



THEORETICAL FOUNDATIONS OF FIDUCIARY DUTIES IN COMMON LAW CORPORATE GOVERNANCE

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Abstract

The concept of the modern corporation governed by a board of directors emerged within the framework of the common law legal tradition that developed after the Anglo-Saxon period. At that historical stage, corporate entities in the form understood today did not yet exist within the Anglo-Saxon legal order. Nevertheless, the contemporary understanding of corporate directors can be traced back to the early notion of a trustee or trusted representative operating in that period.

Keywords: Corporate governance, fiduciary duties, common law legal system, board of directors, duty of loyalty, duty of care, duty of disclosure, conflict of interest.

Аннотация

Понятие современной корпорации, управляемой советом директоров, сформировалось в рамках правовой традиции общего права, развившейся после англосаксонского периода. На данном историческом этапе корпоративные образования в том виде, в каком они понимаются сегодня, ещё не существовали в англосаксонской правовой системе. Вместе с тем современное понимание института корпоративных директоров восходит к ранней концепции доверенного лица или уполномоченного представителя, действовавшего в указанный период.



Ключевые слова: корпоративное управление, фидуциарные обязанности, правовая система общего права, совет директоров, обязанность лояльности, обязанность заботливости, обязанность раскрытия информации, конфликт интересов.

Annotatsiya

Direktorlar kengashi tomonidan boshqariladigan zamonaviy korporatsiya tushunchasi anglo-sakson davridan keyin shakllangan umumiy huquq (common law) huquqiy an'anasi doirasida rivojlangan. Mazkur tarixiy bosqichda bugungi kunda tushuniladigan shakldagi korporativ tuzilmalar anglo-sakson huquq tizimida hali mavjud bo'lishiga qaramay, korporativ direktorlar institutining zamonaviy talqini aynan o'sha davrda amal qilgan ishonchli vakil yoki ishonib topshirilgan shaxs konsepsiyasiga borib taqaladi.

Kalit so'zlar: korporativ boshqaruv, fidutsiar majburiyatlar, umumiy huquq tizimi, direktorlar kengashi, sodiqlik burchi, g'amxo'rlik burchi, axborotni oshkor qilish majburiyati, manfaatlar to'qnashuvi.

Introduction

In modern Anglo-American legal systems, the duties and functions of corporate directors are structured around a set of fiduciary obligations designed to ensure that directors act in the best interests of the corporation and its shareholders. Central among these obligations is the duty of loyalty, which requires directors to prioritize corporate interests and to avoid situations involving conflicts of interest. Complementing this is the duty of care, which obliges directors to exercise prudence, diligence, and informed judgment when making decisions on behalf of the corporation.

In addition, directors are subject to an obligation to remain adequately informed about the company's business activities, to participate actively in meetings of the board of directors, and to exercise oversight over corporate management. Finally, directors are bound by a duty of compliance, which requires adherence not only to applicable laws and regulations, but also to the corporation's charter documents and internal bylaws.



Literature review

Academic literature further recognizes that, within the corporate law of common law jurisdictions, the functions and responsibilities of directors extend beyond core fiduciary obligations and encompass a range of operational and governance-related tasks.

In defining these duties and functions, fiduciary obligations occupy a particularly significant position. This is because, in common law jurisdictions, the role of corporate directors has been fundamentally shaped by the concept of fiduciary representation, under which directors are regarded as trusted stewards acting on behalf of the corporation and its shareholders.

In his study devoted to the general duties of corporate directors under English law, A. Kalandarov emphasizes that directors are subject to overarching obligations related to accountability, transparency, and the exercise of informed and reasoned decision-making. English corporate legislation adopts a codified approach to defining directors' duties, the vast majority of which are classified within the framework of fiduciary obligations. [1]

Analysis and results. First, directors are entrusted with the formulation of strategic decisions that determine the overall direction and long-term objectives of the corporation. This includes approving major transactions such as mergers and acquisitions, determining capital allocation priorities, and endorsing strategies aimed at sustainable growth.

Second, directors exercise financial oversight over the corporation. In this capacity, they are responsible for approving budgets, reviewing and monitoring financial statements, and ensuring that the company's financial management is conducted in a sound and responsible manner.

Third, directors play a central role in structuring and supervising the governance architecture of the corporation. This involves appointing and overseeing senior executives, including the chief executive officer and the chief financial officer, establishing board committees, and ensuring adherence to accepted standards of effective corporate governance.



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Fourth, directors are charged with the identification, assessment, and management of risks that may threaten the corporation's stability, performance, or long-term viability.

In the United States, a transaction involving a conflict of interest may be upheld where it has been negotiated and approved by disinterested directors following a meaningful process of deliberation. Such a process typically includes genuine negotiations and preserves the authority of non-interested directors to reject the transaction altogether. In these circumstances, the transaction will be sustained unless a shareholder demonstrates before the court that it fails to satisfy the standard of entire fairness to the corporation. The burden of proving the absence of entire fairness rests with the shareholder.

Conversely, where directors are unable to establish that the challenged transaction meets the entire fairness standard, and where the transaction has been contested, it may be declared invalid. In such cases, the burden of demonstrating entire fairness shifts to the directors. [2]

A second fundamental obligation of corporate directors arises in situations where no conflict of interest is present. In such circumstances, the duty of care requires directors to act thoughtfully, to remain attentive to the corporation's affairs, and to strive to make sound and reasoned decisions. U.S. courts generally refrain from imposing liability on directors for decisions taken without conflicts of interest, except in cases where the decision is so irrational that it cannot be justified by any reasonable business rationale. [3]

This judicial restraint is grounded in the business judgment rule, which reflects a broader principle of non-interference in the internal management of both the corporation and its directors. Moreover, business activity is inherently risk-based. Although such risk is ultimately borne by the corporation's shareholders, the consequences of directors' decisions likewise fall upon those shareholders, as it is they—or their authorized representatives—who appoint and empower directors to manage the company on their behalf.

