

Semerster 2

COMPANY LAW

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COMPANY ADMINISTRATION

LECTURE 3

1. Power of directors

Powers of the board (179 and Rule 8 of Companies (Meetings of the board and its powers) Rules, 2014)

1. The BOD is allowed to exercise all powers as it may be exercised by the company under the ambit of MOA and AOA, provisions of this act, others laws and regulations and other resolutions set in the AGM
2. Any prior act made by the board will not be invalidated due to some new regulations made by the AGM
3. The powers of the board:
 - (a) To make share calls
 - (b) To authorize buy-back of securities
 - (c) To issue securities outside India
 - (d) To borrow, invest, grant loans and give guarantee with respect to securities. In this case, the board may authorize any of its committees, or any director to take up the responsibilities in this regard. However, in case of banking company, this borrowing or investing in the ordinary course of business will not require the board to exercise its powers. In fact, borrowing by banks from RBI will also not come under the provision of this section.
 - (e) To approve financial statements and board report along with quarterly financial statements
 - (f) To diversify the business of the company
 - (g) To approve amalgamation, merger
 - (h) To take over a company or obtain controlling stake
 - (i) To make political contributions
 - (j) To appoint or remove, KMP, medium level managers, internal auditors or secretarial auditors
 - (k) To take note of disclosure of director's interest and shareholding
 - (l) To buy and sell investments up to 5% of paid up capital and free reserves of the investee company
 - (m) To invite, accept or renew public deposits and review changes in terms and conditions of public deposits

2. Liabilities of directors

Disclosure of Directors' Interest

- Every director in every first board meeting of the year should disclose his interest in any firm, body corporate or company in the form of shareholding entered in the last year. The disclosure should be made as a notice in form MBP 1. That notice should be preserved in company's registered office for 8 years under the custody of company secretary.
- If the director along with any other director is holding 2% of the shareholding in another company or is acting as promoter, CEO or partner in that company, should disclose his interest to the board, if any contract is agreed upon by such director with that company
- If director's interest is not disclosed, the company void the transaction
- Punishment for contravention: fine up to to Rs. 1 lakh and jail term of 1 year [Sec. 184 of Companies Act 2013, Companies (Amendment) Act 2017, Rule 9 of Companies (Meeting of Board and its Powers) Rules 2014]

Negligence, default, breach of duty, misfeasance and breach of trust

- A director may be liable of negligence, default, breach of duty, misfeasance and breach of trust. If the director apprehends that civil proceedings will be brought against him, he may apply to High Court for his relief. The court will serve a show-cause notice to ROC asking why a relief cannot be granted to the director concerned. After having the reply of that show-cause, if the court believes that the director has acted honestly and reasonably having regard to the circumstances of the case including those related to his appoint, it may grant full or partial relief to the director. However, if criminal proceedings are brought against him, relief will not be granted (u/s 463) [Ref case law: P.K. Nedungadi vs. Malayalee Bank Ltd. AIR 1971 S.C. 829].

Liability with respect to prospectus

- A company is required to file a prospectus with ROC and SEBI before public issue of securities. A prospectus should include certain information as per the provisions of section 26 of the act. The directors are liable sign the prospectus ensuring that the provision has been properly complied with. If they contravene the provisions of this section, they are subject to imprisonment which may extend up to 3 years and fine from Rs. 50000 to Rs. 3 lakhs (u/s 26).
- If there is any omission or misstatement in the prospectus, then the directors responsible for issuing such prospectus will be personally liable and are supposed pay the compensation to all the allottees who have suffered financial loss because of such misstatement. However, if a person has withdrawn his consent of becoming a director, or if he has sent out public notice following issue of the prospectus that the prospectus was issued without his consent, he will not be liable (u/s 35).
- If the prospectus contains a statement which is untrue and misleading or any omission or inclusion in the prospectus is misleading then the director responsible will be liable u/s 447 (criminal proceedings). However, if the director can prove that at the time of issue the statement was true or he believed it to be true, then no liability shall arise (u/s 34).

Liability with respect to fraudulent trading

- The directors are liable u/s 447 if they make a deceptive and reckless statement, conceals material fact, forecast knowing it to be false and induce a person to subscribe to the securities of the company and book profit taking the advantage of price fluctuations or make banks or FIs to invest in the company (u/s 36).

Liability with respect to allotment of shares

- Directors are liable to refund the entire application money if at least 5% of the nominal value of security is not received at the time of application. They are also liable to file a

return to ROC in case of allotment. If they are in default, they are subject to a fine of Rs. 1000/ day for each day of default or Rs. 1 lakh whichever is lower (u/s 39).

- Director of the company are liable u/s 447 if they issue duplicate share certificates with a view to defrauding their investors (u/s 46).

Liability with respect to financial statements

- If the directors contravenes the provisions of section 129 with respect to financial statements they are liable for an imprisonment which may extent up to 1 year or a fine not less than Rs. 50000 which may extend up to Rs. 5 lakhs, or with both (u/s 129).

