ARTICLE

Concept of "Director" under the Companies Act, 2013–Its Ambivalence

Definition of Director under the Act is restrictive Section 2(34)of the Act provides that a "Director" "means" a Director appointed to the Board of a company." As the definition is a "means" definition, it is Prima facie restrictive and exhaustive as held in (Vanguard Fire &General Insurance Co.Ltd , Madras v Fraser&Ross (AIR 1960 SC 975 at PP975), Kasilingam v PSG College of Technology (1995)(2) Scale 387 and in a host of other citations. When the word "means" is used in the definition as in this case, it is a hard and fast definition and its amplitude is not extendable to consider words that are not part of the definition. No meaning other than what is provided in the definition can be assigned to the definition. From the above definition, it follows that the Statute contemplates that whomsoever who is appointed as Director to the Board of the company shall alone be construed as a Director.

CS Ramaswami Kalidas, FCS
Practicing Company Secretary
Mumbai
ramaswami.kalidas@hotmail.com

INTRODUCTION

There has been a subtle but material change in the definition of the term "Director" under the Companies Act, 2013(hereinafter "The Act") as compared to the definition in the Predecessor Act of 1956.

DEFINITION OF DIRECTOR UNDER THE ACT IS RESTRICTIVE

Section 2(34)of the Act provides that a "Director" means " a Director appointed to the Board of a company."

As the definition is a "means" definition , it is *Prima facie* restrictive and exhaustive as held in *(Vanguard Fire &General Insurance Co.Ltd , Madras v Fraser&Ross (AIR 1960 SC 975 at PP975), Kasilingam v P.S,G,College of Technology (1995)(2)Scale 387* and in a host of other citations.

When the word "means" is used in the definition as in this case, it is a hard and fast definition and its amplitude is not extendable to consider words that are not part of the definition. No meaning other than what is provided in the definition can be assigned to the definition.

From the above definition, it follows that the Statute contemplates that whomsoever is appointed as Director to the Board of the company shall alone be construed as a Director. The definition therefore considers *prima facie* only those individuals who have been appointed as Directors to the company Boards and recognizes the existence of only those that have been appointed *de jure* to the Board and not those that are in fact operating behind the scene in obscurity , holding the reins of authority without officially donning the mantle of a Director. The restrictiveness in the definition has obviously been triggered off due to the exuberance in certain corporate circles to anoint as Director persons in higher echelons of the corporate ladder say as Executive Directors, Director-Marketing without officially appointing them as Directors on the Board.

Persons who are designated with the above nomenclatures could be considered *de facto* Directors since it could be said that they are holding out as Directors without being endowed with any appointment to such position. A *de facto* Director is one who assumes to act as a Director and claims and purports to be a Director despite never being validly appointed to the position. To prove that a person acted as *de facto* Director it is necessary to prove that the incumbent undertook in relation to the company such functions which could be appropriately discharged only by a Director.

It is pertinent to note that the Department of Company Affairs through its circulars dated December 2, 1963 (Reference Company News and Notes) and Circular No.2/82 dated 20.1.1983 has discouraged the use of the nomenclature of the designation in respect of those who are not actually part of the Board. The Department has held out that the above practice needs to be discouraged particularly in the case of Listed Companies as the investing public is likely to be misled into assuming that persons so designated form a part of the Board.

DEFINITION OF DIRECTOR UNDER THE 1956 ACT

Section 2(13) of the 1956 Act defined a Director inclusively thus:

"Director includes any person occupying the position of a Director by whatever name called".

Being an inclusive definition , the definition is extensive and the scope of the definition can be widened to bring within its fold words and expressions which are beyond what has been used in the definition. The term "includes" automatically widens the contours of the definition to consider not only things as they signify according to their natural import but also things which the definition considers that it shall include. An "inclusive" definition does not also exclude the ordinary meaning of the term.

Reference in this connection may be made to the following citations:

1)Dilworth v Commissioner of Stamps (1899)AC 99 at Page 105)(PC)

2)State of Bombay v Hospital Mazdoor Sabha (AIR 1960) (SC 610 at Page 614).

The definition in the old Act also conjures up someone who is occupying the position of Director regardless of the nomenclature used to describe him. It is not the name by which the person is described which is material but the position he occupies and the functions and duties he discharges which are relevant in determining whether a person is a Director.

In *Forest of Dean Coal Mining Co, In re.(1878)(10 Ch.D450*) it was observed that :

"function is everything. Name matters nothing. So long as a person is duly appointed by the company to control the company's business and authorized by the articles to contract in the company's name and on its behalf , he functions as a Director."

