THE ILLUSION OF STAKEHOLDER PROTECTION UNDER S. 166 OF THE COMPANIES ACT, 2013: A CRITICAL ANALYSIS

Zzhara Batra, O.P Jindal Global University

ABSTRACT

This paper critically examines Section 166(2) of the Companies Act, 2013 arguing that while prima-facie, the section seems to adopt a stakeholder-inclusive framework, it ultimately perpetuates shareholder primacy. By analyzing legislative history, comparative law and literature, this paper demonstrably showcases how section 166(2)'s pluralist language is weakened by its four structural failures: the absence of hierarchy of interests, pronounced enforcement gap, India's promoter ownership structure and its operational equivalent to the UK's ESV model. By drawing on the works of acclaimed scholars, this paper concludes that non-shareholder stakeholders lack justiciable rights under the current architecture and proposes targeted reforms to operationalize the provision's stated pluralist intent.

I. INTRODUCTION

Moving towards a pluralist stakeholder model from shareholder primacy, the incorporation of s.166 of the Companies Act, 2013 **('The 2013 Act')** represents a paradigm shift in Indian corporate law jurisprudence[1]. By mandating that the directors act in good faith and in the best interests of the company, which includes the employees, shareholders, as well as the community, there exists a positive and binding obligation toward non-shareholder constituents. Not only are shareholders no longer the sole beneficiaries of directorial duties, but the Indian corporate legislature now extends to include employees as well as the community as important benefactors.

However, this paper seeks to argue the converse: s.166, at its very core, creates an illusion of stakeholder protection. While, prima facie, it adopts the language of stakeholderism, it falls short in its architectural framework to give this language its legal force. Though it appears pluralist, it functions primarily as an extension of shareholder primacy.

By situating s.166 within the legislative history of the 1956 and 2013 Acts, and by analyzing the appropriate literature available, this paper substantiates that s.166 is not all that it appears to be. Moreover, this paper offers critical analysis of the architectural failures of s.166 and provides policy recommendations.

II. LEGISLATIVE HISTORY: A COMPARATIVE ANALYSES

S.166 of the Companies Act, 2013 lays down the role of the director in ensuring compliance with the fiduciary duties entrusted to them. Under the 1956 Act, s.291 conferred on the directors general powers to exercise such powers as the company was authorized to exercise.[2] The codification of the above-mentioned section in the 2013 Act represented a departure from the 1956 Companies Act, which lacked a properly codified catalogue of directorial duties, relying otherwise on common law principles, especially the 'no conflict' and 'no profit' doctrines.[3] Moreover, the previous Act relied on the foundational principles laid down in *Nanalal Zaver v. Bombay Life Assurance Co. Ltd.*, which established the role of directors as

[1] Companies Act, 2013, No. 18 of 2013, § 166(2) (India).
[2] Companies Act, 2013, No. 18 of 2013, § 291 (India).
[3] PAUL L. DAVIES & SARAH WORTHINGTON, *GOWER'S PRINCIPLES OF MODERN COMPANY LAW* 507–12 (10th ed. 2016).

agents and trustees of the company, and not of individual shareholders or employees.[4] Stakeholder protection or non-shareholder constituents were absent from the statutory framework and were relevant only insofar as they were incorporated within the company's AoA and MoA.

The 2005 report of the Expert Committee on Company Law, chaired by Dr. J.J. Irani, provided that the law should include an inclusive list of directors' duties.[5] Keeping in mind the ongoing reform processes in the UK and the Enlightened Shareholder Value model to be incorporated in the UK Companies Act of 2006, the committee did not recommend a pluralist reform that treated stakeholder interests as ends in themselves.[6] It was the Parliamentary Standing Committee on Finance, in its 2012 report on the 2009 Companies Bill, that recommended the inclusion of non-shareholder entities, i.e., employees, the community, and the environment.[7] Born of this intervention, the 2013 Act's incorporation of s.166 went beyond what the Irani Committee had recommended and what the UK model had contemplated.

