

WHO IS MINDING THE ALGORITHM? SECTION 166(3) OF THE COMPANIES ACT, 2013 AND A PROCESS STANDARD FOR AI-ASSISTED BOARD DECISIONS

by

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ABSTRACT

Section 166(3) of the Companies Act, 2013 requires directors to act with ‘due and reasonable care, skill and diligence’ and to exercise ‘independent judgment’. The provision was drafted for human decision-makers and is silent on what that duty demands when a board relies on an algorithmic system whose reasoning it cannot inspect. This article argues that the gap is practical, not theoretical. Indian courts have not fixed a consistent standard of care, the protections available to directors under sections 463 and 149(12) operate only after a dispute arises, and the regulatory material now addressing AI in Indian finance, from SEBI’s 2025 consultation paper to the RBI’s FREE-AI report and 2026 draft model-risk guidance and the Digital Personal Data Protection Act, 2023, binds entities rather than defining the individual director’s duty of care. Drawing on Delaware’s process-based oversight cases and on the distinction between substance and process in corporate governance scholarship, the article proposes a five-part Board AI Oversight Standard (identify, understand, challenge, monitor and document). It recommends two routes to give the Standard legal force: an amendment to Regulation 21 and Schedule II of the SEBI Listing Regulations, and a rebuttable presumption of due care under section 166(3) for boards that follow it. The proposal gives firms an ex ante and auditable benchmark for defending board decisions, and gives courts a workable test.

Keywords: Directors’ duties; Section 166(3); Artificial intelligence; Board oversight; Business judgment rule; SEBI

I. Introduction

A board approves a credit-risk model, a pricing engine or a compliance-screening tool. Months later the system proves to have been systematically wrong, and a shareholder, a regulator or a liquidator asks the directors one question: did you exercise due care? Under section 166(3) of the Companies Act, 2013, a director must ‘exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment’.¹ The question is easy to ask. Where the decision was shaped by an AI system, it is very hard to answer.

This article argues that section 166(3) gives directors and courts no usable standard for AI-assisted decisions, and that this uncertainty is a governance risk for firms and not only an academic puzzle. Part II shows that the provision sets a quality of conduct without a method, and that Indian law protects directors only after a dispute has begun. Part III explains why AI strains each element of the duty. Part IV surveys the regulatory material that now exists and shows that it governs entities and not directors. Part V draws on Delaware’s oversight cases. Part VI proposes a Board AI Oversight Standard and two ways of giving it legal force.

The article is limited to the directors’ duty of care, with emphasis on listed companies and regulated financial firms, where AI use is most advanced. It does not address the liability of AI developers or the separate question whether AI systems could hold office. As far as the author is aware, no reported Indian decision has yet considered a director’s duty of care in relation to an AI-assisted decision, which is itself the gap the article addresses.

II. The Duty of Care as It Stands

A. A Standard Without a Method

Section 166(3) is a single sentence. It names the quality of conduct required (care, skill, diligence and independent judgment) but not the steps by which a director shows it. Singh, Esser and MacNeil make a similar observation about section 166(2): provisions of this kind ‘give directors a wide discretion’ but ‘do not tell them how to do this’.² They describe this as a substance-based approach, which defines what directors must achieve, and contrast it with process-based regulation, which prescribes how decisions are made and so

¹ Companies Act, 2013, § 166(3), No. 18, Acts of Parliament, 2013 (India).

² Snehta Singh, Irene-marie Esser & Iain MacNeil, *Board Decision-Making and Stakeholder Protection*, 9 NLS Bus. L. Rev. 9, 11 (2023).

opens the board's reasoning to scrutiny.³ Section 166(3) fits the first category. It tells a director to be careful, but not what carefulness looks like.

