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

Mihir Naniwadekar & Umakanth Varottil***

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

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I. 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 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

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 embodied 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).

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.

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”). Briefly, this requires directors to have regard to non-shareholder interests *as a means* of enhancing shareholder value over the long term.⁵ Although this is a hybrid approach that adopts features of both the shareholder and stakeholder theories, in the event of a conflict among various interests, it has a stated preference for shareholder interest thereby creating a distinct hierarchy. 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 (without necessarily constituting a means to enhancing shareholder value).⁶ This approach stays true to the stakeholder model in corporate law.

In this article, we examine the nature and content of the duty cast under section 166(2) of the 2013 Act in India. We consider the implications of the duty on the scheme of the law generally, and how it is likely to impact other settled principles. We also examine some of the difficult questions emanating from section 166(2). How do directors resolve conflicts among various stakeholder interests? How do non-shareholder constituencies obtain the benefit of these directors’ duties? How should Indian courts rationalize and apply the provisions of section 166(2)? In looking at these questions, we also draw on the experiences from similar debates in other jurisdictions, principally the United Kingdom (UK). We believe that analysing section 166(2) in the context of the comparative developments in the UK will be helpful in several ways. First, both India and the UK have engaged in codification exercises when it comes to directors’ duties in general, and those relating to non-shareholder constituencies in particular. Second, one can make up for the lack of clarity in legislative debates in the enactment of section 166(2) in India by examining the rather detailed legislative efforts and consultations that preceded section 172 in the UK. Such a comparative analysis will shed light on the purpose, scope and meaning of section 166(2), which is an important exercise given that the provision is likely to receive judicial attention in the near future.

⁵ Deryn Fisher, ‘The enlightened shareholder – leaving stakeholders in the dark: will section 172(1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?’ (2009) 20 ICCLR 10; Andrew Keay, ‘Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom’s “Enlightened Shareholder Value Approach”’ (2007) 29 Sydney L Rev 577; Virginia Harper Ho, “‘Enlightened Shareholder Value’: Corporate Governance Beyond the Shareholder-Stakeholder Divide’ (2010) 36 J Corp L 59.

⁶ See Umakanth Varottil, ‘The Evolution of Corporate Law in Post-Colonial India: From Transplant to Autochthony’ (2016) 30 Am U Int’l L Rev (forthcoming).

Our principal thesis in this article is that while section 166(2) of the 2013 Act in India at a superficial level extensively encompasses the interests of non-shareholder constituencies in the context of directors' duties and textually adheres to the pluralist stakeholder 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. Moreover, while the stated preference of the Indian Parliament veers towards the pluralist approach that recognizes the interests of shareholders and non-shareholder constituencies with equal weight, the functioning the Companies Act as well as principles of common law relating to directors' duties makes the Indian situation not altogether different from the ESV model followed in the UK. Proponents of the stakeholder theory in India must do better than to declare victory with the enactment of section 166(2). Arguably, the magnanimity of its verbiage and rhetoric in favour of stakeholders merely pays lip service to them and obscures any real teeth or legal ammunition available to non-shareholder constituencies to assert those rights as a matter of law.

This introduction apart, we begin in the second section of this article with a broad outline of the shareholder-versus-stakeholder debate in the corporate law literature and an examination of the position of stakeholders under law (both in India and the UK) prior to the codification exercise. The third section examines the language of section 166(2) as enacted, and also looks at the intentions of the legislature in introducing the provision in its present form. We also take a brief detour into the provisions of section 172 of the 2006 Act in the UK to examine the similarities and differences in the statutory scheme in the two jurisdictions. The fourth section attempts to look at some of the problems that may arise in applying the language of section 166(2). In particular, we look at the question of conflicts between the interests of various stakeholders inter se, and conflicts between stakeholders on the one hand and shareholders on the other. We also examine whether the recognition of the directors' duties to consider non-stakeholder interests would in any manner affect any broader principles of law. We conclude by offering some brief remarks on how one could interpret the relevant provisions going ahead.

II. 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.⁷ 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.⁸ The question of whether

⁷ Reinier Kraakman, et al, *The Anatomy of Corporate Law* (Oxford: Oxford University Press, 2nd ed, 2009), 12-14.