The codified section provided for several distinct duties of directors, including good faith under sub-section (2), duty of care and diligence under sub-section (3), the exercise of independent judgment under sub-section (4), and the duty to not make any undue gains or profits under sub-section (5). Specific to stakeholder protection is sub-section (2), which, when contrasted with the 1956 Act, represents a codified commitment to employees and other constituents, but its practical operation falls short of the textual provision.[8]

III. STAKEHOLDER THEORY, SHAREHOLDER PRIMACY AND THE INDIAN POSITION

Before analyzing the corporate law position in India today with regard to stakeholder theory and shareholder primacy, it is prudent to understand the two academically. For Hansmann and Kraakman, two academics who elaborate on the Friedman doctrine, the world has reached a consensus on shareholder-oriented governance, where the purpose of a corporation is solely to

[4]Nanalal Zaver v. Bombay Life Assurance Co. Ltd., AIR 1950 SC 172 (India).
[5] MINISTRY OF COMPANY AFFAIRS, REPORT OF THE EXPERT COMMITTEE ON COMPANY LAW (J.J. IRANI COMM. REP. 2005) ¶ 5.
[6] Companies Act 2006, c. 46, § 172 (UK).
[7]PARLIAMENTARY STANDING COMM. ON FIN., REPORT ON THE COMPANIES BILL 2011, ¶¶ 7.3–7.5 (2012).
[8] Companies Act, 2013, No. 18 of 2013, §§ 166(2)–(5) (India).

maximize shareholder value and to whom the directors owe their fiduciary duties.[9] The stakeholder duty, developed by R. Edward Freeman, stands in contrast to this claim and argues that, by occupying a position of social significance, corporations generate obligations towards their employees, creditors, consumers, and the environment, each of whom contributes significantly to corporate functioning.[10]

As highlighted by Varottil in a historical analysis of the Companies Act, 1956, India's corporate law post-independence has embodied a degree of statist welfareism that has been absent from common law jurisdictions. Grounding the 1956 Act in the context of Nehruvian economic planning, Varottil posits that the welfare philosophy of corporations as instruments of social development has never fully been translated into stakeholder rights and has remained an abstract idea unsupported by legal infrastructure.[11] The 2013 Act, enacted in the aftermath of the Satyam scandal to include and constitutionalise stakeholder protection, has been a response to the crisis of corporate governance laid bare in the *Sahara India Real Estate Corporation Ltd. v. Securities and Exchange Board of India* case.[12]

While, prima facie, India appears to have shifted towards a stakeholder-centric system with the incorporation of s.166(2), which has been characterized by Mukhopadhyay and Mandal as a 'radical experiment' in corporate purpose[13], Varottil and Naniwadekar demonstrate that this textual pluralism has collapsed into shareholder primacy when examined through the lens of enforcement and judicial interpretation.[14]

IV. LITERATURE REVIEW

An analysis of the appropriate literature on s.166(2) of the Companies Act, 2013 demonstrates that while some scholars celebrate the legislative departure, some critiques juxtapose the text with its operation, and some identify mechanisms to effectively achieve stakeholder protection.

[9] Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 GEO. L.J. 439, 440–43 (2001).
[10]R. EDWARD FREEMAN, *STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH* 25–31 (1984).
[11]Umakanth Varottil, The Stakeholder Approach to Corporate Law: A Historical Perspective from India, SSRN (2018), https://ssrn.com/abstract=3173953.
[12] Sahara India Real Est. Corp. Ltd. v. Sec. & Exch. Bd. of India, (2012) 10 S.C.C. 603 (India).
[13]Devarshi Mukhopadhyay & Rudresh Mandal, The End of Shareholder Primacy in Indian Corporate Governance? Says Who?!, 46(4) COMMONWEALTH L. BULL. (2020).
[14]Mihir Naniwadekar & Umakanth Varottil, The Stakeholder Approach Towards Directors' Duties Under Indian Company Law: A Comparative Analysis, in *THE INDIAN YEARBOOK OF COMPARATIVE LAW 2016* 95–120 (Mahendra Pal Singh ed., 2017).