The courts have not filled the gap. Under the Companies Act, 1956, the Supreme Court held in *Tendolkar* that a director may be liable for misfeasance 'even though no specific act of dishonesty is proved against him personally', where his negligence is such as to enable frauds to be committed, because he 'cannot shut his eyes to what must be obvious to everyone who examines the affairs of the Company even superficially'.⁴ In *Raghawa Desikachar* the Court added that a misfeasance application must contain 'a detailed narration of the specific acts of commission and omission' alleged, and that the burden of proof rests on the Official Liquidator.⁵ The Supreme Court has also described a non-executive director as 'a custodian of the governance of the company' who 'only monitors the executive activity', although that observation came in a negotiable-instruments case and not in a duty-of-care dispute.⁶ Commentary on section 166(3) finds that Indian courts applied no consistent standard of care under the 1956 Act,⁷ and recent scholarship reaches the same view. One 2026 study concludes that judicial interpretation 'remains fragmented and inadequate as a substitute for legislative clarity',⁸ and another finds that inconsistencies in judicial interpretation and enforcement continue to weaken the framework.⁹ It also remains unsettled whether section 166 is a complete code or leaves room for common-law duties.¹⁰

B. Protection Arrives Only After the Dispute

Directors are not without protection. Section 149(12) confines the liability of independent directors, and of non-executive directors who are not promoters or key managerial personnel, to acts of the company that occurred with their knowledge, attributable through Board processes, and with their consent or connivance or where they had not acted

³ *Id.* at 20–22.

⁴ *Official Liquidator, Supreme Bank Ltd. v. P.A. Tendolkar*, (1973) 1 S.C.C. 602, ¶ 40 (India).

⁵ *Official Liquidator v. Raghawa Desikachar*, A.I.R. 1974 S.C. 2069, (1975) 45 Comp. Cas. 136, 142 (India).

⁶ *Pooja Ravinder Devidasani v. State of Maharashtra*, (2014) 16 S.C.C. 1, ¶ 17 (India) (arising under Section 141 of the Negotiable Instruments Act, 1881).

⁷ Rishabh Mohnot & Hrithik Merchant, *Analyzing Directors' Duty of Care under the Companies Act, 2013*, IndiaCorpLaw (Mar. 29, 2023), <https://indiacorplaw.in/2023/03/29/analyzing-directors-duty-of-care-under-the-companies-act-2013/> (summarising Rishabh Mohnot & Hrithik Merchant, §166(3) of the Companies Act, 2013: *Filling the Gaps of an Incomplete Provision*, 15 NUJS L. Rev. 154, 165 (2022)).

⁸ Pawan Goyal, *Section 166 and the Vagueness Problem: Director Duties, Article 14, and the Case for a Business Judgment Rule in India* (Apr. 7, 2026) (unpublished manuscript), <https://ssrn.com/abstract=6563498>.

⁹ Shreya Wanchoo, *Directors' Duty of Care Under the Companies Act, 2013: A Critical Evaluation of Judicial Interpretation and Enforcement Mechanisms* (Apr. 20, 2026) (unpublished manuscript), <https://ssrn.com/abstract=6738301>.

¹⁰ Umakanth Varottil, *Codification of Directors' Duties: Is Common Law Excluded?*, IndiaCorpLaw (May 31, 2014), <https://indiacorplaw.in/2014/05/31/codification-of-directors-duties-is/>.

diligently.¹¹ Section 463 allows a court to relieve a director who has acted honestly and reasonably.¹² Goyal argues that both mechanisms are ‘post-hoc remedies rather than ex ante safe harbours’.¹³

That description is accurate. Both provisions ask, after a loss, whether the director behaved reasonably. Neither tells a director beforehand what to do. A board that wants certainty before approving an AI deployment therefore has nothing to hold on to.

III. Why AI Strains the Duty

A. Independent Judgment and Opaque Systems

‘Independent judgment’ presupposes that a director can form a view of her own. Where a model’s output cannot be explained, a director can accept or reject it but cannot evaluate it. SEBI’s consultation paper itself lists lack of explainability as a risk, observing that generative models are ‘difficult to comprehend or explain’, which makes it hard to assess a model’s robustness and may impede supervision.¹⁴ A rule of independent judgment that is silent on what a director must understand about a system before relying on it has little content.

B. Deference to the System

A growing literature on human–AI decision-making studies how people use AI recommendations in high-stakes settings, including business, where fully automated decisions are often neither practical nor desirable and AI is used to augment a human decision-maker.¹⁵ The legal concern follows directly. If the human reviewer defers by default, the ‘independent’ judgment that section 166(3) requires may exist only on paper. Regulators have begun to name this risk: the RBI’s 2026 draft model-risk guidance asks regulated entities to consider automation bias and over-reliance on model outputs.¹⁶ Section 166(3), by contrast, says nothing about how much reliance on a system is too much, and a case-by-case answer is

¹¹ Companies Act, 2013, § 149(12), No. 18, Acts of Parliament, 2013 (India).

