

Legal Analysis of Artificial Intelligence in Corporate Board Rooms

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ABSTRACT: Artificial Intelligence has the potential to revolutionize the corporate boardrooms. AI has recently entered the corporate boardrooms. As per the literature available AI can be divided into three forms- assisted, augmented and autonomous artificial intelligence. There is a difference of opinion some scholars is of the view that AI can only be used as a tool or aid by boards while other believe in delegating the directors' duties to AI for efficient results The author in this article will examine the technological development in field of AI and board of directors with special reference to India.

Keywords— Artificial Intelligence, Covid 19, Corporate Boardroom, AI and Board of Directors

I. INTRODUCTION

1. INTRODUCTION:

The Covid 19 Pandemic has affected communities, companies, and business globally [1]. The global outbreak of the novel corona virus has remolded the functions of board of directors. The boards are now looking for long term corporate strategies in light of COVID-19[2]. One such corporate strategy is the introduction and advancement of technology in boardroom. Recently, there have been breath-taking advancements in information technology- from Block chain to smart contracts to artificial intelligence (AI) to machine learning to Internet of things to human cloud etc[3]. These technologies have the potential to revolutionize the corporate boardrooms.

The recent studies indicate that AI is going to enter the Boardroom soon [4]. In 2014, a venture capital firm based in Hong Kong announced that it had made VITAL[5], an algorithm a board member. This algorithm was given an "observer status" and a right to vote in meetings. Similarly, in 2016 Tieto, a Finnish software company appointed an algorithm, named Alicia T, to its management team also with the capacity to vote[6]. In 2015, even the World Economic Forum acknowledged that AI will become part of companies' board of directors by 2025[7]. It is comprehensible that AI is being utilized in boardrooms but the question is to what extent AI can be exploited in Boardrooms. Can AI be utilized by the board for only decision making or can AI substitute the directors in a company and consequently what will be the legal implications of AI in the field of company law.

A. Legal Status of a Director and AI:

The Director has been defined variedly. As per the American Heritage Dictionary, director means "a member of a group of persons chosen to control or govern the affairs of an Institution or a corporation"[8].The Webster's dictionary defines director as a "one of a group of person chosen to control or govern the affairs of a company or corporation"[9]. The board of directors occupies a very crucial position in corporate enterprise as they play a key role in the management of company's business. The role of director is quintessential in corporate law as their role comes up in every aspect and decision making process of the Company. Thus, analyzing the role of AI in boardroom decisions becomes significant.

B. Possible Roles played by AI in Boardrooms:

The views of various scholars on the role played by AI in boardroom are distinct. According to the present literature, the role of AI can be divided into three forms- assisted, augmented and autonomous artificial intelligence [10]. In the first stage i.e. assistance stage, AI executes certain specific tasks but the authority in decision making remains with the human. In the second augmented stage, AI supports human decision making

and learn from each other and finally in the autonomous stage, machines substitute the human intelligence and replace the directors [11].

Thus, some scholars support a limited role for AI [10] stating that AI can only be used as a tool or aid by boards. Some scholars support [12] the idea of delegating the directors' duties to AI for efficient results whereas some scholars [13] support the idea that AI will replace human directors in near future. When we consider these different positions of scholars, many legal questions arise. Can an AI be appointed into the boardroom, Can AI be dismissed from a boardroom, What will be the liability and responsibility of AI as a director, can the Director delegate the authority to AI of decision making etc. The authors have tried to answer these questions in context of Indian jurisprudence in next part of the article.

C. AI in Boardroom: Advantages and Disadvantages

The key benefits of introducing AI in Boardroom are:-

- The engagement of AI in corporate governance will lead to reduction of agency costs for the companies.
- AI as directors will lead to increase in efficacy of management.
- The AI does not require any remunerations and holidays. They are only programmed to work in the interest of the company.
- AI will be able to analyze large amounts of data in a short period of time and will be able to come to conclusions and suggestions much rapidly.
- AI as a director will act as an unbiased and a neutral tool which will enhance the quality of decision making.
- AI in corporate governance will facilitate better compliance with national laws which in turn will be valuable for reducing penalties, liabilities, fines etc.
- AI may reduce the employee workload in general, it may signify increase in profits for the business.

The main limitations of introducing directors in boardroom are:-

- AI cannot prepare a business and strategic plan and ensure the smooth functioning of company.
- AI lacks the human qualities of creativity and innovation.
- AI as directors will lack business instincts and entrepreneurial flair of business-person.
- The duty of looking after the interest of the stakeholders and the management of the company will not be fulfilled by AI.
- The issues relating to rights, civil and criminal liabilities of AI as a director are extremely vague.
- The inability of the user to accurately identify the information and the processes based on which the AI made its decision [14].

II. AI AND BOARDS UNDER INDIAN LAW:

The use of AI in Indian Corporate Governance framework has remained uncharted despite of the dynamic nature of AI to revolutionize the Indian Boardrooms. Involvement of AI in corporate governance can be viewed at two levels. Firstly, utilization of AI by the board for its decision makes, and secondly, utilization of machine learning for substituting one or more directors or perhaps even the entire board[15]. This part of the article will explore the possibilities of AI in Indian Boardrooms under the Indian corporate law.