An additional duty of heightened care arising in the context of a corporate sale is identified by Professor Bernard S. Black as a distinct category of fiduciary obligation. In principle, this situation could be assumed under the general duty of care. However, it is treated separately due to the particular relevance of



conflicts of interest that may arise in such transactions. As noted above, the traditional duty of care presupposes the absence of conflicting interests.

By contrast, when a corporation is being sold, directors may face the risk of losing their positions, a circumstance that can give rise to personal incentives inconsistent with the interests of the corporation or its shareholders. It is this potential for conflicted decision-making that justifies recognizing heightened care in sale-of-control situations as a separate fiduciary responsibility rather than as a mere extension of the ordinary duty of care.

In an English case, a director of a fishing company was instructed to conclude a contract for the purchase of fishing vessels on behalf of the company. The director entered into the transaction with a third party, and the seller of the vessels provided the director with a personal benefit in connection with the deal. The director failed to disclose this benefit to the company. Subsequently, when the director was asked to arrange the supply of ice for the company, he placed the order with an ice supplier in which he held a membership interest. That supplier operated a bonus scheme under which members received rewards based on orders placed. As a result, the director personally received bonuses arising from the company's purchases.

When these circumstances were later discovered by the fishing company, the matter was brought before the court. The court held that, by obtaining undisclosed personal benefits in connection with contracts concluded on behalf of the company, the director had breached his fiduciary obligations. Consequently, the director was ordered to account for and return all bonuses received to the fishing company. [4]

Determining the scope of directors' duties represents one of the most complex areas of corporate law, as such duties are often articulated or clarified only in the context of corporate misconduct, fraud, or alleged breaches of fiduciary obligations. Under the influence of English law, the Indian Companies Act of 1956 did not expressly enumerate the duties of directors, resulting in considerable uncertainty regarding the contours of their responsibilities.

Over time, however, the need to codify directors' duties in India became increasingly apparent. Section 2(13) of the Companies Act 1956 defined a director as "any person occupying the position of director, by whatever name



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called.” This broad statutory definition was subsequently interpreted by the Indian judiciary in a functional manner, leading courts to characterize directors as fiduciaries or agents of the company. [5] Where a company director is found to be guilty of negligence, misconduct, breach of duty, or abuse of trust in relation to the company, no agreement, corporate instrument, or statutory provision may operate to exempt that director from liability. [6] Where a director is found to have engaged in fraud, abuse of position, or a breach of duties owed to the company, a court may order that such individual be disqualified from serving as a director. [7]

The board is required to present a statement on directors’ responsibility at the company’s general meeting. The law further provides that a director’s office may be deemed vacated where the director, without obtaining leave from the board, fails to attend three consecutive board meetings or remains absent from all board meetings over a continuous period of three months. In addition to attendance obligations, directors are subject to a range of procedural duties connected with the conduct of board meetings.

Certain contracts in which a director has a personal interest require prior approval by the board. Likewise, where directors seek to hold an additional office or derive personal benefits, obtaining board consent is mandatory. These requirements are particularly relevant in transactions involving affiliated or related parties, where enhanced oversight is necessary to mitigate conflicts of interest.

Another significant statutory obligation imposed on directors is the duty to disclose personal interests. Where a director has a direct or indirect interest in a contract or arrangement entered into by, or on behalf of, the company, failure to disclose such interest may give rise to the imposition of financial penalties.[8] A director is required to disclose the nature and extent of any interest or rights held in shares or debentures that are subject to statutory registration requirements.[9] The obligation to disclose shareholdings rests with directors, as well as with individuals who are deemed to be directors under the law.



Conclusion

The foregoing analysis demonstrates that fiduciary duties constitute the conceptual and functional core of corporate governance within common law systems. The duties of loyalty, care, disclosure, and compliance collectively serve to align directors' decision-making with the interests of the corporation and its shareholders, while simultaneously constraining opportunistic behavior and conflicts of interest. Judicial doctrines such as the business judgment rule further reflect a careful balance between managerial autonomy and accountability, allowing directors to engage in risk-taking inherent in business activity while preserving mechanisms for legal oversight in cases of abuse or misconduct.

The comparative examination of case law and statutory frameworks illustrates that fiduciary obligations are not merely abstract ethical standards, but legally enforceable duties shaped by judicial interpretation, legislative codification, and evolving governance practices. The recognition of heightened duties in sale-of-control situations, as well as strict disclosure requirements in conflict-of-interest transactions, underscores the adaptive nature of fiduciary law in responding to complex corporate realities.

In this context, the experience of India provides a particularly instructive example of the gradual transition from reliance on judicial interpretation toward legislative codification of directors' duties. The shortcomings of the Companies Act 1956 revealed the limitations of an uncodified approach, prompting a systematic effort to articulate directors' obligations more clearly. As a result, the amendments introduced by the Companies Act 2013 reflect a deliberate alignment with the legislative techniques and governance principles developed in the United Kingdom and other common law jurisdictions. These reforms have contributed to greater legal certainty, enhanced transparency, and more effective enforcement of directors' responsibilities.



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