¹² *Id.* § 463.

¹³ Goyal, *supra* note 8.

¹⁴ Securities and Exchange Board of India, Consultation Paper on Guidelines for Responsible Usage of AI/ML in Indian Securities Markets, Annex. B, risk D (June 20, 2025) [hereinafter SEBI Consultation Paper].

¹⁵ Vivian Lai et al., *Towards a Science of Human–AI Decision Making: An Overview of Design Space in Empirical Human-Subject Studies*, in Proceedings of the 2023 ACM Conference on Fairness, Accountability, and Transparency (2023), <https://doi.org/10.1145/3593013.3594087>.

¹⁶ Reserve Bank of India, Draft Guidance on Regulatory Principles for Model Risk Management, 2026, ¶ 61 (June 24, 2026) [hereinafter RBI Draft MRM Guidance].

exactly what a firm cannot plan around. India has no statutory business judgment rule to fill that gap, and Goyal argues that it should adopt one.¹⁷

C. Proof and Attribution

Misfeasance law asks what was ‘obvious’ to a director¹⁸ and requires a claimant to narrate the specific acts and omissions alleged.¹⁹ Both assume that decisions can be traced to people and that warning signs are visible to anyone who looks. Neither assumption holds easily for an opaque model, whose errors may be obvious to nobody who examines it ‘even superficially’. When an algorithm sits between the board and the outcome, the evidentiary chain breaks. A claimant cannot show what a director should have noticed if neither the director nor the company kept a record of how the system worked. SEBI’s paper treats record-keeping as a control, proposing that logs be retained ‘with full verbosity’ so that events can be chronologically reconstructed.²⁰ Company law has no equivalent obligation for the board.

D. The Compliance Representation

The directors’ responsibility statement requires directors to state that proper systems have been devised to ensure compliance with all applicable laws and that those systems are adequate and operating effectively.²¹ Where compliance monitoring, screening or reporting runs on AI, that statement becomes a representation about an AI system. Directors who sign it have no yardstick for what ‘adequate’ means in that setting.

E. The Temptation to Blame the Machine

SEBI’s paper names a further risk: that market participants ‘might attempt to avoid liability for such outcomes by attributing them to the AI systems’.²² It also proposes that AI services supplied by third-party vendors be ‘deemed to be provided by the market participants’, who remain responsible for compliance.²³ Company law should close the same door for directors. Delegating analysis to a system should not delegate the duty of care.

¹⁷ Goyal, *supra* note 8.

¹⁸ *Tendolkar*, (1973) 1 S.C.C. 602, ¶ 40.

¹⁹ *Raghawa Desikachar*, (1975) 45 Comp. Cas. at 142.

²⁰ SEBI Consultation Paper, *supra* note 14, ¶ 5.1(k).

²¹ Companies Act, 2013, § 134(5)(f), No. 18, Acts of Parliament, 2013 (India).

²² SEBI Consultation Paper, *supra* note 14, Annex. B, risk F.

²³ *Id.* ¶ 5.1(e).

IV. The Regulatory Patchwork: Entity Duties, Not Director Duties

A. SEBI

On 20 June 2025 SEBI issued a consultation paper proposing guiding principles for responsible use of AI and machine learning in securities markets, organised around model governance, investor disclosure, testing, fairness and bias, and data privacy and cyber security.²⁴ The model-governance principles include an internal team with the skills to oversee models, designated senior management with the relevant technical knowledge, independent auditing of AI systems and the ability to switch to manual control.²⁵ A tiered approach would apply a lighter regime to internal uses such as compliance and surveillance.²⁶

Three features limit its usefulness for the question in this article. First, it remains a set of proposals: comments closed on 11 July 2025,²⁷ and as of October 2026 SEBI had not issued final guidelines, although its Chairman said they would follow shortly.²⁸ Second, it is directed at market participants such as exchanges, brokers and mutual funds,²⁹ and not at the board of a listed company generally. Third, even for those entities it places oversight with ‘senior management’, not with the board. Meanwhile, the Listing Regulations make the board responsible for framing, implementing and monitoring the risk management plan,³⁰ and require the Risk Management Committee of the top 1,000 listed entities to cover risks such as cyber security, information risk and sustainability, but do not name AI or model risk.³¹