⁸ 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,

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,⁹ 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.¹⁰ 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 the 1960s with amendments to the Companies Act, 1956 (the predecessor of the 2013 legislation).¹¹ 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.¹² 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,¹³ 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)¹⁴ or in a winding up¹⁵ of the company.

‘Shareholder Value, Company Law and Securities Markets Law’ (2000), available at <http://ssrn.com/abstract=250324>, 6-7.

⁹ 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).

¹⁰ Varottil, ‘The Evolution of Corporate Law in Post-Colonial India’.

¹¹ Ibid.

¹² 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).

¹³ Companies Act, 1956, s. 529-A.

¹⁴ 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).

¹⁵ 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).

As far as creditors are concerned, while company law does provide them with the standard rights and remedies,¹⁶ other special laws confer further corporate law rights such as the ability of the creditors to convert their loans into equity of the debtor company and, more specifically from a corporate governance standpoint, to appoint nominee directors on boards of debtor companies.¹⁷ These rights are seemingly provided to protect the interests of the creditors. Building upon the element of “public interest”, affected parties may exercise remedies in case the affairs of a company are carried out in a manner prejudicial to public interest,¹⁸ or if a scheme of arrangement¹⁹ is not in consonance with public interest.²⁰ For example, while according its sanction to a merger, demerger or corporate restructuring that is carried out through a scheme of arrangement, the court must take into consideration the effect of such a transaction on public interest.²¹ Hence, Indian company law (both under common law as well as statute) did recognise stakeholder interests even before the codification of directors’ duties was effected in 2013.

Moving to the UK, the seemingly shareholder-centric approach adopted in that jurisdiction did leave sufficient room to cater to stakeholder interests. At one level, English courts have been understood to interpret the “interests of the company” as synonymous with the interests of the shareholders as a collective body (rather than individual shareholders).²² Less clear is the answer to the question whether the interests of the shareholders are to be considered in the short term or on a long-term basis.²³ While the realization of short-term value to shareholders will narrow the focus on their interests, a long-term sustainable view of shareholder interests will naturally require the directors to consider the interests of other stakeholders such as employees, creditors

¹⁶ Companies Act, 1956, s. 439(1)(b) (stating that these include the right to initiate a winding up of the company, which is a customary company law right conferred on creditors in most jurisdictions).

¹⁷ See e.g., State Bank of India Act, 1955, s. 35A.

¹⁸ Companies Act, 1956, s. 397(2).

¹⁹ See Jennifer Payne, ‘Schemes of Arrangement, Takeovers and Minority Shareholder Protection’ (2011) 11 J Corp L Stud 67 (mergers, demergers and other forms of corporate restructuring are usually effected through a scheme of arrangement that not only requires the approval of different classes of shareholders and creditors, but also the sanction of the relevant court of law).

²⁰ Companies Act, 1956, s. 394(1), proviso.

²¹ *Hindustan Lever Employees’ Union v Hindustan Lever Ltd* AIR 1995 SC 470.

²² See *Brady v Brady* (1987) 3 BCC 535; Elaine Lynch, ‘Section 172: a ground-breaking reform of director’s duties, or the emperor’s new clothes?’ (2012) 33 Comp Law 196, at 196; Daniel Attenborough, ‘Recent developments in Australian corporate law and their implications for directors’ duties: lessons to be learned from the UK perspective’ (2007) 18 ICCLR 312, at 313.

²³ *Provident International Corporation v International Leasing Corp Ltd* [1969] 1 NSW 424 at 440; *Paramount Communications Inc v Time Inc* 571 A. 2d 1140 (Del, 1989); *Harlowe’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil NL* (1968) 121 CLR 483; *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288 (BCSC); *People’s Department Stores Inc v Wise* [2004] SCC 68; *Lonrho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627 (HL). Keay summarizes the principle emerging from these cases by saying, “while directors are to manage their companies with shareholders in mind, they do have a reasonably wide discretion in the factors which they may consider in deciding what is going to benefit the company.” Andrew Keay, ‘Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom’s “Enlightened Shareholder Value Approach”’ (2007) 29 Sydney L Rev 577 at 581.

and consumers.²⁴ There is, however, some level of clarity that the law has rarely insisted upon realization of short-term profits to shareholders.²⁵ The long-term view of shareholders is consistent with the ESV model.