Deva Prasad, in his 2018 study in the *Statute Law Review*, argues that the 2013 Act represents a move towards stakeholder inclusion, which for him represents the evolution of global norms surrounding corporate accountability.[15] For Mukhopadhyay and Mandal, India's framework is a radical experiment that encompasses the British ESV model, which required directors to consider stakeholder interests but ultimately in the service of promoting long-term success for its members, by refusing to put long-term member value over non-shareholder interests.[16] Moreover, the interpretation of s.166(2) as substantive rather than a mere symbolic commitment is also supported by Shaji and Shaji, for whom the 2013 Act's codification represents an alignment with international corporate governance norms.[17]

However, this is not without critique, the most important of which comes from Varottil and Naniwadekar, who argue that while the text may diverge from the ESV model, its operation is nevertheless ESV-equivalent because the architecture of the 2013 Act does not allow non-shareholder entities to bring cases against directors.[18] Substantiating this critique and expanding further, Jason John argues that these provisions ultimately favour the company rather than the stakeholders because the duty is owed to the company as a legal entity.[19] Moreover, several roadblocks have been identified by Majumdar in his 2025 analysis, including the absence of a hierarchy of interests, India's concentrated promoter ownership structure, the breadth of directorial discretion, as well as the lack of an enforcement mechanism.[20] These structural failures will be discussed further in the next section of the paper, offering a critical analysis of s.166(2).

Focusing on the enforcement scholarship, Mohnot and Merchant, in a doctrinal analysis of s.166(2) and 166(3), show that it is only the good faith doctrine that extends to stakeholders and that the duty of care, in fact, is not owed to them at all. But even the duty of good faith does not allow for a justiciable individual cause of action[21]. Such stakeholder commitments, lacking enforcement mechanisms, remain unsatisfactory and unfulfilled, especially within the

[15] M. Deva Prasad, Companies Act, 2013: Incorporating Stakeholder Theory Approach into the Indian Corporate Law, 39(3) STATUTE L. REV. 292, 294–96 (2018).
[16] Mukhopadhyay & Mandal, supra note 13.
[17] Angel Shaji & Bensha C. Shaji, *Duties of Directors Under the New Indian Companies Act 2013 — Section 166 Classification in Connection with Corporate Governance*, 3(1) L. Audience J. 134, 138–140 (2021)..
[18] Naniwadekar & Varottil, supra note 14, at 107–12..
[19] Jason John, Section 166(2) of the Companies Act 2013: Protection of Stakeholders or Primacy of Company, SSRN (2016), https://ssrn.com/abstract=2885847..
[20] Arjya B. Majumdar, India's Experiment with Stakeholder Inclusion, SSRN (2025), https://ssrn.com/abstract=5503059
[21] Rishabh Mohnot & Hrithik Merchant, Section 166(3) of the Companies Act, 2013: Filling the Gaps of an Incomplete Provision, 15(2) NUJS L. REV. 12–15 (2022).

Indian context, where the enforcement gap is more pronounced.[22] Building on this critique through an entity-based analysis, Pandey and Ram Mohan argue that for genuine stakeholder governance to truly take shape, a reconceptualization of corporate purpose is necessary, one that extends beyond the already existing legal framework.[23]

V. S. 166(2) STRUCTURAL FAILURES

1. **No Hierarchy of Interests:** Section 166(2) fails to establish an order of priority with respect to the interests of non-shareholder constituencies. While, textually, it mandates the consideration of employees, committees, the environment, members, and shareholders, it falls short in its architecture by failing to specify whose interests would take priority over whose in cases of conflict. While the court, in the case of *Tata Consultancy Services Ltd. v. Cyrus Investments Pvt. Ltd.*, provided a substantial engagement with s.166(2) and acknowledged the necessity to balance the duty of directors across the named constituencies under s.166(2)[24], it failed to provide a framework to do so. In the absence of a hierarchy of interests, decisions made in the exercise of good faith discretion cannot be impugned, regardless of how harmful they may be to stakeholders, as these decisions remain shielded by the business judgment rule. In contrast, a hierarchy, as explained above, is evident in the UK's ESV model under s.172 of the UK Companies Act, 2006, where non-shareholder interests are considered in aid of the long-term success of the company. Thus, while stakeholders remain relevant, they cannot be thought of as equal claimants[25]. The Indian position, in failing to implement this hierarchy, impliedly or directly, allows directors to easily justify their decisions regardless of how they may harm the claimants, for the duties are expansive but indeterminate. As has been observed by Varottil and Naniwadekar, such a model weakens protection for non-shareholder interests even more than the ESV model it aimed to surpass.[26]

