Critical Analysis of Appointment, Duties & Remuneration of Directors – Companies Bill, 2009

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Though much of the existing provisions of The Companies Act 1956 relating to directors find place in the Companies Bill, 2009, there are some new provisions too. The concept of key managerial personnel has also been proposed. This article critically examines these proposals.

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INTRODUCTION

The Companies Bill, 2008 which was introduced in Lok Sabha on 23rd October, 2008 lapsed due to dissolution of the 14th Lok Sabha. Therefore, the Minister for Corporate Affairs, Mr. Salman Khurshid introduced the Companies Bill, 2009 in the Lok Sabha on 3rd August, 2009. It is hoped that the Companies Bill, 2009, on its enactment, would provide a modern legislation for growth and regulation of the corporate sector. The Bill has proposed various reformatory and contemporary provisions together with omission of existing unwanted and obsolete compliance requirements. Thus it is expected that the companies would be able to comply with the requirements of the proposed Companies Act in a more effective manner. The Bill has proposed various changes with respect to the appointment, duties and remuneration of Directors. This Article endeavours to critically analyse the provisions relating to directors and other managerial personnel.

COMPOSITION OF BOARD OF DIRECTORS

Clause 132 of the Bill provides that the Board of Directors of every company shall consist of – (a) minimum 3 directors in case of a public company; 2 directors in case of a private limited company and 1 director in case of one person company; and (b) maximum 12 directors, excluding the directors nominated by the lending institutions.

At least one of the directors should be a person ordinarily resident in India, i.e., a person who has stayed in India for not less than 182 days during a calendar year. The Clause further provides that in every listed company at least one-third of the total number of directors shall be independent directors.

Clause 49 of the Listing Agreement which *inter-alia* deals with the composition of the Board of Directors provides as under:-

“(i) The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors.

(ii) Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

Provided that where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

It is worthwhile to note here that the Listing Agreement contains elaborate provisions regarding the composition of the Board of Directors whereas the Companies Bill, 2009 is completely silent on the number of non-executive directors in case of listed companies. Moreover, the Bill only states that at least one third of the total number of directors shall be independent directors, whereas the Listing Agreement clearly states that in case Chairman of

the Board of Directors is an Executive Director, at least half of the Board shall comprise of independent directors. Therefore, Clause 132 (3) requires a relook by Ministry of Corporate Affairs.

The Bill is also silent about the composition of the Board in case the Non-Executive Chairman is a promoter of the Company or is related to any promoter as mentioned in proviso to Clause (ii) of the Listing Agreement mentioned above. It is submitted that when the Bill is proposing to include a provision relating to composition of the Board in case of listed companies; it should have been carefully drafted to avoid any sort of contradiction between the proposed Companies Act and the existing Listing Agreement.

Clause 132(5) of the Bill defines "Independent director", of a company, as a non-executive director of the company, other than a nominee director:-

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant, expertise and experience;

(b) who, neither himself nor any of his relatives;-

((i) has or had any pecuniary relationship or transaction with the company, its holding, subsidiary or associate company or its promoters, or directors amounting to 10% or more of its gross turnover or total income during the two immediately preceding financial years or during the current financial year;

(ii) holds or has held any senior management position, position of a key managerial personnel or is or had been employee of the company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(iii) is or has been an employee or partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed of (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to 10% or more of the gross turnover of such firm;

(iv) holds together with his relatives 2% or more of the total voting power of the company; or

(v) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives 25% or more of its income from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company; or

(c) who possesses such other qualifications as may be prescribed.

Explanation: For the purposes of this section, "nominee director" means a director nominated by any institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government to represent its shareholding.

Under the Listing Agreement, the Nominee Directors are considered as Independent Directors whereas as per the Companies Bill, the nominee directors shall not be treated as Independent Directors. On reading the explanation given above one can construe various meanings. One of the views is that the nominee director appointed by a lending institution shall be treated as an independent director whereas a nominee director appointed by an Institution on the strength of its shareholdings shall not be treated as independent director. This will definitely lead to confusion as different experts will interpret the explanation in different manner to suit their purpose.

