the loss to creditors is 'a reflection of the loss to the company', and the liquidator can recover this in the name of the company. Any recovery will go to increase the general pool of assets available in liquidation. See: *Johnson v. Gore Wood & Co*., [2002] 2 AC 1; Goode, *Principles of Corporate* Insolvency, at 522-523.

[33] Employees may have a right to sue under applicable labour laws; other stakeholders may have some specific remedies: that however, does not answer the question in principle regarding the enforcement of directors' duties in company law, of which stakeholders are the ultimate beneficiaries.

the community and for the protection of environment…'

The first question that arises is whether the 'good faith' qualification applies only to the first part of the clause (i.e. to the words '*in order to promote the objects of the company for the benefit of its members as a whole,*') or whether the qualification applies to the second part as well. The difference is not merely semantic: if the good faith qualification applies only to the first part, that would mean that the second part is an objective test. In other words, is it the case that (a) directors must act <u>in good faith</u> in order to promote the objects of the company as a whole, and

- directors must act in the best interests of the company, its employees, the shareholders, the community and for the protection of environment? Or is it instead the case that

a) directors must act <u>in good faith</u> in order to promote the interests of the company as a whole and

b) directors must act <u>in good faith</u> in the best interests of the company, its employees, the shareholders, the community and for the protection of environment? In the first interpretation, the 'good faith' qualifier operates only with respect to promoting the objects of the company as a whole, while in the second it also extents to acting in the interests of stakeholders.

It is submitted that the language is capable of both meanings; but the provision ought not to be construed as giving rise to a duty of objectively acting in the best interests of stakeholders. The section must be read as meaning that there is a duty on directors to act in order to promote the objects of the company as a whole and to act in the best interests of the company and the stakeholders; however, this duty is to be assessed not by an objective test of what the best interests are. Rather, it would be sufficient if the directors subjectively believe in good faith that they are acting in the interests of all stakeholders. This again does not make the provision meaningless: there is a positive duty on directors to actively consider the interests of stakeholders. If an objective interpretation were preferred, directors would be under a duty to objectively act in the best interests of all the stakeholders. It would often be impossible for directors to be objectively right about whether to prefer the interests of shareholders or employees, for instance. The objective interpretation will also not sit comfortably with the legislative history and Parliamentary materials, including the Standing Committee's views.

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In sum, therefore, it seems that the best interpretation of the clause is to consider that it casts a duty on directors that is owed to the company. What directors *could* have done under common law, they *must* do now. To effectively discharge this duty, directors must act in order to promote the objects of the company, in the best interests of the company as well as other stakeholders. However, the principle in *Smith & Fawcett*[34]continues to apply while discharging the duty. In passing, it is also worth noting that a subjective duty imposed on the directors coupled with a pluralist approach towards stakeholders' interest may turn out to be a recipe for failure. The pluralist approach is confronted with several problems.[35] Due to the subject nature of the duty, directors could be faced with several choices. For instance, in case of conflict between the interests of shareholders and stakeholder, or among various types of stakeholders, whose interests do they ought to prefer? This leaves with directors with substantial (and somewhat untrammeled) discretion.[36] More dangerously, the opportunity available to the directors to balance various competing interests may be utilised to foster their own self-interest, and leave them with little accountability to anyone.[37] All of these could potentially have the effect of substantially diluting the interests of stakeholders.

The subjective nature of the directors' duties regarding stakeholder interests is similar to the one that ensues in the UK where the position is stated rather expressly. As previously discussed, directors in English companies only need to "have regard" to stakeholders' interests while discharging their duties.[38] More pertinently, if the common law that preceded the 2006 Companies Act made the relevant directors' duties subjective, that position has not altered under statute. Section 172 expressly provides that a director "*must act <u>in the way he considers</u>, in good faith, would be most likely to promote the success of the company* ...". It is clear that directors enjoy a great deal of discretion in that it is for the directors rather than for the courts to decide whether and how the various stakeholders' interests are to be considered when directors discharge their duties.[39] For this reason,

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[34] See n. 46 above.
[35] For this reason, the approach was jettisoned in the UK in favour of the ESV approach.
[36] See Vikramaditya Khanna & Umakanth Varottil, 'Board Independence in India: From Form to Function?' in Harald Baum, et al, *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (Cambridge University Press, 2016 forthcoming), available at http://ssrn.com/abstract=2752401, p. 26.
[37] Keay, 'The Duty to Promote the Success of the Company', p. 18;Mark Arnold & Marcus Haywood, 'Duty to Promote the Success of the Company' in Simon Mortimore QC, *Company Directors: Duties, Liabilities, and Remedies* (Oxford University Press, 2013), p. 257. It is to avoid such a situation that the UK adopted the ESV approach that will make boards accountable to at least one constituency, viz. shareholders.
[38] Companies Act 2006, s. 172(1).
[39] See Keay, 'Stakeholder Theory in Corporate Law', p. 287.

even if a shareholder derivative action were possible, it would be an onerous task on the part of the claimant to demonstrate the breach of directors' duties as the situation is dependent upon the subjective opinion of the relevant director, which can be defensible in a number of ways.[40] A claim, if at all, may lie only if the director acted so egregiously as to have failed to act in good faith.[41] This may not be easy to establish for a claimant.

In sum, both in India as well as the UK, there could be difficulties in the implementation and enforcement of directors' duties under section 166(2) of the 2013 Act and section 172 of the 2006 Act respectively. In both jurisdictions, stakeholders do not enjoy meaningful remedies in case of breach of directors' duties that require them to take care of stakeholder interests. Mechanisms such as derivative actions and class actions are woefully inadequate. While shareholders, in theory, could espouse the claims of stakeholders, we are not sanguine that there is reason for them to do so. Even if they do, we do not expect them to succeed as it would be incongruous for shareholders to pursue claims on behalf of stakeholders. In any event, the high degree of subjectivity in the duties imposed on directors not only compound the problems of stakeholders, but it also confers a great amount of discretion to directors that they could potentially use to act in their own interest. Both the pluralist approach in India and the ESV

CONCLUSION

Section 166(2) is likely to be considered by courts and tribunals sooner rather than later. However, as far as tackling the problems in the existing provision are concerned (some of which we have pointed out above), it seems that a well-thought out legislative reconsideration would be more appropriate than fashioning ad-hoc judicial responses. As we have seen, providing real ammunition to stakeholders on the basis of the existing provision is likely to be a double-edged sword: any innovative approach by the judiciary is likely to have repercussions on the entire scheme of the common law which are better addressed by legislative rather than judicial measures. The question of what remedies are to be provided to stakeholders must be one which needs to be squarely addressed in any legislative reformulation of the provisions.

[40] Lynch, 'Section 172', p. 201.
[41] See Keay, 'Stakeholder Theory in Corporate Law', p. 287.

Meanwhile, courts and tribunals will have to ensure that the provision does not become a shield for directors from all accountability. In other words, it will be for the judiciary to ensure that the provision does not become a means of excuse to the director who acts in neither the shareholders' nor the stakeholders' interests. If a director claims the she acted in good faith to balance the interests of shareholders and stakeholders, that claim must be scrutinized through properly manageable judicial standards. Evolving those standards of scrutiny – perhaps by incrementally developing on the common law standards of scrutiny of the actions of directors – is likely to be the most important challenge the judiciary will have to address in deciding cases involving the application of section 166(2).

We do not suggest that courts or tribunals should substitute the judgment of directors with their own judgment. However, a case may well be made out that a purposive reading of the provisions compels courts to proactively satisfy themselves that the judgment of the directors was actually held in good faith, and was based on relevant materials and considerations.