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Background

The general rule that directors on the board of a company must exercise due care, diligence, and act in good faith as fiduciaries of the company, is well established both in judicial precedents and under Indian statutory law.

The precise scope and standard of review governing board decisions in the context of an acquisition, has not been sufficiently addressed by courts in India. Nonetheless, the general principles applied by Indian courts when reviewing the decisions of the board, together with the experience from other developed common law jurisdictions such as Delaware, United States (US) and the United Kingdom (UK), should inform the approach adopted by the board of a company in India.

General Fiduciary Rule in India

Section 166 of the Companies Act, 2013, which codifies the existing judicial principles in India concerning a director's fiduciary duties, requires a director to exercise reasonable care, skill, diligence and independent judgment. Directors are expected to act in good faith for the interest of the company including its shareholders, and refrain from participating in decisions where the director is likely to be conflicted.

Generally, although not codified under Indian statutory laws unlike other common law jurisdictions, courts in India defer to the business judgement of the board and there is a presumption in favour of the decisions made by the board (similar to the "**business judgment rule**" in Delaware).[1] Although in the Indian context, the decision of the board remains untested in the context of class action suits specifically seeking damages for the breach of fiduciary duties – the scope of judicial review of board decisions has been evaluated in the context of statutory claims for oppressions / mismanagement and contentious schemes of arrangement.[2] Anecdotally, the plaintiff / claimant is required to discharge an elevated burden to invite a judicial review of board decisions and it is challenging to discharge such a burden for a non-conflicted board decision.

If you have any questions regarding the matters discussed in this publication, please contact the attorney(s) listed above or call your regular contact at Anagram.

1 *Harinagar Sugar Mills Limited vs. Shyam Sunder Jhunjhunwala and Ors.*, (1961) SCC OnLine SC 38; and *Sangramsinh P. Gaekwad and Ors. vs. Shantadevi P. Gaekwad (Dead) thr. Lrs. and Ors.*, AIR 2005 SC 809.

2 *Needle Industries (India) Ltd. and Ors. vs. Needle Industries Newey (India) Holding Ltd. and Ors.*, (1981) 3 SCC 333; and *Miheer H Mafatlal vs. Mafatlal Industries Limited*, (1997) 1 SCC 579.

If, however, the board is conflicted, then the onus would be on the board or the director to establish the bona fides of a business decision and that it was made in the interest of the company (similar as the "**enhanced scrutiny**" or "**entire fairness standard**" in Delaware).[3] Conflict of interest has been broadly construed by Indian courts – for instance: (a) conflicts can arise even where there is no financial interest in relation to the specific decision in question but there are historical professional cross-linkages / indirect business relationships; and (b) "**likelihood**" of a conflict is sufficient and it is not necessary to establish an "**actual**" conflict.[4]

Guidance by Indian Courts

There are no specific findings by Indian courts on the standard of judicial review of board decisions in the context of acquisitions. In general, Indian courts have held that directors discharge their fiduciary duties when they: (a) act with genuine independence and apply their minds to decision-making, including seeking professional advice to inform their decisions and avoiding undue influence; and (b) ensure shareholders receive sufficient and accurate information before meetings to enable informed and robust decision-making.[5]

Conversely, Indian courts have found that directors have failed to discharge their fiduciary duties in situations where: (a) they have acted passively or neglected their responsibilities; (b) where their lack of oversight has led losses to the company; and (c) they indirectly influence board decisions despite having disclosed conflicts of interest.[6]

Guidance by UK Courts

The "**fiduciary rule**" in the UK is similar as the position under India laws.[7] Therefore, the findings of UK courts should provide the boards in India with meaningful guidance.

