

## **Corporate Governance: Fiduciary Duties of Executive and Non-executive Directors**

We have so far delved into governance protections available to shareholders under law and contract. In this article we focus on directors and their pivotal role in companies as well as a brief analysis of the statutory obligations bestowed on directors (including nominee directors) under the Companies Act, 2013 (the “Act”). Directors are the custodians of a company’s vision and serve as a representative of shareholders’ interests. They are responsible for making key strategic decisions in a company, overseeing management and safeguarding shareholder interests within the contours of the law, in an ethical and accountable manner thereby ensuring business decisions align with the company’s values.

### **Fiduciary duties of directors**

- In addition to the obligation to comply with a company’s constitutional documents and the law, directors have been bestowed with fiduciary duties under the Act (Section 166) requiring them to act in good faith in the best interests of the company, its employees, shareholders, community and for the protection of the environment. These fiduciary obligations form the backbone of ethical corporate governance, ensuring that directors place a company’s long-term sustainability and shareholder trust above their personal interests.
- Directors are also required to exercise their duties with reasonable care, skill, diligence, and independent judgement. The expected degree of skill and diligence required is to exercise reasonable care which an ordinary man might be expected to take in the circumstances. Several instances of ‘reasonable care, skill and diligence’ have been tested in courts to uphold the expectation of oversight and prudence required by directors in different scenarios.
- The Delhi High Court in one instance observed that obtaining legal opinions by directors of a company to support the applicability of specific legal provisions displayed reasonable care and diligence on their part (*Ashok Bhatia and Ors. Vs. Registrar of Companies, Delhi & Haryana and Ors. 1992 (23) DRJ527*). Notably also, where a director was being prosecuted for signing financial statements which incorrectly recorded deposits as secured loans, the High Court of Punjab and Haryana opined that the director ought to have exercised his duties with reasonable care and independent judgement, irrespective of the intricacies involved in preparing the financial statements, and that the blame cannot be shifted on the advisor, whose statement the said director had allegedly relied upon (*Vijay Shukla vs Serious Fraud Investigation Officer AIR ONLINE 2021 P AND H 792*).
- Ensuring undue advantages for themselves or others is a key principle that directors must follow by avoiding situations where their interest conflict with those of the company. They must not, in any manner, achieve personal gain at the company’s expense. In a situation where a director had set up a competing business and diverted employees and customers from the concerned company to the newly set up business, the Delhi High Court (*Rajeev Saumitra vs Neetu Singh & Ors ((2016) 198 Comp Cas 359)*) ordered the director to pay up the undue gains. The Court also opined that such conflict of interest is liable to be set aside by the court of law.

- Another case concerning a conflicted director involved a managing director who, by virtue of his position, had inured undue gains by utilizing the goodwill of the company. This resulted in the concerned company losing revenue and jeopardized the interests of its employees, who were deprived of their statutory benefits. The National Company Law Tribunal (NCLT), emphasising the necessity of adhering to the provisions of corporate governance and acting in the interest of the stakeholders, allowed for the removal of the managing director in question (*Dispur Polyclinic and Hospital Private Limited and Ors v/s Dr. Nilim Kr. Deka and Anr IA/Comp. Act/6/GB/2022 in CP/18/GB/2021*).

### **Non-executive directors: Role and statutory framework**

While the general principles set out above apply to all directors, its imperative to focus on the liability of non-executive directors. Executive directors are those who are in charge of the business and day-to-day affairs of a company and designated as whole-time directors / managing directors; whereas non-executive directors, to the contrary, are not in charge of the affairs or operations of the company.

Investors often acquire the right to appoint their nominees on board of companies. While such non-executive directors participate in key strategic decisions, the positions of investors has always been that they are not involved in the day-to-day operations of the company and hence cannot be held to be officers of the company. The Act supports this intent and provides for a non-obstante provision (Section 149 (12) of the Act) that a non-executive director (*not being a promoter or key managerial personnel*) is only to be held liable in respect of any acts of omission or commission by a company where such acts had occurred with his knowledge, attributable through board process and with his consent or connivance or where he had not acted diligently.

