

POSITION OF DIRECTORS IN A COMPANY

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INTRODUCTION

The law relating to companies in India is contained in the Companies Act, 1956. The Companies Act, 1956 is a consolidation of existing laws, statutory rules and certain principles laid down in decisions of the Courts in India and England. The Act of 1956 substantially incorporates provisions of the English Companies Act, 1948.

A company means, a company formed and registered under the Companies Act, 1956 or under any of the preceding Acts¹. The word company is used to denote an association of persons who have associated together to the conduct or to carry on a business for gain. The persons associating together will contribute some money for the conduct of the business and the amount is known as the share capital of the company. The association will be registered under the Companies Act and thereafter it will be a legal person having an artificial personality.

A company is a legal person who is leaving only in the eyes of law. It's a creation of law which lacks both body and mind. It cannot act, just like a human being. It can act only through some human agency. Directors are those persons through whom company acts and does business. They are collectively known as Board of Directors.

Section 252 – 323 of the Companies Act, 1956 deal with the appointment of directors, remuneration of directors, disqualification of directors, vacation of office by directors, Meeting of Board of Directors.

Board of Directors is the brain and the only brain of the company which is the body, and the company can does act only through the board of directors. A director is a person who has control over the direction, conduct, management, or superintendence of the affairs of the company. Only an individual can be appointed as a director. An association or a firm cannot be appointed as director of a company.

¹Sec. 3 (i) of the Companies Act, 1956.

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It is not easy to explain the position that a director holds in a corporate enterprise. A director is not a servant of any master. He is the controller of the company's affairs. Director of a company is neither an employee nor a servant to the company. They are professional people who were hired by the company to direct its affairs.

However there is no restriction under the Act, that a director cannot be an employee to the company. In *Lee v. Lee's Air Farming Ltd*², it was held that, a director may, however, work as an employee in different capacity. There is no definite definition for director under the Companies Act, 1956. Director includes any person who is occupying the position of a director, whatever name called³. So in order to understand the position of a director in a company we have to look in to various decided cases.

In *Judhah v. Rampada Gupta*⁴, it was held that, director of a company registered under this Act⁵ are persons duly appointed by the company to direct and manage the business of the company. A director is sometimes described as agents, trustees, managing partners etc. But each of these expressions is used not as exhaustive of their powers and responsibilities, but as indicating useful points of view from which they may for the moment and for the particular purpose be considered.

DIRECTOR AS AGENTS

In *Ferguson v. Wilson*⁶, the court clearly recognised that directors are in the eyes of law, agents of the company. It was held that, the company has no person; it can act only through directors and the case is, as regards those directors, merely the ordinary case of a principal and agent. When the directors contract in the name, and on behalf of the company, it is the company which is liable on it and not the directors.

² 1961 AC 12

³ Sec. 2 (13) of the Companies Act, 1956

⁴ AIR 1959 Cal 715.

⁵ Companies Act, 1956.

⁶ (1866) 2 Ch App 77: 15 LT 230

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In *Elkington & Co. v. Hurter*⁷, where the plaintiff supplied certain goods to a company through its chairman, who promised to issue him a debenture for the price, but never did so and company went into liquidation, he was held not liable to the plaintiff. Similarly, a director was held to be personally not liable in a suit against a private chit fund company. Attachment of the property of the director was held to be not permissible⁸.

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

In *Sarathi Leasing Finance Ltd v. B Narayana Shetty*¹⁰, the articles of association empowered the managing director to represent the company in legal proceedings. It was held that a further authorization was not necessary to enable him to file a complaint for dishonor of cheque under Sec. 138 of Negotiable Instrument Act.

Directors are the agents of a company. They are acting on behalf of the company. So the directors cannot be held personally liable for any default of the company. It was held that, for a loan taken by a company, the directors, who had not given any personal guarantee to the creditor, could not be made liable merely because they were directors.