2. **Enforcement Gap:** A plain reading of section 166(2) showcases the absence of enforcement mechanisms for non-shareholder stakeholders, and it is only in s.166(7)

[22]Lucian A. Bebchuk & Roberto Tallarita, The Illusory Promise of Stakeholder Governance, 106 CORNELL L. REV. 91, 94–101 (2020).
[23] Astha Pandey & M.P. Ram Mohan, Navigating the Indian Corporate Purpose Dilemma: Insights from an Entity-Based Approach, SSRN (2025), https://ssrn.com/abstract=5147314
[24] Tata Consultancy Servs. Ltd. v. Cyrus Invs. Pvt. Ltd., 2021 SCC OnLine SC 272, ¶ 19.30 (India).
[25] Companies Act 2006, c. 46, § 172 (UK).
[26] Naniwadekar & Varottil, supra note 14, at 107–12.

that a director may be liable to pay a fine of up to 1 lakh rupees in contravention of his duties as prescribed in the section.[27] However, this remedy is merely punitive and cannot be initiated by the stakeholders' own claim. The absence of provisions for injunctive relief or compensation mechanisms provides compelling proof of this enforcement gap, reinforcing the argument that s.166 operates through shareholder primacy, despite what the text might indicate. Section 245, which allows for class action, is limited only to members or depositors to seek such action, and only when the conduct of the management is prejudicial to their interests.[28] Non-shareholder stakeholders cannot claim this remedy—the closest available mechanism—as they have no standing under s.245. While the court, in *Rajeev Saumitra v. Neetu Singh*, found that directors diverting a company's goodwill, employees, and intellectual property to a competing entity were in breach of s.166, it becomes prudent to note that the case was brought by a shareholder and that the relief ordered was to the company—not to the employees whose interests had been harmed.[29] Thus, even when accountability is created, it runs towards the company, not the stakeholders affected.

3. **Promoter Concentration:** Within the Indian landscape, which is characterized by concentrated promoter groups, the distinction between director and majority shareholder collapses. Majumdar identifies this problem and provides that when promoters not only control the board but also hold majority equity, the pluralist idea collapses and duties under s.166(2) become circular[30]. Identified by Pandey and Ram Mohan as the 'corporate purchase dilemma', when the company's interests are to be protected by the directors but these are determined by the promoters whose very conduct the law seeks to regulate, the governance structure is rendered circular.[31] The case of *Sahara India Real Estate Corporation v. SEBI* captures this problem effectively.[32] In the case, neither the company's directors nor the shareholders were willing to act in the interests of the investor-stakeholders whose funds had been misappropriated, requiring Supreme Court intervention. This preceded the 2013 Act's

[27] Companies Act, 2013, No. 18 of 2013, § 166(7) (India).
[28] Companies Act, 2013, No. 18 of 2013, § 245 (India).
[29] Rajeev Saumitra v. Neetu Singh, 2016 SCC OnLine Del 512, ¶¶ 34–38 (India).
[30] Majumdar, supra note 20, at 8–10.
[31] Astha Pandey & M.P. Ram Mohan, Re-evaluating Corporate Purpose: A Critical Assessment of the Indian Stakeholder Governance Framework through a Historical and Comparative Analysis, 49(2) DEL. J. CORP. L. (forthcoming 2025), https://ssrn.com/abstract=4874378
[32] Sahara India Real Est. Corp. Ltd. v. Sec. & Exch. Bd. of India, supra note 12.

architecture, and the protection came through SEBI's jurisdiction. Post-Sahara reform in the 2013 Act under s.166(2), however, did not alter the architecture for enforcement. Moreover, the court's preference for majority stakeholders over minorities, as reflected in the case of *Miheer Mafatlal v. Mafatlal Industries*[33], also highlights concerns that have not been substantively displaced.

