Under Common Law, duties of the directors are founded on the concept that directors are fiduciaries and so much of the case law on their duties is founded on principles originating from the law of trusts and agency. We can also find that the early part of the 20th century marked a significant shift in the way the judges of the common law courts viewed the office of director. In tandem with this development the courts adopted a stricter approach towards the standard of care and skill expected of directors in the performance of their management roles. A concern of both equity and common law courts was to develop a corpus of rules designed to prevent directors abusing their considerable powers. The policy objectives of the courts were based on deterrence and the result was a formidable body of reported decisions in which the judges have been developing the contours of directors’ liabilities. These measures were particularly created in relation to preventing fraudulent asset stripping. The situation was grim even in countries like the UK, where concept of modern company has its roots where both the Law Commission and the Company Law Review, in line with their objectives of maximizing clarity and accessibility, recommended that the duties of directors should be codified by way of a statutory restatement. It is indeed the trend all around the globe that the powers of the directors should be pre-determined and should be addressed directly by provisions in statute in order to achieve clarity. While all these advances were happening in the western countries, Nepal also felt the need to update the archaic provisions of old Companies Act which was systematically repealed by the new Companies Act, 2063 (2006), inter alia, to address these new advances in Company law, whereby fetters were sought to be placed upon the wide sweeping powers of the directors in order to curb the potential abuse. The Companies Act, 2063 [*the Act* hereafter], inter alia, was devised principally as reactive and preventive measure against specific abuse of powers by directors.

**The General Duties of the Directors**

The basic legal duties of directors are fiduciary duties i.e. to act in good faith i.e. *bona fide* in the interests of the company and for a proper purpose; and to exercise care and skill. The Black’s Law Dictionary defines "fiduciary" as "1. A person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor; and 2. One who must exercise a high standard of care in managing another’s money or property". This duty is derived from

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common law and are common to all directors. The fiduciary duties are owed to the company, meaning generally the shareholders collectively, both present and future and not merely the shareholders at a given point in time. Examples of other persons having fiduciary duty are Legal Guardians and Trustees. Thus, the nature of duty owed by a director to its company and its shareholders can be compared to that of duty of care owed by a guardian or a trustee to their wards or trust/beneficiary.

Recently, there have been suggestions that directors should look beyond the narrow interests of shareholders and rather their duties should be owed to the stakeholders of the company. This would include, for example, employees, creditors, customers and the environment in which the company was located. However, there is a great debate whether such additional duties can be placed on directors at par with duties owed to shareholders as a director’s relationship with the shareholders is different in kind from their relationship with the other stakeholders interests as the shareholders elect the directors. The directors as a board are responsible for relations with stakeholders, but they are accountable to the shareholders. Some of these wider duties are also envisaged under the Company Act, 2063. However, we will only be examining the traditional common law duties that can be found in the Act in this paper.

It has long been settled that directors are viewed as agents of the company and as such they are subject to the full rigor of the fiduciary duties developed by equity to ensure strict compliance with the overriding principle that fiduciaries must not benefit from their position of trust. A statement that has been quoted many times on the position of directors was given by Lord Cranworth LC in *Aberdeen Rly Co v Blaikie Bros* (1854): "The directors are a body to whom is delegated the duty of managing the general affairs of the company. A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal."

One consequence of this fiduciary relationship has been the judicial juxtaposition of the terms fiduciary and trustee when referring to the legal status of company directors. In tracing the origins of the director/trustee concept, the widely held view is "that the concept had its origin in the fact that, in the earliest companies, the director was a trustee in the full technical sense". Before the modern process of incorporation was introduced most companies were established by a deed of settlement, and the deed almost invariably declared the directors to be trustees of the funds and assets of the business venture.

The earliest cases in which the equitable or fiduciary duties were developed relate to the usual 18th and 19th century uses of equity namely, regulating the conduct of trustees of family trusts (see, for example, the leading trust case of *Keech v Sandford* (1726). Adopting this case law by analogy, the courts used it as the template for framing the fiduciary obligations of directors. However, unlike trustees, directors do not hold the

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4 Supra. note 2.
6 See, supra. note 1 at pp.333-334.
legal title to the property under their control which, belongs to the company as a separate legal person. But, directors are analogous to trustees because they have the duty to manage the company’s affairs in the interest of the company.