DIRECTOR AS TRUSTEES

Directors are the trustees of the company's money, property and their powers and such must account for all the moneys over which they exercise control and shall refund any moneys improperly paid away, and shall exercise their powers honestly in the interest of the company and all the shareholders, and not their own sectional interest.

The directors of a company are trustees for the company, and for reference to their power of applying funds of the company and for misuse of the power they could be rendered liable as

⁷ (1892) 2 Ch 452

⁸ *Kuriakos v. PVK Group Industries*, (2002) 111 Comp Cas 826 Ker

⁹ (2001) 103 Comp Case 161 Del

¹⁰ (2006) 131 Comp Cas 798 Kant

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trustees and on their death, cause of action survives against their legal representatives¹¹. Directors are those persons selected to manage the affairs of the company for the benefit of shareholders. It is an office of trust, which if they undertake, it is their duty to perform fully and entirely. This peculiar nature of their office is one of the reason why the directors been described as trustees.

In the real sense the directors are not trustees. A trustee is the legal owner of the trust property and contracts in his own name. On the other hand, director is a paid agent or officer of the company and contracts for the company¹². In fact, the directors are commercial men managing a trading concern for the benefit of themselves and of all the shareholders in it.

To whom the directors are trustee? Whether to the company or to the individual shareholders. This principle was laid down in 1902 in *Percival v. Wright*¹³, and still holds ground as a basic proposition. In this case the court held that, directors have no duty towards individual shareholders. From this it is very clear that, the directors are trustees to the company and not of individual shareholders. The principle of the case was reiterated in *Peskin v. Anderson*¹⁴. Ordinarily the directors are not agents or trustees of members or shareholders and owe no fiduciary duties to them.

However we have to take the decision of *Allen v. Hyatt*¹⁵. It was held that, the directors are trustees of the profit for the benefit of the shareholders. They cannot always act under the impression that they owe no duty to the individual shareholders. But it is of no doubt that the primary duty of the director is to the company.

But in such circumstances where the directors act as agents for the share holders, the later would be liable to the purchasers of their shares for any fraudulent misrepresentation made by the directors in the course of negotiations¹⁶.

¹¹ Ramaswamy Iyer v. Brahmayya & Co, [1966] 1 Comp LJ 107

¹² Smith v. Anderson, (1880) 15 Ch D 247 at p 275

¹³ [1902] 2 Ch 421, cited with approval of Madras HC in Ramaswamy Iyer v. Brahmayya & Co, [1966] 1 Comp LJ 107

¹⁴ [2000] 2 BCLC 1

¹⁵ (1914) 30 TLR 444

¹⁶ Briess v. Woolley, 1954 AC 333

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DIRECTOR AS ORGANS OF CORPORATE BODY

The organic theory of corporate life “treats certain officials as organs of the company, for whose action the company is held liable just as a natural person is for the action of his limbs¹⁷. Thus the modern directors are more than mere agents or trustees. The Board is also correctly recognised to be a primary organ of the company. Directors and managers represent the directing mind or will of the company and control what it does.

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

CONCLUSION

A Director is an agent of the Company for the conduct of the business of the company. Directors of a company have fiduciary relationship with the company as well as the shareholders when he acts as an agent or officers of a company.

The director as the Companies Act, 1956 indicates, holds an extremely important position in the administration and management of a Company. It must be noted that the director actually works in different capacities at different times to ensure that the company is run in a legal and an efficient manner. The Act places immense responsibility on the shoulders of the directors.

Directors are bound to use their fair and reasonable diligence while discharging their duties and they shall act honestly, and with such care as may be reasonably expected from, having regard to their knowledge and experience.

The Companies Act has also seeks to introduce an element of objectivity in the office of a director, for this purpose the act also introduced the office of independent directors. However,

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

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the office of independent director has not been as successful in bringing efficient and honest corporate governance as it was expected. The Satyam scam is the biggest example!

Therefore, it can only be concluded that the Companies Act should be suitably be amended to introduce such in built checks and balances that the office of a director does not become an absolute, which practically is the case.