4. **The Illusion of Distinction from the ESV Model:** For Naniwadekar and Varottil, as has been illustrated in this paper above, s.166(2) functions as an ESV provision for two major reasons:[34]

   (a) The duty under s.166(2) is owed to the company and not to the stakeholder. This principle was established by the court in *Sangramsinh P. Gaekwad v. Shantadevi P. Gaekwad*[35] and reaffirmed in *TCS v. Cyrus Investments*.[36]

   (b) Because the duty is to act in the best interests of the company, and those interests are determined by the shareholders, the language of s.166(2) becomes shareholder-centric. Mandal arrives at a similar conclusion with regard to s.166(2)'s legal architecture and provides that the section diverts protective obligation to the company instead of the stakeholders.[37]

VI. POLICY RECOMMENDATIONS

The failures illustrated in the foregoing critiques of s.166(2) are not impossible to correct. Targeted reforms that create clear frameworks and provide enforcement mechanisms for stakeholders would strengthen the pluralist architecture the Act aims to move towards.

1. The Act should be amended to include an established hierarchy of interests with regard to stakeholders that provides appropriate and much-needed guidance on the resolution of conflicts of interest. Provisions that give primacy to long-term corporate sustainability in cases where interests are irreconcilable would help operationalize the

[33] Miheer H. Mafatlal v. Mafatlal Indus. Ltd., (1997) 1 S.C.C. 579 (India).
[34] Naniwadekar & Varottil, supra note 14.
[35] Sangramsinh P. Gaekwad v. Shantadevi P. Gaekwad, (2005) 11 S.C.C. 314 (India).
[36] Tata Consultancy Servs. Ltd. v. Cyrus Invs. Pvt. Ltd., supra note 24.
[37] Rudresh Mandal, Directors' Duties, CSR and the Tragedy of the Commons in India: Mutual Coercion Mutually Agreed Upon, 23(2) ENV'T L. REV. 144, 150–53 (2021).

pluralist intent of the provision.

2. Class action suits under s.245 must extend to employees and other non-shareholder constituencies in cases of breach of directors' duties under s.166(2). Such a reform, as per Deva Prasad, would align India's framework with the stakeholder protection purposes declared in the Standing Committee's report.[38]

3. Non-shareholder entities must be allowed to petition for relief in cases of directorial misconduct by extending the NCLT's jurisdiction under ss.241–245[39].

4. Stakeholder impact assessment reports must be made mandatory before any significant board decisions are taken, to create accountability without requiring litigation. This would build upon the CSR framework under s.135 of the Act, turning social consideration into a governance obligation.[40]

VII. CONCLUSION

The incorporation of s.166(2) in the Companies Act, 2013 aimed at departing, at least textually, from a shareholder-centric view to an inclusive stakeholder model by requiring consideration of the interests of non-shareholder entities such as employees, members, committees, and the environment. While the governance architecture now seemed pluralist in nature, as this paper has demonstrated, this shift remains incomplete.

Through a thorough examination of legislative history, scholarly literature, and judicial interpretation, the inadequacy of the architecture of section 166(2) to promote stakeholder protection has been clearly illustrated. Its operation reveals the limitations that the current framework is ill-equipped to substantially address. While, textually, it seeks to include non-shareholder constituencies, the lack of individual stakeholder enforcement mechanisms, the vagueness arising from its failure to prioritize interests, and the weakening of directorial accountability with respect to stakeholders have revealed the weak transformative potential of the provision.

[38] Deva Prasad, supra note 15, at 300–03.
[39] Companies Act, 2013, No. 18 of 2013, §§ 241–244 (India).
[40] Companies Act, 2013, No. 18 of 2013, § 135 (India).

Additionally, the realities of Indian corporate governance further exacerbate the challenges in the implementation of the pluralist model, especially when the interests of the company are blurred with those of the controlling shareholders.

The policy recommendations proposed in this paper seek to appropriately address these challenges at the very base of their legal structure by introducing mechanisms that aim to bridge the gap between the provision's operation and its objectives.

In conclusion, while the objectives of s.166(2) appear to be pluralist, their meaningful manifestation would only be possible through bridging gaps in enforcement and strengthening institutional clarity. The future of stakeholder governance depends on the willingness of lawmakers to move beyond mere textual inclusion.