A. AI as a board member in India:

The term director has not been comprehensively defined under the Companies Act, 2013. Section 2(34) defines director as “*any person appointed to the Board of a company*”. Thus under the Indian Corporate governance law, no AI can be appointed as a board member as the definition prescribes that only natural persons can be appointed as directors.

B. AI as a Supporting Tool to the Directors:

Indian Company Law allow for limited delegation of powers of the directors that to only to a natural person. Section 179 of the Companies Act, 2013 states- “*the Board has the power to delegate in cases such as borrowing monies, in investing the funds of the company or to grant loans or give a guarantee or provide security in respect of the loans, and on such conditions as may be specified, to any committee of Directors, the Managing Directors, the Manager or any other principal officer of the company*”[16]. On further examination, if we analyze the respective definition of a Director[17], Managing Directors[18], Managers[19] and principal officer under the Act, 2013 on whom the power has been conferred, we conclude that under Indian laws the directors can delegate there powers but only to natural person.

C. AI and Directorial Duties:

The Board of Directors is charged with the role of governance and collectively, the directors enjoy wide powers to govern and manage the company along with this primary role of governance [20]. In India, the duties of the director are codified under Section 166 of the Companies Act, 2013. The result of the codification of duties is that non-adherence to these duties invite statutory penalty [21] for the directors. These duties arise from the fact that directors hold a fiduciary relationship to the corporation and shareholders [22]. Thus, an analysis needs to be made with reference to duties of the director under the Act with special reference to AI in Indian Boardroom.

Section 166 of the Companies Act, 2013 lays down the following statutory duties of a director:

1. Duty of the director to act in accordance with Articles of Association of company[23]
2. Duty to act in good faith and in best interest of company[24]
3. Duty of exercising reasonable care, skill and diligence and Independent Judgment[25]
4. Duty to avoid conflict of Interest with the company[26]
5. Duty not to make undue advantage or gain[27]
6. Duty not to assign office of director and any assignment so made shall be void[28]

The Indian Corporate Laws does not allow the AI to autonomously manage a company [29]. The author will like to focus here on the last statutory duty which makes it clear that the office of director cannot be assigned to anybody. A director in a company is chosen because of his skills, expertise, experience and competence [30]. Thus, the present law does not allow AI to take on the functions of the director. To support the argument, In Re central Calcutta Bank Ltd.,[31] it was declared by the court that “ Directors cannot disinvest themselves of the responsibilities by delegating the whole management to the agent and abstaining from all enquires”[32]. Thus, the author articulates that directors cannot delegate their functions to AI but can rather use AI as a supporting tool to help them in fulfillment of their duties.

If however in near future, AI is allowed into the boardroom then AI are capable to perform the duties by the director. Special duties like to act in accordance with Articles of Association of company; to act in good faith and in best interest of company etc. can be added into the internal codes of AI, while the other duties like duty of care [33] and duty of loyalty[34] etc. are already inbuilt in the structure of AI that cannot be breached. Rather, if the directors in Indian Boardroom allow AI to assist them in boardroom, then the directors will have to perform their duty more vigilantly. They will have to be careful about the “source code”, their working, reports submitted by AI etc. Further, special importance should be given to the director’s duty of maintaining confidentiality since there can be chances of violation of privacy which can lead to huge losses for the company and ruin the business of the company.

D. AI and Directorial liabilities:

With the introduction of AI into the boardroom, another question arises- What is the relationship between AI and directorial liabilities? Can the directors be held liable for the decisions of AI?

Under the Companies Act, 2013, the responsibilities for contravention of Companies Act fall on the “officer in default”[35]. The term “officer in default” includes whole time director, key managerial personnel, Share transfer agents, directors, Company secretary, chief financial officer the company. Thus, only the natural persons can be made liable under the Act.

In the scenario that AI is assisting the board in making decisions and the director is relying on the opinion of AI after reasonable checks, then the director will be liable for acts of AI. The Act, 2013 has laid down both civil and criminal liabilities for defaulting directors. The directors are liable for not duly discharging their fiduciary duties [36], Issuing of Prospectus with untrue or misleading statements[37], Issuing of shares by a company at a discount[38], Preservation of minutes of meetings by the company[39], not filling financial statement in a prescribed form[40] and approval by officials of the company[41], in cases of related party transaction[42], fraud[43] and false statements[44] etc. Accordingly, the directors are still held accountable as they cannot claim ignorance for not accordingly to their duty of care even in cases where a third-party has been delegated to collect and review information in a specific case.

The author would also like to mention the director’s liabilities under the Information Technology Act, 2000 with regard to AI in boardroom. The director will have to ensure proper implementation, adequacy and effectiveness of appropriate systems to comply with the cyber security requirements [45]. The failure of the directors to comply with these requirements will lead to a breach of director’s duties making them liable under Section 43-A [46] and Section 85[47] of the Information Technology Act, 2000.