Moreover, common law as well as statute have recognised the interests of specific stakeholders such as creditors and employees. As already discussed,²⁶ directors must take cognizance of the interests of creditors (whose interests represent that of the company) in case of insolvency. There are also instances of stakeholder interests being considered in specific factual scenarios. For instance, in *Parke v. Daily News*,²⁷ the court considered whether it was legitimate for a company to pay gratuitous compensation to an employee who has been dismissed. An action by a shareholder challenging such gratuitous payment to the employees was allowed.²⁸ The Supreme Court of India considering a somewhat similar issue arrived at a different conclusion: it emphatically considered that it was within the proper purpose of the company to consider employee interests, and upheld the payments of *ex gratia* sums to employees.²⁹ Statutorily, section 309 of the Companies Act 1985 in the UK provided that directors had a duty to consider the interests of employees, although the employees did not have a remedy against the directors for breach of such a duty.³⁰ Hence, while the interests of stakeholders did receive recognition under English law, there was nothing to suggest that these interests were to be considered on par

²⁴ Generally, it is understood that directors are not required to prefer short-term shareholder interests. Illustratively, even if a company makes adequate profits, it may well choose not to distribute them entirely as dividend. Directors may well choose to retain the funds within the company or use them for purposes other than distribution, with the goal of long-term wealth creation, which might benefit other stakeholders as well. There is also no obligation to maximize immediate profits at the cost of long-term interests. Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach"' (2007) 29 Sydney L Rev 577. Also see, for a useful summary, Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations* (2006) at 84-89.

²⁵ Exceptional situations include the extensively debated ruling of a US court in *Dodge v Ford Motor Co* 170 NW 668 (1919) (Michigan) or where a company is up for sale and the principal duty of the directors is to realize the best possible price for shareholders (*Heron International Ltd v. Lord Grade* [1983] BCLC 244 (Court of Appeal)).

²⁶ See nn. 3-4 above.

²⁷ [1962] Ch 927.

²⁸ In a note commenting on this decision, Professor Pennington foreshadowed the modern debate: "*The other question of policy is whether it is satisfactory that directors should be required by law to manage the company's affairs solely with a view to the financial benefit of shareholders. Are there not other interests which deserve recognition..?*" R.R. Pennington, 'Terminal Compensation for Employees of Companies in Liquidation' (1962) 25 Modern Law Review 715.

²⁹ *Shahzada Nand & Sons v CIT*, AIR 1977 SC 1182. The Court held (at para 4):

... It is obvious that no business can prosper unless the employees engaged in it are satisfied and contented and they feel a sense of involvement and identification and this can be best secured by giving them a stake in the business and allowing them to share in the profits... What is the requirement of commercial expediency must be judged not in the light of the 19th Century *laissez faire* doctrine which regarded man as an economic being concerned only to protect and advance his *serf-interest* but in the context of current socio-economic thinking which places the general interest of the community above the personal interest of the individual and believes that a business or undertaking is the product of the combined efforts of the employer and the employees...

³⁰ Lynch, 'Section 172', pp. 198-199.

with that of shareholders. In that sense, the preexisting position appears similar to the ESV model rather than a pluralist approach.³¹

Apart from legal developments, it is also worth noting that the ideas of corporate social responsibility (CSR) and socially responsible investing (SRI) gained traction towards the end of the twentieth century.³² The interests and preferences of institutional investors altered the manner in which boards and managements began viewing stakeholders.³³ To that extent, the ethical preferences of shareholders began driving greater recognition of stakeholder interests.

All of these indicate that stakeholder interests did receive a fair bit of attention in the UK even prior to the reforms that led to the enactment of the 2006 Act. Although stakeholders did not necessarily possess legal enforceable rights against corporate boards, directors did owe duties (to the company) to consider stakeholder interests. Hence, some commentators have argued that the ESV model did exist even prior to the 2006 Act, and that section 172 merely codifies the preexisting position, and does not create any new rights to stakeholders.³⁴

After highlighting that stakeholder interests were recognized both in India and in the UK prior to recent legal reforms, we now analyze the specific statutory duties imposed on directors with respect to the interests of stakeholders in both these jurisdictions.