On comparing the aforesaid definition of " independent director" with the definition given in Clause 49 of the Listing Agreement, it becomes clear that there are some differences between the two definitions like the Bill provides "10% or more of gross turnover" which is not there in the Listing Agreement. Moreover, the Listing Agreement provides that a material supplier, service provider or customer or a lessor or lessee of the company cannot be an Independent Director, which is not there in the Bill.

The purpose of appointing independent directors on the Boards of listed companies is to ensure adherence to good corporate governance standards and to check diversion of funds. After, the Satyam's episode, the integrity of the high-profile independent directors of the said Company was in doubt. The ambiguity on the nature of duties of independent directors often leads to a situation where they are blamed for all wrong-doings of the Company. The Satyam episode led to spate of resignations by the independent directors.

Unfortunately, in the Companies Bill, 2009, the Government has not laid down any guidelines with respect to the role of the independent directors. Moreover, there are no provisions to safeguard them against any legal action when they are not directly at fault. This again will force the prospective directors to think twice before joining the board as independent directors. It may be worth pointing out here that in the past, so many independent directors have been routinely harassed and hounded in cheque bouncing cases under Section 138 of the Negotiable Instruments Act. The Supreme Court had clarified in a number of cases that independent directors who are not directly involved in the day to day management of the business of the company should not be proceeded against, yet quite often the lower courts proceed against the independent directors due to lack of knowledge about these judgements. In a case filed by UP Pollution Control Board, the Supreme Court has observed that " a director would not be vicariously liable for the company's actions, unless he is in charge of and responsible for running the company." Recently, some of the high profile Independent Directors were harassed in the case of Nagarjuna Finance Ltd., which had defaulted in the repayment of public deposits. Hence, the independent directors deserve some immunity against the threat of prosecution and the Companies

Bill, 2009 should have provided for the same.

DELEGATION OF POWERS TO SEBI

SEBI has prescribed the parameters for composition of the Board of Directors of listed companies through Clause 49 of the Listing Agreement. It is interesting to note here that Section 55A of the Companies Act, 1956 empowers SEBI to regulate the matters relating to issue and transfer of shares only in case of listed companies. In addition to Section 55A of the Companies Act, 1956, SEBI derives its powers from Sections 11 and 11A of the SEBI Act, 1992. However, a careful reading of both these sections of SEBI Act, makes it clear that these sections also empower SEBI only to make rules and regulations for protection of interests of investors and to promote development of the securities market only with respect to the matters relating to issue and transfer of shares. In other words, matters relating to the composition of the Board of Directors are outside the purview of SEBI's powers. Further, explanation to Section 55A also specifically provides that powers in respect of all other areas shall be exercised by the Central Government, which re-inforces the above argument. In the Companies Bill, 2009 also, the same powers are proposed to be delegated to SEBI through Clause 22 of the Bill. However, SEBI is amending the Listing Agreement from time to time in order to alter the composition of the Board of Directors or to amend the definition of "Independent Directors"etc. It seems that SEBI is going overboard. Hence it is necessary that the Companies Bill must contain necessary provisions empowering SEBI to deal with the matters relating to composition of the Board, powers & functions of Audit Committee & other matters that are covered under the Listing Agreement.

APPOINTMENT OF CHAIRMAN

There is no statutory provision in the Companies Act, 1956 that every company should have a Chairman. In the Bill also, the provisions relating to Chairman are absent except Clause 93 of the Bill which contains the provision relating to Chairman of Shareholders' meetings. The Chairman of the Board of Directors is the highest position in a company but still the Companies Act, 1956 and the Companies Bill, 2009 do not provide the manner of appointment or the role and responsibilities of the Chairman. This aspect needs to be looked into by the Ministry of Corporate Affairs.