B. The RBI

The RBI has gone furthest towards the board. Its FREE-AI Committee report of 13 August 2025 recommends that regulated entities adopt a board-approved AI policy and annexes a suggested outline for one.³² Its June 2026 draft guidance on model risk management goes further. It would require a board-approved model risk management framework covering

²⁴ *Id.* ¶ 5.

²⁵ *Id.* ¶ 5.1(a), (d), (h), (l).

²⁶ *Id.* ¶ 6.

²⁷ *Id.* ¶ 7.2.

²⁸ Khushboo Tiwari, *Sebi to Issue Closing Auction Guidelines in a Week: Tuhin Kanta Pandey*, Bus. Standard (Oct. 10, 2026), https://www.business-standard.com/markets/news/sebi-to-issue-closing-auction-guidelines-in-a-week-tuhin-kanta-pandey-126101000778_1.html.

²⁹ SEBI Consultation Paper, *supra* note 14, ¶ 4.1.

³⁰ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, reg. 17(9) (India).

³¹ *Id.* reg. 21 & sched. II, pt. D.

³² Reserve Bank of India, FREE-AI Committee Report: Framework for Responsible and Ethical Enablement of Artificial Intelligence, Recommendation 14 & Annex. V (Aug. 13, 2025).

AI and machine-learning models, make the board responsible for overseeing that framework, and task the board's Risk Management Committee with overseeing the monitoring of models that involve AI.³³ It also calls for human oversight of AI models, including override and kill-switch arrangements.³⁴

This is the closest any Indian regulator has come to a board-level AI standard, and it supports the proposal made below. Its limits are nonetheless clear. It is a draft, it applies only to RBI-regulated entities, and it frames the obligation as the entity's: the regulated entity 'is accountable for the outcomes of all models used by it'.³⁵ It is enforced through supervision and does not tell a court what section 166(3) requires of an individual director.

C. The Digital Personal Data Protection Act, 2023

The Act reaches AI only indirectly, through personal data. Where personal data is likely to be used to make a decision affecting a data principal, the data fiduciary must ensure its completeness, accuracy and consistency, and must implement appropriate technical and organisational measures.³⁶ A Significant Data Fiduciary must appoint a Data Protection Officer who is responsible to the board, engage an independent data auditor and carry out periodic data protection impact assessments.³⁷ Breaches will carry penalties of up to ₹250 crore for failure to take reasonable security safeguards and up to ₹150 crore for breach of the additional obligations of Significant Data Fiduciaries.³⁸ These provisions are not yet in force: under the commencement notification of 13 November 2025, sections 8, 10 and 33 take effect eighteen months after its publication, in May 2027.³⁹ Once in force, the Act will give boards a statutory reporting line and a penalty exposure, but still no standard for evaluating an AI system's output.

D. The Result

Four regimes, none of which says what a director must do. A firm operating across these regimes faces overlapping and partly advisory expectations with no common benchmark. That is the compliance gap the proposal below is meant to close.

³³ RBI Draft MRM Guidance, *supra* note 16, ¶¶ 9, 11, 12(3).

³⁴ *Id.* ¶ 60.

³⁵ *Id.* ¶ 8.

³⁶ Digital Personal Data Protection Act, 2023, § 8(3)–(4), No. 22, Acts of Parliament, 2023 (India).

³⁷ *Id.* § 10(2).

³⁸ *Id.* § 33(1) & sched., items 1, 4.

³⁹ Ministry of Electronics & Information Technology, Notification G.S.R. 843(E) (Nov. 13, 2025) (India).