III. 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

³¹ Ibid.

³² Kiarie, 'At crossroads', p. 336.

³³ Fisher, 'The enlightened shareholder', p. 14.

³⁴ Attenborough, 'Recent developments in Australian corporate law', p. 318; Lynch, 'Section 172', pp. 202-203; Rachel C Tate, 'Section 172 CA 2006: the ticket to stakeholder value or simply tokenism?', available at <https://www.abdn.ac.uk/law/documents/Section172CA2006-theticketstakeholdervalueorsimplytokenism.pdf>.

based on the recommendations of the Irani Committee Report.³⁵ The provision as originally inserted did 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:³⁶

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 the 2013 Act). 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.³⁷ The Standing Committee noted that the Institute of Company Secretaries of India ("ICSI"), the

³⁵ Report of the Expert Committee on Company Law, May 2005 ("Irani Committee Report"). Available at: [http://reports.mca.gov.in/Reports/23-](http://reports.mca.gov.in/Reports/23-Irani%20committee%20report%20of%20the%20expert%20committee%20on%20Company%20law,2005.pdf)

[Irani%20committee%20report%20of%20the%20expert%20committee%20on%20Company%20law,2005.pdf](http://reports.mca.gov.in/Reports/23-Irani%20committee%20report%20of%20the%20expert%20committee%20on%20Company%20law,2005.pdf).

³⁶ Irani Committee Report, Part 3, Chapter IV – Management and Board Governance, Duties and Responsibilities of Directors, paras 18.1 – 18.3, pp. 43 – 44

³⁷ 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>.

professional body regulating company secretaries, had recommended that a specific reference be inserted for a duty of directors towards shareholders, employees, environment and community.³⁸ 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.³⁹ 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:⁴⁰

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...

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.⁴¹

³⁸ Ibid, para. 11.77.

³⁹ Ibid, para. 11.78.

⁴⁰ Ibid, para 11.80.

⁴¹ 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.

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 from the separate references to '*...for the benefit of its members as a whole*' and '*and in the best interest of the company...*' The Committee'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.⁴² 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.

A minor point is in order here: as we have seen,⁴³ it is not as if the common law barred directors from taking into account non-shareholder interests. In the words of Bowen LJ, "*law does not say*

⁴² The point that there may be two duties does not detract from the proposition, discussed later, that both the duties are of good faith.

⁴³ See section II above.

that there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company.”⁴⁴ Again, the common law did not equate shareholder interests with short-termism: directors could well have the discretion even in common law to consider stakeholder interests as a means of promoting long-term shareholder value.⁴⁵ However, the 2006 Act converts that discretion to consider stakeholder interests into a duty to do so.

The common law prior to legislative reformulations cast a duty of loyalty on directors, which included a duty to act in good faith in the best interests of the company. The test was a subjective one. The classic formulation is in *Re Smith & Fawcett*:⁴⁶ “[Directors] must exercise their discretion bona fide in what they consider – not what a court may consider – is in the interest of the company...”⁴⁷ In 1998, when thoughts were given to enacting a new companies statute in England, the UK Department of Trade and Industry constituted a committee, the Company Law Review Steering Group (“CLRSG”) for formulating proposals for reform. The CLRSG saw the question of whose interests the company law ought to protect as being central to any debate on reform of English law.⁴⁸ The CLRSG labeled the two competing principles as ‘shareholder value approach’ and ‘pluralist approach’. Ultimately, the CLRSG adopted the ESV model as a hybrid. It expressly rejected the pluralist approach on the grounds that such an approach would require complete reformulation of the entire law on directors’ duties, and was not desirable or practicable. The UK government adopted this approach, which made its way to section 172. Ultimately, section 172 was enacted to read as follows:

(1)A director of a company must act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to —

- (a)the likely consequences of any decision in the long term,*
- (b)the interests of the company’s employees,*
- (c)the need to foster the company’s business relationships with suppliers, customers and others,*
- (d) the impact of the company’s operations on the community and the environment,*
- (e)the desirability of the company maintaining a reputation for high standards of business conduct, and*
- (f)the need to act fairly between the members of the company.*

⁴⁴ *Hutton v. West Cork Railway*(1883) 23 Ch D 645, at 673.