APPOINTMENT OF DIRECTORS

The provisions relating to appointment of directors in the Bill, 2009 are given below:-

- Subscribers to the Memorandum, who are individuals, shall be deemed to be the first directors of the company.
- Every director shall be appointed by the Company in general meeting save as otherwise expressly provided in the Bill.
- No person shall be appointed as a director of the company unless he has been allotted the Director Identification Number (DIN).
- Every person proposed to be appointed as director by the company in general meeting or otherwise shall furnish his DIN and a declaration that he is not disqualified to become a director.
- The director has to give his consent in writing to hold the office as director and the same has to be filed with ROC within the prescribed time.
- In case of appointment of an independent director, the Board shall also give a report in the general meeting that in its opinion, he fulfils the conditions specified for appointment of independent director.
- "Unless the Articles provide for retirement of all the directors at every annual general meeting, not exceeding one-third of the total number of directors of a public company shall be liable to retire, and out of the remaining, one-third shall retire by rotation at every annual general meeting in accordance with such procedure and principles as may be prescribed and such retiring directors shall be entitled to be re-appointed." [Clause 132(6)]

It seems that there is a drafting error in this sub-clause since this sub-clause should have been worded as " not less than two-third of the total number of Directors" instead of " not exceeding one-third of the total number of Directors" because in its present form this sub-clause will permit a company to have all the non-retiring directors on its Board, which cannot be the intention of the proposed law. For example, If a company has 6 Directors then as per the Companies Act, 1956 not less than two-third out of 6 directors shall be liable to retire by rotation, which means that at least four directors are liable to retire by rotation. However, if we apply the provisions of the Companies Bill which provides that " not exceeding one-third of the total number of directors of a public company shall be liable to retire"then the company would have the discretion either to have nil or one or two directors on its Board who may be liable to retire by rotation. Accordingly, the number of directors not liable to retire by rotation shall be 6(6-0) or 5 (6-1) etc., which under any circumstance is not possible. Thus, Clause 133(6) needs to be redrafted by the Ministry of Corporate Affairs.

Clause 132 (7) provides that in case a company fails to re-appoint a retiring director or to appoint any person as director in place of the retiring director at any annual general meeting, then such appointment shall be made at any adjourned meeting within such time as per the procedure prescribed.

DUTIES OF DIRECTORS

The moment a person accepts the position of Director in a company, such a person ought to know what he/ she is supposed to contribute to the company and what powers and duties he or she can exercise to carry out the functions of director. The duties of directors are contained in Clause 147 of the Bill which are as

under :

- A director shall act in accordance with the company's Articles of Association subject to the provisions of the Act.
- He shall act in good faith in order to promote the objects of the company for the benefit of the members as a whole, and in the best interest of the company.
- He shall exercise his duties with due and reasonable care, skill and diligence.
- He shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
- He shall not achieve or attempt to achieve any undue gain or advantage either to himself or his relatives, partners or associates. In case if any of the director is found guilty of making any undue gain either to himself or to his relatives, partners or associates he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees plus the undue gains, if any made.
- He shall not assign his office and any assignment so made shall be void.
- An important duty of every director is to regularly attend the Board Meetings. The Bill has also emphasised the same as clause 148 (b) provides that the office of a director shall become vacant in case he absents himself from all the meetings of the Board during a period of 12 months irrespective of the fact whether the Board grants him leave of absence or not. *However, no cooling period has been specified for the purpose of re-appointment of the director whose office had been vacated for the aforesaid reason. Therefore, it would have been appropriate if the Bill had specified that such a director cannot be re-appointed for at least (say) one year.*

It would be observed that most of the duties of the Directors given above are almost similar to the duties and responsibilities that are generally contained in the Code of Business Conduct for Directors & Senior Executives of listed companies as per Clause 49 of the Listing Agreement.

RESIGNATION OF A DIRECTOR

Clause 149 of the Bill provides that a notice of resignation given by a director shall take effect from the date on which the notice is received by the company or from the date specified in the notice, whichever is later. Where as a result of any vacancy in the Board, the number of directors is reduced below the quorum fixed for a meeting of the Board, the continuing director (s) shall be deemed to constitute the quorum. Further, it has been provided that where all the directors resign from their office or happen to vacate their offices under Clause 148 (which is similar to Section 283 of the Companies Act, 1956), the promoter or in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in general meeting.