V. A Comparative Lesson from Delaware

Delaware has long treated board oversight as a matter of process. *Caremark* held that a board's 'utter failure to attempt to assure a reasonable information and reporting system exists' is an act of bad faith.⁴⁰ In *Marchand v. Barnhill* the Delaware Supreme Court held that a board must 'make a good faith effort—i.e., try—to put in place a reasonable board-level system of monitoring and reporting', and reinstated claims against a board that had no such system for food safety, the central compliance risk of a single-product food company.⁴¹ *Smith v. Van Gorkom* adds that directors must make informed decisions.⁴²

Three lessons carry across. Oversight is judged by whether a system exists and is monitored, not by whether the outcome was good. The obligation is heightened for matters central to the business. And the board itself, and not only management, must receive the information. These lessons match the process-based approach that Singh, Esser and MacNeil recommend as a complement to broadly stated duties.⁴³

India should not import *Caremark* wholesale. Its 'utter failure' threshold is deliberately high and tied to bad faith, whereas section 166(3) is a duty of care that carries its own statutory consequences. The better lesson is that a legislature or regulator can say, in advance, what a defensible oversight process looks like.

VI. A Board AI Oversight Standard

A. The Standard

The Standard would apply to 'material AI systems': systems whose outputs materially influence financial reporting, regulatory compliance, pricing or credit decisions, customer outcomes, or any matter the board designates as mission critical. It has five elements, each drawn from material that already exists in Indian or comparative sources.

1. Identify. The board, or its Risk Management Committee, maintains a register of material AI systems and designates a senior officer with the relevant expertise to be accountable for each.⁴⁴
2. Understand. Before relying on a material system, directors receive a plain-language briefing on its purpose, data, known limits and explainability. Where a meaningful

⁴⁰ In re *Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).

⁴¹ *Marchand v. Barnhill*, 212 A.3d 805, 821–22, 824 (Del. 2019).

⁴² *Smith v. Van Gorkom*, 488 A.2d 858, 872–73 (Del. 1985).

⁴³ Singh, Esser & MacNeil, *supra* note 2, at 20–22.

⁴⁴ See SEBI Consultation Paper, *supra* note 14, ¶ 5.1(d), *Marchand*, 212 A.3d at 821.

explanation is unavailable, the board records why it relied on the system anyway and what compensating controls apply. AI supplied by a vendor is treated as the company's own.⁴⁵

3. Challenge. For high-impact decisions, a human decision-maker retains the authority and practical ability to override the system, and board minutes record the questions asked and the alternatives considered.⁴⁶
4. Monitor. The board receives periodic reports on performance, drift and incidents. An independent team, which had no role in development, reviews the system, and failures are escalated to the board.⁴⁷
5. Document. The company retains the logs, model versions, board papers and minutes needed to reconstruct how a material decision was made, for a prescribed period.⁴⁸

The Standard should be proportionate. The depth of each step would scale with the system's materiality, and internal-compliance tools could attract a lighter regime, as SEBI's tiered approach already contemplates.

Recent scholarship has begun to converge on similar elements. Pathak proposes five governance safeguards for AI-assisted board decisions (disclosure of material AI use, board-level competence, governance-level explanation, records and continuing model review, and non-delegable human responsibility) and suggests that courts assess the quality of the board's process, such as whether directors tested the system's assumptions and could realistically reject its output.⁴⁹ The Standard proposed here differs in two respects. It anchors each element in an existing regulatory source, and, as the next section explains, it gives the elements legal effect through a presumption under section 166(3).

B. Two Routes to Legal Force

—*First, SEBI*. The Listing Regulations could be amended so that AI and model risk are expressly named in Regulation 21 and Schedule II Part D, and so that the Risk Management Committee must oversee the Standard for material AI systems. Regulation 17(9) already makes the board responsible for the risk management plan, so the amendment would sit within an existing structure. The Committee's mandate already covers cyber security risk,

⁴⁵ See SEBI Consultation Paper, *supra* note 14, ¶¶ 5.1(e), 5.3(d) & Annex. B, risk D.

⁴⁶ See *id.* ¶ 5.1(l) & Annex. B, risks E–F, Companies Act, 2013, § 166(3).

⁴⁷ See SEBI Consultation Paper, *supra* note 14, ¶¶ 5.1(f), (h), 5.3(e), Digital Personal Data Protection Act, 2023, § 10(2)(c).

⁴⁸ See SEBI Consultation Paper, *supra* note 14, ¶¶ 5.1(k), 5.3(d).