⁴⁵ This is the position adopted by courts not just in England but also in jurisdictions such as Australia and Delaware: *Provident International Corporation v International Leasing Corp Ltd* [1969] 1 NSW 424 at 440 (Helsham J); *Paramount Communications Inc v Time Inc* 571 A. 2d 1140 (Del, 1989).

⁴⁶ [1942] Ch 304 (CA).

⁴⁷ *Ibid*, at 306.

⁴⁸ The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: The Strategic Framework* <<http://www.berr.gov.uk/files/file23279.pdf>>

The ESV model in the UK thus asserts that the directors are to act in shareholder interests, but in doing so to have regard to certain enumerated stakeholder interests. As one author notes:

Under this conception, attention to traditional “stakeholder” interests such as effect of corporate operations on the environment, employees or local communities, is seen as a *means of* generating long-term shareholder wealth and improving portfolio- and firm-level risk assessment. Enlightened shareholder value thus emphasizes the benefits to *shareholders* that can result from focusing corporate management on areas of shared shareholder and stakeholder concern while recognizing the very real challenges posed by the diversity of shareholder and stakeholder interests.⁴⁹

At the same time, it is clear that stakeholders do not have an independent cause of action against either the company or the directors that enable them to assert their rights.⁵⁰ Moreover, the ESV approach is designed to be clearly hierarchical in that in case of conflict between various interests, the directors must prioritize shareholders’ interests, which is the paramount goal.⁵¹ Such a tiered approach is also borne out by the language of section 172 of the 2006 Act, which imposes an obligation on the directors “to promote the success of the company for the benefit of its members as a whole”, but in doing so only to “have regard to” the interests of the other stakeholders. While the success of the company for the benefits of members is the ultimate goal, having regard to stakeholder interests is only a means to achieving that end.

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.

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

⁴⁹ Harper Ho, “Enlightened Shareholder Value”, p. 62 [emphasis in original].

⁵⁰ Tate, ‘Section 172 CA 2006’.

⁵¹ See Christopher M Bruner, *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* (Cambridge University Press 2013) 34, 44.

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.

IV. 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.

1. 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 stakeholders 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...”⁵² 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’.⁵³ 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 words...”⁵⁴

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?⁵⁵ The second approach involves asking whether there is an “assumption of responsibility”.⁵⁶ Third, there is an incremental approach of expanding the categories of duty of care by drawing analogies from existing, settled categories.⁵⁷ 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

⁵² *Cutler v. Wandsworth Stadium* [1949] AC 3398 at 407.

⁵³ 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.

⁵⁴ 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.

⁵⁵ *Caparo Industries v Dickman* [1990] 2 AC 605

⁵⁶ *Customs & Excise Commissioners v Barclays* [2006] UKHL 28.

⁵⁷ *Winfield & Jolowicz on Tort* (2010), p. 161

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.⁵⁸ 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.⁵⁹ 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 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.⁶⁰

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,⁶¹ 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.⁶² Shareholders enjoy the benefit of bringing

⁵⁸ 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.

⁵⁹ *Miller v. Bain* [2002] 1 BCLC 266; DD Prentice, 'Creditors Interests and Directors Duties' (1990) 10 OJLS 275.

⁶⁰ 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 Hellinger, '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.

⁶¹ In *Percival v Wright* [1902] 2 Ch421 it was established that directors owed their duties to the company and not directly to shareholders.

⁶² 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.

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?⁶³ 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).