The Bill does not specifically provide as to for how long and for what purposes the newly constituted Board can function. The Bill should not have left any scope for ambiguity in this regard.

BOARD MEETINGS

- The Bill provides that every company shall hold its first Board Meeting within 30 days of the date of incorporation and thereafter at least 4 meetings must be held every year. The gap between any two consecutive meetings of the Board must not exceed 120 days. Thus, here also an attempt has been made to replicate the provisions of Clause 49 of the Listing Agreement.
- Participation of directors may be either in person or through video conferencing or such electronic means and the director participating through video conferencing shall also be counted for quorum. This is a welcome move as the industry had been demanding for quite sometime that participation through video conferencing must be allowed in view of the fact that Directors have to frequently travel to far off places due to the business needs.
- The Central Government has got power to specify such matters which shall not be dealt with in a meeting through video conferencing.
- A meeting of the Board shall be called by giving not less than seven days' notice in writing or by electronic means to every director at his address registered with the company. Failure to give notice as above attracts penalty of Rs. 25,000 on the Company Secretary or whosoever is made responsible for it.
- A Board Meeting may be called at shorter notice to transact urgent business subject to the condition that at least one independent director attends the meeting. In case no independent director is present at the meeting, the decisions taken at the meeting must be circulated to all the directors. The decisions would be final only on ratification of the same by at least one independent director.

POWERS OF THE BOARD

Clause 159(3) is similar to Section 292 of the Companies Act, 1956. It provides the powers that can be exercised only at board meetings. They are as follows:-

- Making calls on shares.
- Buy-back of securities.
- Issue of securities including debentures.
- *Borrowings including temporary borrowings from company's bankers.*
- *Investment of funds of the company.*
- *Granting of loans or giving guarantee or providing security in respect of loans.*
- Approval of Financial Statement and Directors' Report.
- Diversification of company's business.
- Approval of amalgamation, merger or reconstruction.

- Take over or acquisition of controlling or substantial stake in another company.

The business stated at the items italicized above may be delegated to any Committee of Directors, Managing Director, Manager or any principal officer through Resolutions passed at a Board Meeting.

RESTRICTIONS ON BOARDíS POWERS

Clause 160 of the Bill retains the same provisions as Section 293 of the Companies Act, 1956 as regard to the restrictions on board's powers that can be exercised with the shareholders' approval. The exceptions are :-

(a) It applies to all companies whether private or public limited companies.

(b) All the powers contained in the clause have to be consented to by the company at general meeting by way of a special resolution instead of the present requirement of an ordinary resolution.

RELATED PARTY TRANSACTIONS

A company can enter into any contract or arrangement with a related party in respect of the following transactions only with the consent of its Board of Directors.

- Sale, purchase or supply of any goods or materials;
- Selling or otherwise disposing of or buying, property of any kind;
- Leasing of property of any kind;
- Availing or rendering of any services;
- Appointment of any agents for purchase or sale of goods, materials, services or property;
- Appointment to any office or place of profit in the company or its subsidiary company; and
- Underwriting the subscription of any securities or derivatives thereof, of the company.

Further, no contract or arrangement shall be entered into except with the prior approval of the company by a special resolution in case the company is having a paid up capital of not less than such amount or transactions not exceeding such sums as may be prescribed. The above provisions do not apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis. Arm's length transaction means a transaction between two related parties that is conducted on the terms as if they were unrelated, so that there is no question of conflict of interest. Every contract or arrangement entered into under this clause has to be referred to in the Directors' Report along with the justification for the same. As on date Accounting Standard 18 also requires reporting of Related Party Transactions in the Annual Report of the Company. However, the definition of " Related Party" under AS 18 is significantly different from the definition given under the Companies Bill. Thus, there is need to bring parity between AS 18 and the Companies Bill.

