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In order to engage with our readers and simplify the legal complexities of the infrastructure sector, EPC World has partnered with Rajani Associates, a full-service law firm for a series of legal Q&As. Through this Legal Q&A column, **SHISHAM PRIYADARSHINI**, Partner, Rajani Associates and **AMISH SHROFF**, Associate Partner, Rajani Associates, will endeavour to address the queries and challenges faced by our readers.

Shisham Priyadarshini

Amish Shroff

Are there any specific provisions dealing with the duties of the directors under the Companies Act, 2013?

Unlike the erstwhile Companies Act, 1956, the Companies Act, 2013 enumerates specific duties for the directors of the Company. The specified duties of the Directors apply to all types of Directors (including the Independent Directors). Such duties can be broadly classified into fiduciary duties which ensure and secure that the directors of companies always keep the interests of the Company, including its stakeholders, ahead and above their own personal interests; the duties and responsibilities which promote corporate governance through the best efforts of directors in efficient management and swift resolution of critical corporate issues; and duties to act in the manner which will avoid unnecessary risks to the corporate entity and its shareholders.

In the absence of any specific provisions under the Companies Act, 1956, how were the duties of the directors evolved and defined?

As the company acts through the Board of directors, the directors are responsible to ensure regulatory and statutory compliances by the Company. The law relating to the duties of directors has evolved over the period of time into specific duties owed by directors to the Company, its shareholders and all other stakeholders. Prior to the specific provisions under the new Act, the duties of a director were initially elaborated by judges under various decisions of the Courts. In terms of these judicial pronouncements, director has a duty to exercise a reasonable degree of skill and care in carrying out duties and to act in good faith.

The duties set out were based on certain considerations which being the likely consequences of any decision in the long run; the need to foster the company's business relationships with suppliers, customers and any third party; the interests of the company's employees; the impact of the company's operations on the community and the environment; the desirability of the company to maintain a reputation for proper business conduct; and the need to act fairly as between the members of the Company.

What are the specific duties of the directors under the new Act?

The following duties have been imposed on the directors of companies under the new Act. A director of a company shall Act in accordance with the Articles of Association (AOA) of the Company; Act in good faith, in order to promote the objects of the company, for the benefits of the company as a whole, and in the best interests of the stakeholders of the Company; Exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment; Involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the Company; Not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the Company; Not assign his office and any assignment so made shall be void.

What are the penalties prescribed for non-compliance of provisions dealing with duties of the director?

In the event, a director of the Company contravenes the specific provisions dealing with the duties of the director provide that such director shall be punishable with fine which shall not be less than ₹ 1 lakh but which may extend to ₹ 5 lakh. Although, contravention of the provisions attracts penalty {not imprisonment}, it does not render vacation of his office in terms of Section 167 of the Act, unless he becomes disqualified by an order of a court or the Tribunal.

What is the extent to which the directors of the Company can be held liable?

The liability of any Directors of a company can be unlimited if so specified in the Memorandum and Articles of Association or approved through a special resolution authorized by Articles of Association. Any provisions provided in the Article of

Association to indemnify directors against default, negligence, breach of duty or trust is construed to be void. However, in case innocence of the director is proven such indemnity can be enforced. In order to protect the Directors from such eventuality, the Company can obtain insurance for protection against loss caused to it by Directors, also the Director and Officers insurance can be obtained to compensate for loss incurred to the directors due to liability to the company.

Why are exit options crucial for any investors?

An exit strategy for any business venture is discussed between the promoters, the company and investors and agreed upon between them before any investment by the investors in any business venture. An exit option is put in place as a safeguard; risk mitigation; a bargaining power for the investor and more importantly a way to achieve optimal returns for the investment made.

What are the usual exit options for the investors?

There are innumerable permutations and combinations of exit options available to the investors. The three basic groups of exit options, are Right of first refusal/offer; Drag and Tag options and Put and Call options.

What is Right of First Refusal and Right of First Offer?

The Right of First Refusal (ROFR) and the Right of First Offer (ROFO) are contractual rights under an agreement, whereby, a party (being a right holder) is given an option but not under any obligation to enter into a share transfer with the owner of the shares who desires to transfer the shares to third party, before such owner is entitled to enter into the transaction with a third party. A ROFR is triggered when an owner receives an acceptable offer for the shares from a third party. Prior to accepting the third party offer, the owner is contractually obligated to allow the right holder to match the offer from the third party (or upon terms otherwise specified in the agreement). The owner may only proceed with selling the shares to the third party (with the same price and terms) if the right holder refuses to exercise his right. A ROFR is typically incorporated in an agreement when the right holder has a minority stake in the company, a ROFR therefore allows the other shareholders to increase their stake in the company while providing the other party a clean exit.

A ROFO on the other hand is triggered when the owner elects to make the shares available for purchase. In such cases, the owner first offers to sell the shares to the right holder on terms and conditions that are determined by the owner or as laid down in the agreement. If the right holder refuses to exercise its right to purchase the shares, the owner may proceed to offer the shares for sale to third parties. A ROFO is typically used when the Right Holder is on equal footing with the Owner and both have a substantial stake in the company. ROFO allows one of the parties to leave the company without including any third parties to the transaction.

What are Tag Along and Drag Along Rights?

A tag along right gives a shareholder the right to exit along with another shareholder when that other shareholder is exiting the company. A tag is an exit option available to a shareholder who does not wish to be in business with unknown third parties. The Tag is usually granted to minority shareholders and it has a dual benefit of increasing the cost of the offer, as on enforcement of the tag, the third party receives complete (or a substantial) stake in the company. A drag along right is a right granted which allows the right holder to compel the other shareholders to participate in the sale of shares at the same price and terms, in the event the right holder is selling his stake in the company. A Drag therefore ensures that the right holder gets a good price as the shares offered for sale would constitute a majority shareholding even if the right holder does not have the requisite numbers. A drag along right is usually granted to an investor as an additional incentive to invest, the Drag is therefore a means to ensure that the original shareholders are managing the company in the best possible way. The investor with a Drag has complete control of the pricing at which he would sell his shares and the other shareholders must agree to the same price and terms. The investor therefore gets a higher valuation of his investment, though the exit is usually left to be the measure of last resort.

What are Put and Call Options?

An option can be defined as a contract that gives the right holder a right to buy/sell the shares of the company to the other party of the agreement at a pre-determined price on or before a specified time. It is the option holder's prerogative to exercise the acquired right, if and when the right is exercised, the other party has to honour it. Broadly speaking, options can be classified as 'call' or 'put'. A call option is the right to buy the shares and a put option is the right to sell the shares. The right or obligation to buy or sell the underlying asset is always at a pre-decided price known as the 'exercise price'; the price may be either a specific amount or the market price as on the date. A call option is usually granted to the majority shareholder, who has direct control of the company and is actively engaged in its management. It is granted to ensure that the minority shareholding does not create hurdles in the management of the company. The majority shareholder can thus use the call option to consolidate his shareholding and ensure a clean exit for the minority shareholder. A put option, on the other hand is usually granted to an investor or a minority shareholder who does not have direct control of the business; it is an exit that ensures suitable returns to the investor for the amount invested. EPC World