When initiating cases of breach of duties, a breach of duty by a director is as such, a wrong done to the company and therefore the proper claimant in proceedings in respect of the breach is the company itself.⁸

Although, there are hardly any cases on the subject matter in Nepal, as most disputes appear to be settled outside the courts, before having the opportunity of becoming a precedent from the Supreme Court, thus most of these duties are addressed appropriately in our statute. The duties of the director under Nepalese Law have been statutorily codified and can be found under Chapter 6 of the Act. These common law duties can be classified as under:

i. Duty to act within powers

It is common law principle that directors have to act within their powers which has been statutorily recognized almost everywhere in the word now. In Nepal, the duty has been enshrined under Ss.95 and 99(6) of the Act generally and under S.103(2) of the Act viz third parties. Any acts of the director which has been conducted beyond his/her jurisdiction can be ratified subsequently by a special resolution of the company under S.103(3) hover this action by itself does not exonerate the director.

The S.95 mandates that directors have to act collectively as a board subject to the provisions of the Act, the Articles of the company and the decisions of the board of directors and S.99(6) stipulates that it is the duty of every director to comply with the Act, the memorandum of association& articles of association of the company and the consensus agreement.

ii. Duty to promote the success of the company

The objective of every regular company is to make profit and this can only be achieved if the directors promote the success of the company. This duty has been recognized and made mandatory by S. 99(4) of the Act which, inter alia, requires that, every director and officer of a company, while discharging their duties, has to act honestly and in good faith, having regard to the interest and benefit of the company, and exercise such care, caution, wisdom, diligence and efficiency as a reasonable and prudent person exercises. while the extent of these duties under S.94 of the Act has not yet been defined by the courts of the country there has been debate in few countries regarding the issue. In Australia, Lord Goldsmith in the Lords Grand Committee explained that: "it is for the directors, by reference to those things we are talking about—the objective of the company—to judge and form a good faith judgment about what is to be regarded as success for the members as a whole . . . the duty is to promote the success for the benefit of the members as a whole—that is, for the members as a collective body—not only to benefit the majority shareholders, or any particular shareholder or section of shareholders, still less the interests of directors who

⁸ see the rule in Foss v Harbottle (1843) 67 ER 189. See, <https://en.wikipedia.org/wiki/Foss_v._Harbottle>
might happen to be shareholders themselves (6 February 2006 (column 256))

iii. Duty to exercise reasonable care, skill and diligence

This duty has been recognized and made mandatory by S. 99(4) of the Act which, *inter alia*, requires that, every director and officer of a company, while discharging their duties, has to act honestly and in good faith, having regard to the interest and benefit of the company, and exercise such care, caution, wisdom, diligence and efficiency as a reasonable and prudent person exercises. If, any director, having an ulterior motive, violates this duty and causes loss or damage to the company, then such companies can recover damages for such loss or damage caused to the company from such directors.

The objective behind the statutory formulation of the good faith duty (which it termed the "duty of loyalty") was that it should promote "enlightened shareholder value" which resonates with the approach taken by the Supreme Court of Canada in *People’s Department Stores v Wise* (2004), in which the Court stated that acting in the ‘best interests of the company required directors to maximize the value of the corporation. This did not mean acting solely in the interests of the shareholders or in any one stakeholder’s interest. Rather, as Major and Deschamps JJ explained in the judgment:

"We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of the shareholders, employees, suppliers, creditors, consumers, governments and the environment... At all times, directors and officers owe their *fiduciary* duties to the corporation. The interests of the corporation are not to be confused."

Traditionally in England, the level of care and skill a director must show has been framed largely with reference to the non-executive director. In *Re City Equitable Fire Insurance Co.*, it was expressed in purely subjective terms, where the court held that:

"a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience."

Much later this was revised and in *Dorchester Finance Co. Ltd. v Stebbing*, the court held that the rule in Equitable Fire related only to skill, and not to diligence. With respect to diligence, what was required was: "such care as an ordinary man might be expected to take on his own behalf." This was a dual subjective and objective test is now presently practiced by English courts.

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9 See, *supra* note 1 at pp.347-348.
10 See, S.99(5) of the Act.
12 [1925] Ch 407.
iv. Duty to avoid conflicts of interest; duty not to profit personally and the duty to disclose/declare an interest in a proposed or existing transaction or arrangement

Unlike a shareholder, who is free to vote at a general meeting in whatever way he pleases and who can enter into agreements with others as to which way he will vote, a director is bound to act in the best interests of the company and, *prima facie*, he cannot enter into any arrangements or agreements with third parties as to how he should act or vote at board meetings. This would lead to an unlawful fettering of the director’s discretion and the company is entitled to the full, free and unfettered advice of the director in board meetings. In circumstances where a director has to enter into agreements with others in conflict with that of the company, it is required that they make disclosure of such activities before the shareholders.