Could there be a case for instituting a class action, for example? The class action provisions are contained in section 245 of the 2013 Act. That provision entitles members or depositors to file a class action if they are of the view that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors. The interests of stakeholders are not mentioned here.⁶⁴ However, can members argue that a class action is nonetheless possible, because directors have breached a duty that is owed to the company, and this breach is prejudicial to the interests of the company? It seems that this is not what is intended in the scheme of class actions, which seem to be premised in damage to a class of members. The class action procedure does not seem to be intended to agitate the interests of members of a class other than the suing class. The specific reference to ‘interests of the company or its members and depositors’ appears to indicate that interests of other stakeholders were not in the legislature’s contemplation in crafting the class action remedy. Sub-section (10) provides that subject to compliance with the other sub-sections, a class action may be filed by a person or association representing “*the persons affected by the act or omission, specified in sub-section (1)*”. As noted above, the act or omission specified in sub-section (1) does not contemplate the lack of consideration of interests of persons other than member and depositors.

Hence, not only is the availability of the class action remedy limited to members (and depositors), but it appears that they cannot assuage the rights of other stakeholders in bringing those actions.⁶⁵ Hence, the class action remedy is unavailable to stakeholders in ensuring the enforcement of directors’ duties of which they are the ultimate beneficiaries.

Another possible suggestion, which could perhaps be made if one were anxious to provide some remedy to stakeholders, would be for the initiation of a derivative action against breaching directors to challenge an action that is against stakeholder interests. Since the directors owe a duty to the company, such a derivative action can be brought on behalf of the company with the

⁶³ 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.

⁶⁴ However, it may be worth noting that the remedy of class action is available to depositors, who are certain specific types of creditors of the company. It is not available to other types of creditors or to other stakeholders.

⁶⁵ From a comparative perspective, this issue is immaterial in the UK context as no such statutory class action mechanism is available under the 2006 Act.

benefit of the action flowing to the company (and not to the initiating party). A threshold question is: who can bring a derivative action? Can stakeholders bring a derivative action against errant directors? The answer to these questions is rather straightforward in that the law recognizes that only shareholders can bring derivative actions on behalf of the company against directors who have breached their duties. This is so under Indian law where derivative actions can be brought under common law due to the lack of their express recognition under the 2013 Act.⁶⁶ This position is concomitant with that in the UK where derivative action is codified under the 2006 Act and available only to shareholders.⁶⁷

This then raises the question of whether a person wearing the hat of a shareholder can agitate questions that pertain to the interests of non-shareholder constituencies: does a shareholder have the standing to make claims when her direct interests are not affected?⁶⁸ A possible answer is to say that once the duty is owed to the company and the company does not take steps to enforce this duty, as a derivative action, the shareholder certainly can do so: she need not prove that any duty was directly owed to her at all. Ultimately, the duty is owed to the company and breach necessarily results in legal injury to the company; apart from that, the remedy from the derivative action flows to the company. The ordinary derivative action can typically be categorized under the ‘fraud on the minority’ exception to *Foss v Harbottle*.⁶⁹ A derivative action by the shareholder to enforce a duty to consider stakeholder interests is hard to justify under any of the existing exceptions to the rule; but in principle, the development of an analogous exception cannot be ruled out.⁷⁰ It is however clear that ultimately the fruits of a derivative action enure to the benefit of the company. The action is ‘derivative’ in order to protect the real interests of the company, which cannot protect itself if (say) the wrongdoers are in control. This entire logic breaks down when considering stakeholder interests. Unless the law is expanded – and this would necessarily involve the legislative creation of an entirely new remedy – to encapsulate

⁶⁶ For a detailed analysis of the law on derivative actions in India, see Vikramaditya Khanna & Umakanth Varottil, ‘The rarity of derivative actions in India: reasons and consequences’ in Dan W Puchniak, et al, *The Derivative Action in Asia: A Comparative and Functional Approach* (Cambridge University Press, 2012).

⁶⁷ See Keay, *Stakeholder Theory in Corporate Law*, p. 294 (noting, however, that certain other jurisdictions such as Canada and Singapore do recognize the rights of persons other than shareholders to initiate a derivative action, subject to the discretion of the court).

⁶⁸ Some commentators have suggested possible grounds on which shareholders may initiate derivative actions for breaches of directors’ duties to take into account stakeholder interests. For example, (i) shareholders may sue on the ground that their long-term interests are affected, (ii) shareholders may have dual capacities, for instance as employees, or where shareholders are living in the community where the company carries out operations, and (iii) affected stakeholders may acquire shares so as to become shareholders and obtain the *locus standi* to initiate derivative actions. See Keay, ‘The Duty to Promote the Success of the Company’, p. 27; Tate, ‘Section 172 CA 2006’.