APPOINTMENT OF MANAGERIAL PERSONNEL

- A company can appoint or re-appoint any person as its Managing Director, Whole time Director or Manager only for a period of five years at a time with a provision that no re-appointment shall be made earlier than one year before the expiry of his term.
- A company shall not appoint or continue the employment of any person as its key managerial personnel who –
  - is below the age of 21 years or has attained the age of 70 years; Provided that appointment of a person who has attained the age of 70 years may be made by passing a special resolution;
  - is an undischarged insolvent or has at any time been adjudged an insolvent;
  - has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them ; or
  - has at any time been convicted by a court of an offence involving moral turpitude.
- The Managing Director, Whole-time-director or Manager shall be appointed by the Board of Directors at a meeting with the consent of all the directors present at such meeting, which shall be subject to approval by a special resolution at the next general meeting of the company.
- The notice convening the Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, if any, of a director or directors in such appointments, if any.
- In case an appointment as above is not approved by the company at a general meeting, it will not invalidate any act done by him before such approval.

At present Section 269 of the Act provides that the appointment and remuneration of managerial personnel must be in conformity with Schedule XIII of the Act. However, clause 174 does not refer to any Schedule, therefore it seems that there is no need for approval of the Central Government.

REMUNERATION OF MANAGERIAL PERSONNEL

- A Managing Director or Whole-time-director or a Manager of a company may be paid remuneration either by way of monthly payment or at a specified percentage of the net profit of the company, computed in the manner prescribed or partly by monthly payment and partly by percentage of net profits. Thus there is no limit fixed on the remuneration payable to managerial personnel, whereas existing Companies Act prescribes the same. After a long time, the Government has accepted the Industry's demand to abolish the ceiling on managerial remuneration which is a welcome move but the corporate sector would have to live up to the

expectation of the Government and shareholders by not mis-utilising this provision.

- Where Any insurance premium paid for indemnifying any of the managerial personnel against any liability in respect of negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the said amount of premium shall not be treated as part of the remuneration payable to any such personnel.

APPOINTMENT OF KEY MANAGERIAL PERSONNEL

- Clause 178 provides that every company belonging to such class or description of companies as may be prescribed shall have whole-time key managerial personnel. (WTKMP)
- Each WTKMP of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.
- A WTKMP shall not hold office in more than one company at the same time; provided that he may become a director of any company with the permission of the company.
- In case of vacation of any WTKMP, the said vacancy shall be filled up by the Board at a meeting of the Board, within a period of 6 months from the date of such vacancy.

Clause 178(3) specifically provides that a WTKMP shall not hold office in more than one company where as Section 316 of the Companies Act, 1956 permits holding of position of MD in two companies with the unanimous consent of all the directors of the subsequent company and in more than two companies with the prior approval of the Central Government. Thus, the persons who are at present holding the position of MD in two companies would have to relinquish the post of MD from any one of the companies when the Bill is enacted.

CONCLUSION

The Companies Bill, 2009 proposes far reaching changes in matters relating to management of companies. It is suggested that as far as possible, the Bill should not touch upon the matters relating to composition of Board of Directors etc. of listed companies because already there are elaborate provisions under the Listing Agreement. Moreover, the Listing Agreement is amended from time to time to address various urgent issues, where as it would not be possible to amend the Companies Act at such frequent intervals.

Certain provisions of the Bill require to be reviewed and amended suitably in order to ensure better protection to the investors and the independent directors. The Satyam Fiasco has tarnished the image of the corporate sector amongst the Indian and International investors. Therefore, the Bill should be suitably amended to re-inforce the investors' protection measures. The Government has chosen to present the 2008 Bill merely by changing the title from "Companies Bill, 2008" to "Companies Bill, 2009." Soon after the Companies Bill, 2008 was presented in Lok Sabha last year, various eminent corporate professionals, lawyers and intellectuals had given their valuable views and suggestions to improve the Bill which have been completely ignored. It is earnestly hoped that before the Bill is passed by the Parliament, the Government would carefully consider all the valuable suggestions. ❑