In furtherance of the above, the Ministry of Corporate Affairs (the “**MCA**”) has clarified through operating procedures that non-executive directors should not be portrayed in any criminal or civil proceedings under the Act, unless the criteria (under Section 149 (12)) are met. The nature of default must be set out as crucial for arraigning officers of the company as defaulters. Instances of general compliance such as filing of information with the registry, maintenance of statutory registers or minutes of meetings, or compliance with orders issued by statutory authorities under the Act are not the responsibility of non-executive directors unless provided under the Act. That said, the responsibility of non-executive directors should ordinarily arise only in cases where there are no whole-time directors or key managerial personnel involved. Where lapses are attributable to board decisions, reliance is initially placed on records available with the Registrar of Companies (“**ROC**”), including e-forms, to ascertain the presence of a director or key managerial personnel in the company as on the date of default.

Pertinently, vague averments against non-executive directors, without detailing their specific roles in relation to the concerned company, were rejected after taking into consideration the records of the ROC, which indicated that such directors were non-executive directors (*Kiran Chintamani Vaidya vs Dilbagh Singh Rohilla 2024:PHHC:058612*).

Therefore, while courts have assumed liability with respect to managing directors/whole-time directors, owing to the executive nature of their office, the law and courts necessitate corroboration of averments against non-executive directors, as officers of the company who are in default for the acts or omissions on part of the company that occurred with their knowledge or active participation (*Shailyamanyu Singh vs The State of Maharashtra 2025 INSC 995*). Courts have also held in the case of *Dayle De’ Sourza v. Union of India ((2021) 20 SCC 135)*, that the primary responsibility is upon the complainant to make

specific averments to make the accused vicariously liable for the offence committed by the company and that while fastening the criminal liability, there is no presumption that every director knows about all transactions of the company and that criminal liability can only be fastened upon those directors or persons, who at the time of commission of the offence, were in charge of and were responsible for the day-to-day business of the company.

In a case, where prosecution was initiated against non-executive directors under the Negotiable Instruments Act, 1881 for dishonour of cheques issued by a company, the Supreme Court held that participation by directors in a meeting cannot be construed as control over financial decisions or operational management. The Court rejected the prosecution's contention that attendance of board meetings by non-executive directors established knowledge on their part of issuance of the dishonoured cheques, thereby reiterating that it is no presumption "*that every Director knows about the transaction*" (*K.S. Mehta v/s Morgan Securities and Credits Private Limited 2025 INSC 315*).

However, while there are safe harbours for non-executive directors under the law, it is imperative to note that where intent or adverse findings have been established in relation to an investor director, there is no escaping the consequences of law. Courts have held that merely because a director has been appointed by an investor, it cannot be said that such a director is a nominee or non-executive director of the company so as to seek the quashing of an FIR (first information report). The aspect of involvement of such a director in the offence can only be ascertained after investigation is completed (*Shantanu Rastogi and Ors. v/s. The State of Karnataka and Ors 2021:KHC:3136*). Given that the contours of an officer in default are broad, the benefit of doubt must be extended to non-executive directors, considering they are not involved in the day-to-day conduct of the business; however, he/she may not be completely absolved of liability where there is an actual intent or where any contraventions have occurred with the director's consent or connivance.

From a contractual standpoint however, investee companies are typically required to maintain a directors and officers' insurance to ensure directors (including specifically, non-executive directors) are covered for monetary losses and are not held liable for defaults by a company under the Act or other laws applicable to the company. Further, Shareholders' agreements include provisions for indemnification of non-executive directors appointed by investors, against all losses incurred or suffered by them. Provisions are often also included to ensure that such investor representatives are not made party to any suit or proceedings, whether civil or criminal in nature.

Legal jurisprudence time and again reminds us that even though there are statutory protections in place, the law will not differentiate if there is active involvement by a party in the violation of law. It is important for investors to limit their involvement in companies, so that their representatives are not designated as 'compliance officers' or 'officers in default'. For key strategic matters, investors may consider having a limited list of reserved / veto matters (refer to our [previous article](#) in this respect), exercisable by the investor and not their nominee directors. To remain in the know of things, investors should also consider having observer seats instead of board nominations. As companies continue to accept investments for growth, a fine balance needs to be achieved between investor involvement, value addition and investment protection.

**Authors:**

Harsha Sagar | Poonam Sharma | Karan Kalra

Contact: [poonam@bombaylawchambers.com](mailto:poonam@bombaylawchambers.com) | [karan@bombaychambers.com](mailto:karan@bombaychambers.com)