Thus the definition considers not only a *de jure* Director but also a *de facto* Director who wields authority as Director without actually being appointed to the Board.

The present Act confines the expression as discussed only to those who have been appointed as Directors to the Board of the company.

DEFINITION IN THE OLD ACT USES THE EXPRESSION "PERSON" THE FALLOUT THEREOF

It is also important to note that under the former Act a Director was referred to as a "person".

The term "person" was not defined in the Act and one had to therefore necessarily fall back on the definition provided to the term in Clause (42) under Section 2 of the General Clauses Act , 1897 which carries the following *definition "Person shall include any company or association or body of individuals , whether incorporated or not".*

The definition carries a very wide import and would include a juristic person such as an idol or the Gurugranth Shab installed in a public temple (*Shiromani Gurudwara Prabandhak Committee, Amritsar v Shri Som Nath Dass (AIR 2000 SC 1421*)or a company*(Union Bank of India v Khader International Construction (AIR 2001 SC 2277) (2001)..*

The term "person" shall also include a local authority and as held in *Applin v Race Relations Board (1974)2 All Er 73 at Page 92 and 93)* and a contrary intention cannot be inferred simply by virtue of the fact that the legislature after using the word "person" uses the pronoun "him".

DEFINITION OF "PERSON" HAS TO BE CONTROLLED IN A PARTICULAR ACT CONTEXTUALLY

Notwithstanding the wide amplitude to the term "person" as provided above, the Supreme Court had cautioned in its decision in *Dulichand v CIT(AIR 1956 SC 354)*that in any particular Statute the meaning of the word "person" may get controlled by the context.

Under the Companies Act if the term "person" were used in the widest sense , corporate entities could also come within the scope of the definition of "Director". In as much as the Companies Act provides for vicarious liability in respect of certain individuals for non- compliances of the Statute , the scope of the expression "Director" has to be restricted necessarily only to cover individuals. The Apex Court has held for this reason that the expression "Director" can be used only to describe natural persons-individuals.*(Oriental Metal Processing (P)Ltd v Kashinath Thakur(AIR SC 573)(1961).*

Therefore notwithstanding the use of the expression "person" in the former Act to describe a Director, its meaning has to be restricted to cover only individuals.

CHANGE IN DEFINITION OF DIRECTOR IN THE PRESENT ACT SHOULD NOT LEAD TO PRESUMPTUOUS CONCLUSION THAT ITS APPLICABILITY IS RESTRICTED ONLY TO THE DEFINITION IN THE ACT

It is pertinent to note that the restrictiveness in the definition of the term "Director" in the present Act should not be misconstrued such as to lead to a premature conclusion that, for all intents and purposes of the Act, the Director would be one who has been appointed as such to the Board. This is on account of the inter play of certain other provisions in the Act which tend to make the connotation of the term elastic.

DIRECTOR IS AN "OFFICER" UNDER SECTION 2(59)

The definition of "Officer" in the above clause is inclusive and includes any Director, manager or Key Managerial Person or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the Directors is or are accustomed to act.

The term officer would thus cover, apart from Directors, the Manager as defined under Section 2(53), a Key Managerial Personnel as defined in Section 2(51) or any person in accordance with whose directions or instructions the Board or any one or more Directors of the company are accustomed to act.

The term "officer" as can be seen from the above has a wide import to include persons who are regularly employed as part of their business or occupation in conducting the affairs of a company. The Secretary, Accountant and cashiers are all "officers" as held in *Official Liquidator, Golcha Properties P Ltd v P.C,Dhadda (1980)(50 Com Cases 175(Raj.).*

The term has been held to include Assistant Secretaries, Branch Managers etc, in *Suryanarayana (M)v Vijaya Commercial Bank Ltd (1959) (29Com Cases 114).*The term also includes an Agent of the company whether acting under a power of attorney or not .It could also include an Advisor of the company as held in *Satyanath T.S. v J.Thomas &Co.(1985)(57 Com Cases 648)(Cal.).*

USE OF CONJUNCTION "OR" IN THE DEFINITION EXTENDS THE CONNOTATION TO COVER MULTITUDE OF PERSONS

It is pertinent to note that the conjunction "or" has been used consistently in the definition of "officer " above thus making the clauses contained in the same mutually exclusive.