The duty of avoiding conflicts of interest and duty to disclose is, *inter alia*, addressed in Ss.92, 93, 94, 95, 99, 100, and 101 of the Act. The S.92 of the Act requires that a director has to disclose within 7 days if,

a) any close relative has direct involvement or any kind of personal interest in any kind of sale and purchase or other kind of contract related with the transactions of the company. In the explanation to the aforesaid section "Direct involvement" has been defined as a situation where the director or his/her close relative is a promoter of or holds more that ten per cent shares of a company or private firm or partnership firm or a director of a company involved in such transaction.

b) any director has any kind of interest in the appointment of the managing director, company secretary, officer of the company;

c) If he/she is a director of any other company,

d) he/she has made any dealing in the shares or debentures of the company or of its holding or subsidiary company, about matters of such dealing. The section also mandates that if any director has an interest directly or indirectly linked to any kind of contract, lease, transaction or agreement entered or to be entered with the concerned company or its subsidiary company or comes to his/her knowledge that such interest will be so linked, that director has to disclose that matter to the company promptly, setting out the extent and kind of such interest.\(^1\)

Similarly, a public company or its subsidiary cannot without approval of the general meeting, do any significant transaction with its director or his/her close relative or substantial shareholder.\(^2\) A "significant transaction" is defined as a transaction of sale, purchase, exchange and contract the value of which, at the time of doing the transaction, exceeds one hundred thousand rupees or five percent of the total assets of the company.

v. Duty not to accept benefits from company itself and third parties

Section 99 of the Act forbids directors to do anything to derive personal benefit through the company or in the course of conducting business of the company. And if any director breaches this provision the

\(^{1}\) See S.92(4) of the Act.

\(^{2}\) See S.93 of the Act.
company can recover such amounts as if they were a loan from such director.\(^\text{16}\)

The directors cannot do anything yielding personal benefit to themselves without the approval of general meeting. However private companies can make reasonable provisions for allowing the same in the articles or consensus agreement.\(^\text{17}\)

This duty is an element of the wider no-conflict duty upon directors and it too will not be infringed if acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest. It should be noted that it applies only to benefits conferred because the director is a director of the company or because of something that the director does or does not do as director. The word "benefit" is not defined in the Act.

The courts in Australia has held that, where 'directors take it upon themselves to give advice to current shareholders. . . they have a duty to advise in good faith and not fraudulently, and not to mislead whether deliberately or carelessly'.\(^\text{18}\)

**Penalty for Breach of duty**

The penalty for breach of duty by the directors is set out in S.160, 161 and 162 of the Act. It is outside the scope of the paper to go into the details of which breach attracts what quantum of punishment but rather we will see broadly examine the three different classes of punishment under S.160, S.161 and S. 162 that may be applicable to breach of fiduciary duty by a director.

The act differentiates between different classes of offences and has various levels of punishment depending upon the nature of offence. S.160 deals with serious breaches of duty and offenders may be prosecuted under one of the provisions under S.160 and such offense may be punished with a fine between twenty thousand rupees to fifty thousand rupees or with imprisonment for a term not exceeding two years or with both when.

The second class of offences are covered under S.161 where offense may be punished with a fine from ten thousand rupees to fifty thousand rupees where milder forms of breaches may be covered like making false statements etc.

And thirdly and finally the third category under S.162 which covers offences not covered by the earlier S.160 & 161 where the Court may impose a fine of five thousand rupees to twenty thousand rupees on every concerned director.

**Conclusion**

With the beginning of the growth of corporations and corporate culture in Nepal the laws of the country have adapted and accordingly tried to achieve the modern concepts of corporate laws and particularly regarding the powers and duties of directors of a company. While a great emphasis is put on the powers of the directors in practice the complimenting part regarding duties of the directors only appears in the statute and there have hardly ever been cases filed on disputes regarding the duties of the director. Most often such disputes never reach the apex court and as such, we are unable to find rulings of the Supreme court on the issue. While the common law duties of the directors are well covered by the company statute of Nepal in practice most directors are not aware or negligent towards their duties and are only concerned in the powers they can exercise. Perhaps with the further growth of corporate culture in the country we will find more clarity on what is acceptable regarding the issue of duties of directors.\(\square\)

\(^\text{16}\) See S.99(2) of the Act.

\(^\text{17}\) See, proviso to S.95(2) of the Act.