Thus, the author concludes that firstly, AI cannot be made personally liable under the Act. Secondly, when delegating their powers to AI or even engaging their services as an expert opinion the director has to keep an effective oversight [48] on the decisions. A director cannot take a plea that he has allowed a decisions totally depending on the reliability of AI’s work.

E. *Can Independent Directors be replaced by AI?*

The role of independent director has been a subject matter of discussion in several corporate scandals globally in cases of Enron and WorldCom and India in cases of Nirav Modi-PNB fraud scam[49], Satyam computer services,[50] Harshad Mehta Stock Scam, 1992 etc. These instances have highlighted the inefficiency of Independent director's laws. The question is "Are these Independent Director really Independent"[51]. The norms of Independent Director have been laid down in 2013 Act to ensure their independence from management and free from any business or other relationship [52]. The authors proposes that these functions can be effortlessly and effectively performed by AI.

According to the Indian Companies Act, 2013, an Independent director should be a person with integrity who possesses relevant expertise and experience,[53] who is not a promoter or not related to a director or promoter of a company[54], who has no pecuniary relationship with company[55] nor their relatives have any association with the company[56]. It is submitted that these qualifications can be simply be fulfilled by AI. In fact, when we analyze the Roles, Functions, duties of Independent Director under the code described in Schedule IV of the Act, 2013[57]. We can conclude that AI will be able to replace the Independent Director and actually offer a Independent view to the directors and be a useful aid to counter groupthink [58].

F. *Way Forward for AI in India*

According to the report of State of Artificial Intelligence in India-2020[59], India is transforming into a hub of AI research and development. Given the advancement in next generation technologies across industries – with 5G in Telecom, IoT platforms in Engineering and Manufacturing, Connectivity across the Automotive, Smart cities, and Smart utilities sectors are increasing the scope of collaboration of AI across sectors [60]. Howsoever, the role of AI has remained unexplored in the boardroom. According to the Indian Law, currently the AI cannot replace the human agency and algorithms can only play a supportive tool for the directors. Nevertheless, companies must embrace these AI driven technology practices to be victorious in near future. Some suggestions to enhance AI in the Indian Corporate framework are[61]:

a) **Directors and Officers Liability Insurance:**

A Directors and Officers liability insurance policy is not mandatory as per Companies Act 2013[62]. However, the Act, 2013 permits the director to take insurance for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty[63]. Thus, this Insurance will provide the directors the right to protect themselves against any liabilities that might arise from AI. Therefore the author suggests that there should be a mandatory insurance agreement[22] between the insurance companies and company who is intending to operate with AI.

b) **Amendments in the Personal Data Protection Bill, 2019:**

In August 2017, the Union Ministry of Electronics & Information Technology constituted an Expert Committee led by Justice Srikrishna [64] who has proposed the Personal Data Protection Bill, 2019. The author submits that there needs to be amendments in the Personal Data Protection Bill, 2019 to include the data regulations for AI. This will help regulate the data breaches by AI and to protect data privacy. Further, this will lead companies to use AI without any restraints.

c) **Authorized National Agency:**

There should be an authorized national agency in India which determines which activities can be performed by AI and which activities are prohibited by AI. In fact, the Indian Legislation should also define the term AI.

d) **Training of Directors in new technology practices:**

There is a need to give proper training to the directors regarding new technologies like 5G, AI, IoT etc. In India, the directors are technologically diffident. If the Indian companies needs to be successful in future, then they must embrace AI driven technology practices.

III. CONCLUSION

In these unprecedented times of COVID 19, there has been an explosion of technologically advancements in society. The reality is that directors now can no longer afford to ignore the technology expertise. In this 21st century, the directors need to be tech-savvy and should have proper knowledge and training on expanding technologies and innovations. Keeping this in mind, the paper has preliminarily discussed the idea of moving from one Person Company to a zero person company? The authors believes that due to lack of legal jurisprudence on this subject suitable legal principles should be enacted which encourage the development of AI and also ensure necessary safeguards for the directors

Some observations and suggestions to enhance AI in the corporate framework are:

a) **Baby Steps for Introducing AI in Boardroom:**

The entire concept of AI in boardroom is theoretical. The author suggests that in initial years, AI should be confined to administrative aspects of corporate governance¹ only like analyzing data, preparing for meetings etc and then after some time AI can be given the responsibility of making strategic decisions. Further, when the directors become familiar with the concept of AI, the directors can even delegate their work to them.

b) Standards and Codes of conduct for Directors:

If the directors resort to using AI in boardrooms, then the directors must draft a policy that defines the duties and functions of the director. The policy must include any risk and protection from that risk with regard to the liability of AI.

c) Tech-Governance Committees:

The author proposes that there should be a Tech-Governance Committees in every company. These boards can advise the directors and management make best use of the new technologies. This committee can advise the board members on the risks associated with technology.

d) Evaluation of Independent Directors:

As discussed earlier, there should be an evaluation on the role played the Independent director. Recently, there have been a lot of accusations against the Independent Directors and the role played by them. The author suggests that the policy makers must consider replacing the Independent directors with AI to ensure their independence from management and free from any business or other relationship. The author does not articulate that they should be replaced immediately but the idea on their role must be looked into.

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