The significance in the usage of the word "or" in a Statute is worth mentioning .The word "or" is grammatically a conjunction which in legal documents actually acts as a disjunctive expression serving or tending to disjoin , separating, dividing , distinguishing between two words as opposed to the word "and" which generally carries a cumulative sense , requiring the fulfilment of all the conditions that it joins together.

Considering the above , the term "officer" covers Directors, the Manager , the KMPs or any person on whose directions or instructions the Board or any one or more of the Directors are accustomed to act. (Emphasis supplied).

It may be noted that the definition of Officer as above is substantially a mirror image of the definition in the previous Act under Section 2(30) except for the inclusion of KMPs in the present Act which was conspicuous by its absence in the previous Act. The KMP is an innovation under the new Act intended to cover within its ambit, persons in the senior Management of the company who can be made responsible for specific functions and hence act as a catalyst in furthering the cause of corporate governance.

> Director is an "officer " under Section 2(59)- The definition of "Officer" in the above clause is inclusive and includes any Director, manager or Key Managerial Person or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the Directors is or are accustomed to act.

Definition of Officer under old Act was amended by the Companies Amendment Act, 1965 to include "any person in accordance with whose directions or instruction the Board of Directors or any one or more of the Directors is or accustomed to act" based on recommendations of Daphtary-Shastri Committee

The introduction of the above words in the definition of "officer " by the Companies Amendment Act, 1965 has brought in its wake a deeming provision ostensibly to ensure that certain persons who were actually holding the reigns of authority in companies behind the scene whilst staying away from the glare that the office of the Director gives rise to, could be brought to book for any wrong doings or aberrations by a company.

The amendment to the Section was made in the light of the recommendations contained in the Report of the Commission of Inquiry on the administration of Dalmia-Jain Companies. It is worthwhile reproducing the relevant portion of the recommendations of the Daphtary-Shastri Committee :

1,"The position of Directors in relation to the shareholder has been likened to that of a trustee in relation to the beneficiary. Directors are generally under an obligation to see that the company's assets are in a proper state of investment and monies of the company are spent only for purposes which are reasonably incidental to and within the reasonable scope of carrying on the business of the company. They should, therefore take active and immediate steps to prevent any misappropriation or breach of trust on the part of their co-Directors. It goes without saying that a Director has positive duties to perform in order to safeguard the interests of the shareholders .A Director

who is a mere puppet in the hands of another remaining in the background cannot effectively take any action in this regard.

The report of the Commission of Inquiry discloses a very sorry state of affairs in this regard to the companies which were under investigation. Paid employees and young and inexperienced relatives were all on the Board of Directors, whereas a person who was not on the Board wielded authority over them, staying in the background and retaining effective control over the assets and liabilities of the company. These persons, when it came to fixing responsibility, pleaded helplessness and pointed to the person who controlled their actions and called themselves variously as Nominee Directors or benamidar Directors or dummy Directors, remaining on the board only to carry out the directions of that other person. Some of these persons were not even aware of the full implication of what they were directed to do and they were mere stooges for the malpractices of the mastermind behind them.(Emphasis provided).

No legislative measure can provide complete safeguard against such clandestine wielding of control over companies. The Companies Act has attempted to cast Directors responsibilities on persons who conceal their identities behind dummies but retain full control over the affairs by including within the meaning of Director "a person in accordance with whose directions or instructions the Board of Directors is accustomed to act" in Sections 102, 303 , 304 , 307 , 308 , 369 , 370 , 538 etc, The state of affairs in the companies under investigation shows that this provision is not enough. A provision requiring each and every Director to file a declaration through the company with the registrar in all cases where he holds the shares on behalf of another, to disclose thereby the person for whose benefit he holds them might provide some safeguard. A further drastic step may also be considered and that is to impose a duty on every Director to disclose by a declaration the person whose directions he is obliged to carry out and by whom his voting is likely to be controlled , if that other person is not on the board of Directors.

The concept of deemed Directors must therefore be enlarged so as to include "persons in accordance with whose directions or instructions the Board of Directors or any one or some of them is or are accustomed to act" in order that the provisions may be effective and a corresponding amendment should be made in the definition of "Officer" in Section 2(30)"(Para 24 of the Report). *(Emphasis supplied).*

*1,*Relevant Extract from the Report of the Daphtaray Shastri Committee Report

The introduction of the specific words as stated above in the definition of "officer " has given rise to the concept of "deemed Director". An individual appointed as Director to the Board is *ipso facto* an officer of the company as held in *Pravin Sankalchand Shah v D.B.Dalal (Official Liquidator)(1967) 37 Com Cases 317(Bom.).*

IMPORT OF THE WORDS "IN ACCORDANCE WITH WHOSE DIRECTIONS THE BOARD IS ACCUSTOMED TO ACT"-CONCEPT OF DEEMED OR SHADOW DIRECTOR

Where the Board of Directors or any one or more Directors of the company are accustomed to act as per the directions or instructions of a person, the person wielding authority behind the scene often in a clandestine manner is a deemed Director and hence would be an officer under the Act.