Specifically in the context of acquisitions, in the seminal ruling of *Sharp vs. Blank*[8], the *Lloyds* board's decision to acquire HBOS was primarily challenged on the following grounds: (a) due diligence had not gone into a granular asset-level review and the due diligence was subject to time constraints imposed by demands of client confidentiality, competition issues and the need to fit the deal within a constrained takeover timetable; and (b) several key elements of the deal were not disclosed to the shareholders while obtaining their approval such as the need for Lloyds to raise additional capital (and consequently dilute the *Lloyds* shareholders) as part of the transaction was primarily due to the poor quality and risks inherent in HBOS's loan portfolios.

The court applied certain foundational principles for the standard of review of board decisions such as: (a) director's actions must be assessed by reference

3 Section 184 of the Companies Act, 2013. Under S. 184, the onus is on the director to disclose their interest / concern and not participate in a meeting.

4 *Ram Parshotam Mittal and Ors. vs. Hotel Queen Road Pvt. Ltd. and Ors.*, (2019) 20 SCC 326.

5 *Reliance Natural Resources Limited vs. Reliance Industries Limited*, (2010) SCC OnLine SC 128; and *Miheer H Mafatlal vs. Mafatlal Industries Limited*, (1997) 1 SCC 579.

6 *Globe Motors Ltd. vs. Mehta Teja Singh and Co.*, (1983) SCC OnLine Del 193.

7 Chapter 2 (General Duties of Directors) of the UK Companies Act 2006.

8 *Sharp vs. Blank* [2019] EWHC 3078 (Ch).

to what a "**reasonably competent director**" (or chairman/executive director) of a large bank could properly have done or decided, given the material available and timeframe, at the time; (b) it is not the court's role to decide what it, with hindsight, would have done—but to assess if the directors' decisions fell within the range of decisions open to competent directors, acting honestly, with reasonable skill and care and in good faith at the time; and (c) acting on professional advice (legal, financial, accountancy or economic) strengthens the discharge of a director's duty, but does not substitute for the director's own judgement.

Based on these principles and the evidence on record, the UK court concluded that: (a) there was no breach of fiduciary duty by the *Lloyds* board; and (b) while the *Lloyds* board was in breach of its obligation to disclose certain matters to the shareholders – such non-disclosure was not seen as the cause of the loss.

Guidance by Delaware Courts

US courts, especially in Delaware, apply the business judgment rule to board decisions on acquisitions.[9] The rule presumes directors act in good faith and in the company's best interests, unless there is evidence that they breached fiduciary duties or lacked independence. In *Dow*,[10] the court laid down some key findings: (a) decisions to acquire another company, structure the transaction, and decide on terms are the responsibility of the board of directors; and (b) courts will ordinarily not second-guess the merits of an acquisition unless, on the face of it, there is evidence that directors failed to consider relevant risks and benefits, understand the material terms or seek expert advice.

Guidance for the Boards in Acquisitions

While the board of an Indian company must consider the specific actions based on each acquisition, some key guiding principles are as follows:

- Proactively identify any conflicts of interest. Where the board or majority of directors are conflicted, establish a sub-committee of independent and non-conflicted directors to oversee the transaction.
- Where appropriate, seek and rely on professional advice (legal, financial and/ or accountancy), but board members must independently assess recommendations and not substitute a professionals' advice for their own judgment.
- Ensure accurate disclosure of all material facts relating to the transaction in notices to shareholders, including risks, deal structure, financing details, and any need for additional capital.
- Undertake robust due diligence on the target and key aspects of the transaction. Address identified risks adequately, demonstrating a balanced approach.
- Adopt transparent processes to establish genuine application of mind, including detail-oriented negotiation practices, robust reviews and deliberation on each risk.

9 *In re Oracle Corporation Derivative Litigation*, C.A. No. 2017-0337-SG; and *In re Tesla Motors, Inc. Stockholder Litigation*, C.A. No. 12711-VCS.

10 *In re The Dow Chemical Company Derivative Litigation*, C.A. No. 4349-CC.

- Document key decisions, rationale, advice received, and material disclosures to demonstrate that the board's conduct meets fiduciary duty standards and can withstand scrutiny if challenged.

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