⁶⁹ (1843) 2 Har 461. Under this exception, shareholders initiating a derivative action must show that majority shareholders or controllers obtained a benefit from wrongful conduct at the expense of the company, which suffers some loss or detriment. This continues to be the standard under common law in India. See Khanna & Varottil, ‘The rarity of derivative actions in India’, p. 385.

⁷⁰ The multiple derivative action is one such analogous development. Arad Reisberg, ‘Multiple Derivative Actions’, (2009) 125 *Law Quarterly Review* 209. However, a derivative action by the shareholder to safeguard the interests of stakeholders is a far wider proposition.

stakeholder remedies through shareholder derivative actions, the current law is quite unsatisfactory in enabling shareholders to seek remedies for breach of directors' duties to act in the interests of stakeholders. Here again, analogous positions emanate from both India as well as the UK.

In these circumstances, a more efficacious remedy may well be necessary. This could potentially be found in the provisions of section 241 of the 2013 Act. Can the failure to take into account the interests of stakeholders result in a claim under the oppression and mismanagement provisions? The very fact that directors are in breach could also be relevant to regulatory sanctions. For instance, under section 241(2), the Central Government is entitled to apply to the National Company Law Tribunal (NCLT) for appropriate orders under the oppression and mismanagement chapter, if the Central Government is of the opinion that the affairs of the company are being conducted in a manner prejudicial to the public interest. Failing to consider stakeholder interests is conceivably something that would fall within the scope of this clause. At the same time, oppression and mismanagement provisions are generally meant to be remedies for minority shareholders, and it remains to be seen whether they are an appropriate avenue for assuaging stakeholder interests in case of breach of directors' duties.⁷¹

In all, regardless of the specific approaches followed towards stakeholder empowerment either in India or the UK, the statutory provisions that impose directors' duties to consider the interests of non-shareholder constituencies are not capable of being enforced by their ultimate beneficiaries. To that extent, one may question whether the beneficial provisions contained in section 166(2) of the 2013 Act in India and section 172 of the 2006 Act in India carry any legal wherewithal, or if they are simply aspirational in drawing attention to the interests of stakeholders that boards may not afford to ignore.

2. 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, 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

⁷¹ It is also the case that remedies for oppression and mismanagement are granted only when specified grounds are satisfied. A mere breach of directors' duties, with nothing more, may not necessarily satisfy the requirements of oppression and mismanagement, thereby leaving stakeholders in the lurch.

would mean that the second part is an objective test. In other words, is it the case that (a) directors must act in good faith in order to promote the objects of the company as a whole, and (b) 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 in good faith in order to promote the interests of the company as a whole and (b) directors must act in good faith 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 extends 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.

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*⁷² 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.⁷³ 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

⁷² See n. 46 above.

⁷³ For this reason, the approach was jettisoned in the UK in favour of the ESV approach.

untrammelled) discretion.⁷⁴ 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.⁷⁵ 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.⁷⁶ 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 in the way he considers, 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.⁷⁷ For this reason, 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.⁷⁸ A claim, if at all, may lie only if the director acted so egregiously as to have failed to act in good faith.⁷⁹ 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

⁷⁴ 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.

⁷⁵ Key, '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.

⁷⁶ Companies Act 2006, s. 172(1).

⁷⁷ See Key, 'Stakeholder Theory in Corporate Law', p. 287.

⁷⁸ Lynch, 'Section 172', p. 201.

⁷⁹ See Key, 'Stakeholder Theory in Corporate Law', p. 287.

approach in the UK suffer from similar problems when it comes to such implementation matters. Hence, we conclude in this section that despite the perceived dissimilarities of the approach followed in the two jurisdictions relating to directors' duties to consider stakeholder interests, in the end the ability of the stakeholders to address their concerns remain more or less the same in both. To that extent, stakeholder power in India is not as extensive as it is made out to be.

V. 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.

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 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.