It is pertinent to note that the expression "accustomed to act" has been borrowed in the Indian law from Section 125(4) of the English Act of 1948 That the Board was accustomed to act in accordance with the directions of another is an aspect which has to be proved circumstantially. It is not always necessary that there should be formal directions as regards the action to be taken by the Board/Directors in relation to any issue.

Where it could be demonstrated that the person was wielding authority and exercised strategic control over the company and also defined the context in which the company should operate the concept of deemed Director would apply. If official instructions flow from the person behind the scenes as to the decisions to be taken by the board it would be a "no brainer" to conclude that the Board was accustomed to act as per his directions. For drawing the conclusion that a person had acted as a shadow Director, it was observed that it should be demonstrated that there was complete control over the affairs of the company *(PFTZM Ltd re,(1995)2BCLC 354).*

Shadow Directors who operate behind the cloak of obscurity shall be treated on par with the Directors of the company in respect of any defaults committed by the company. Fiduciary duties shall also apply to such persons.

Being an Officer of the company due to the extension given as explained above to the concept, a shadow Director would be liable for wrongly acting and dominating the Board and hence prosecuted as held in *Secretary of State for Trade and Industry v Deverall (2000)(2 All ER 365).*A similar decision was provided by the Bombay HC in *Maharashtra Power Corporation Ltd v Dabhol Power Company Ltd (120 Comp Case 506)(2004).*

OFFICER WHO IS IN DEFAULT INCLUDES A SHADOW DIRECTOR

Under clause (v) of Section 2(60) any person in accordance with whose directions or instructions the Board is accustomed to act being a deemed or shadow Director would be liable like any other Director. However, he would not be considered as shadow Director and consequently not held responsible if such directions or instructions have been given to the Board in a professional capacity,

CAN THE HOLDING COMPANY BE CONSIDERED AS A SHADOW DIRECTOR OF A SUBSIDIARY

Often times it is seen that in the context of a conglomerate, decisions in relating to the subsidiary's business affairs are invariably taken by the holding company. The Holding company sometimes has the authority to appoint or remove the majority of Directors in the subsidiary by mutual arrangement. In many cases the Holding company has the final say in so far as declaration of dividend , capital expenditure to be incurred etc, in relation to the Subsidiary.

The important question that arises is whether under the above circumstances the Holding company can be considered as the Shadow Director. This question was examined by the Court in *Hydrodam (Corby) Limited .Re.(1994)2 BCLC 180)(Ch D).*The Court held the view that merely because the holding company was controlling the affairs of the subsidiary , it could not be said that its Directors were shadow Directors in the Subsidiary.

CONCEPT OF SHADOW DIRECTOR IS ONLY INTENDED TO WIDEN THE CANVAS FOR HOLDING PERSONS RESPONSIBLE AS "OFFICERS" UNDER SECTION 2(59)

It is important to note that although a person who is not part of the Board in reality but masquerades as a shadow Director and hence responsible as an officer in default under the deeming provision contained in Section 2(60), does not have to ensure compliances on the lines applicable to persons appointed to such office such as filing of consent, declaration of his interest. He is not considered as being part of the Board. The same goes for someone who holds out as a de facto Director, Having said this, notwithstanding the above, fiduciary duties would apply to the shadow Director as held in *Yukong Line Ltd v Rendsburg Investments Corporation of Liberia (1WLR 294).*

CONCLUSION

From the above discussion we can say that save and except for the restrictiveness associated with the definition of the term under Section 2(34) of the present Act, the Statute is *pari materia* the same where it comes to fixation of responsibilities as Directors on those persons who do not form part of the Board but yet call the shots. The difference in the definition in the term Director under the new Act and the old Act is a sheer matter of semantics , given the extension given to the term Director under Section 2(59) and Section 2(60) which makes one wonder as to whether the change in the definition under Section 2(34) was at all justified. The restrictiveness in Section 2(34) wears thin finally and gets completely obliterated when we look at the deeming provisions in Sections 2(59) and 2(60).