⁴⁹ Ashutosh Mani Pathak, *Who Is Responsible When AI Shapes Corporate Decisions? Director Duties and Corporate Accountability under Indian Company Law*, 9 Int'l J.L. Mgmt. & Human. 2211 (2026), <https://doi.org/10.63108/IJLMH.12976>.

which offers a precedent for naming a technology risk expressly, and the RBI's draft guidance already uses the board's Risk Management Committee to oversee AI models. This route is quick and reaches the largest listed entities.

A recent practitioner commentary makes a related proposal. Choubey argues that AI does not change the legal standard of board oversight but changes the conditions in which boards must meet it. On that footing, the commentary recommends that SEBI introduce an AI accountability chapter in the Listing Regulations, that the Ministry of Corporate Affairs clarify that model and algorithmic risk falls within the risk-management statement under section 134(3)(n), and that the Institute of Chartered Accountants of India develop an algorithmic assurance standard for internal audit under section 138.⁵⁰ The first route proposed here is consistent with that approach. The difference lies in the second.

Second, the Companies Act. An Explanation to section 166(3), or rules made under it, could provide that a director who has followed the Standard in relation to a material AI system is presumed to have exercised due and reasonable care in relying on that system. The presumption would be rebuttable on proof of bad faith, conflict of interest or a failure to act on obvious warning signs, and the duty of independent judgment would remain. This converts the after-the-fact relief of sections 149(12) and 463 into a benchmark that directors can work towards in advance. It is deliberately narrower than a general business judgment rule.

This second route is what separates the present proposal from the reforms described above. Each of those reforms, like the first route, adds disclosure, structure or assurance at the level of the company. Choubey describes generating evidence of the oversight process as 'the most important defensive move for any board',⁵¹ but the proposed reforms leave section 166(3) itself unchanged. Pathak's safeguards are likewise offered as governance practice and as a guide for courts, not as a change to the statute. A director who follows an AI accountability chapter in the Listing Regulations would still have no assurance that a court will treat that compliance as due care. The rebuttable presumption supplies that link. It ties the regulatory process to the statutory duty, so that following the Standard becomes evidence of care in the director's own defence, and not only evidence of the company's compliance.

⁵⁰ Dhanvi Choubey, *Board Oversight of Artificial Intelligence Risk and Algorithmic Decision-Making: Directors' Duties in the Age of the Black Box*, Khurana & Khurana (Oct. 6, 2026), <https://www.khuranaandkhurana.com/board-oversight-of-artificial-intelligence-risk-and-algorithmic-decision-making>.

⁵¹ *Id.*

C. Why Firms Would Value It

A firm gets three things. The first is a ready benchmark for board papers and AI policies. The second is a documentary record that answers the requirement, traced to *Raghawa Desikachar*, that a claim narrate specific acts and omissions, because the minutes and logs show what the board knew, asked and decided. The third is a single standard that maps onto SEBI's principles, the RBI's draft model-risk guidance and the board-facing obligations under the data protection law, so that one process can serve several regulators.

D. Objections

One objection is that a process standard invites box-ticking. Singh, Esser and MacNeil make a similar criticism of rigid rules, which they say may produce merely 'ticking the boxes'.⁵² The answer is that the presumption is rebuttable and the duty of independent judgment survives, so a board that follows the steps mechanically while ignoring obvious red flags would not be protected. A second objection is that any standard will chill adoption. The opposite is more likely: Goyal argues that the vagueness of section 166 encourages defensive decision-making,⁵³ and a clear benchmark reduces the incentive to avoid AI altogether.

VII. Conclusion

Section 166(3) was written for a world in which a director's care could be assessed by asking what the director did. Where AI mediates the decision, that question needs a structure to answer it. The regulatory material now emerging in India addresses firms, not directors, and the protections that exist for directors work only once a dispute has started. A five-part Board AI Oversight Standard, implemented through the Listing Regulations and backed by a rebuttable presumption in the Companies Act, would give boards a way of showing care in advance and give courts a way of testing it afterwards. Both the standard and the legislative text will need refinement. But the choice is not between regulating AI use by boards and leaving it free. The choice is between a standard that is written down in advance and one that courts will have to improvise after the first large loss.

⁵² Singh, Esser & MacNeil, *supra* note 2, at 14.

⁵³ Goyal, *supra* note 8.