Liability with respect to loan to directors

- A company may advance loan to its director, provide guarantee or securities on the loan taken by a director as per the provisions of section 185. If the director contravenes the provisions of this section, he is liable for an imprisonment which may extend up to 6 months or fine not less than Rs. 5 lakhs which may extend up to Rs. 25 lakhs (u/s 185).

Liability with respect to inspection

- If the company or any regulatory authority assigns an inspector to inspect into the books of accounts and other documents of a company, the directors concerned are required to cooperate with him as per the provisions of section 217. However, if a director fails without reasonable reason or refuses to produce any book or paper or any other information in front of the inspector or person authorized by him; or appear before the inspector and answer to his questions; or sign notes of any examination, he shall be liable of an imprisonment which may extend up to 6 months and fine not less than Rs. 25000 which may extend up to Rs. 1 lakh and Rs. 2000/ day till the failure or refusal continues (u/s 217).

Liability at the time of liquidation of the company

- At the time of liquidation of the company, if the official liquidator, the company liquidator, a creditor or contributory finds out that the business has been carried out to defraud its creditor, then the director(s) who is (are) an assignee (in whose favor) of a debt, obligation, mortgage shall be personally liable (u/s 447) to all or any of the debts of the company as per the direction of the tribunal. In order to prove this liability, the official liquidator may give evidence or call witness (u/s 339).

3. Removal of directors

Removal by shareholders

A director may be removed in the general meeting of the company by passing a special resolution unless the director is appointed by the NCLT or the company has opted for appointing not less than 2/3rd of the directors by way of proportional representation (u/s 163). The director so removed will be allowed write a representation which is to be attached with the notice of the special resolution and sent to all the members. The director is also allowed to be present in the meeting where the resolution is taken. If due to time constraints, the company cannot attach the representation by the director with the notice, it will be read out in the meeting only. However, if the company or any other aggrieved party applies to NCLT by rejecting the directors' right of being heard to avoid false publicity, NCLT after review may grant such application and may ask the director concerned to bear full or part of the cost of such application. The vacancy created due to this removal should be filled up by another person intending to be a director. The letter of consent of that director should also be attached with the notice. The new director should hold the office till the tenure of the removed director ends. If the position is not filled, it is to be treated as casual vacancy. The removed director cannot be reappointed. Any compensation package is not payable to the removed director (u/s 169).

Removal by tribunal

- Any member of the company who has reason believe that the affairs of the company or any material changes to the company (e.g. alternation of board of directors) are prejudicial to the interest of the members, creditors, debenture holders, or a certain class of shareholders may apply to the NCLT for investigation. Central Government too may do the same if the find affairs of a company prejudicial to the public interest (u/s 241).
- After investigating into the company's affair, if the NCLT is of the opinion that the affairs of the company are indeed prejudicial to the interest of its members, then it may take decisions with respect to removal of the director responsible for it; terminate all agreements between the director and the company; recover the undue gains made by the director and deposit it in IEPF for repaying the identifiable victims; and decide the manner in which a new director is to be appointed in his place. A certified copy of the order of the tribunal should be submitted to the ROC within 30 days. If any director fails to comply with any provision of this section, he shall be punishable with an imprisonment which may extend up to 6 months or fine not less than Rs. 25000 and which may extend up to Rs. 1 lakh or both (u/s 242).
- After termination of the order, the director so removed cannot ask for damages for the loss of office. After 5 years from the date of termination of the order, the director may be reappointed in the company's board. However, even after the order of removal, if the director knowingly continues his office and all other directors who are party to this contravention shall be punishable with an imprisonment for a term which may extend up to 6 months or with fine which may extend to Rs. 5 lakhs or with both (u/s 243).

4. Key Managerial Personnel

- Key managerial personnel (KMP) in relation to a company mean CEO, MD or a manager; the CS; the whole-time director; the CFO and such other officers as may be prescribed [u/s 2(51)].
- Every listed company and public companies having paid-up capital of Rs. 10 crores or more should have a whole time KMP [u/s 8 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014].
- Whole time KMP should include MD, CEO, or manager or in their absence whole-time director; CS and CFO. If the company does not have multiple businesses then chairperson of the board should not be appointed or reappointed as the CEO or MD. If the company has multiple businesses, it may appoint separate CEOs for separate businesses. The whole-time KMPs is appointed by a special resolution of the board containing the terms of appointment and remuneration. They are not allowed to hold office in more than one company unless it is a subsidiary. However, at the time of appointment, they are allowed to hold office in more than one company subject to prior permission of the board. Within 6 months, he must decide with which company they would like to continue as whole-time KMP. If the office of the whole-time KMP is vacated, it is to be filled within 6 months in the board meeting. If the whole-time KMP contravenes any provisions of this section, they are punishable with a fine which may extend up to Rs. 50000 and additional Rs. 1000/ day for each day of default (u/s 203).

5. Managing Director

Definition

MD is a director who by virtue of AOA or an agreement with the company or by a resolution passed in the general meeting or board meeting is entrusted with substantial

powers (affix common seal of the company, draw or endorse a cheque or other NIs in company's name, sign on share certificate, direct registration of transfer of shares) of management of affairs of the company [u/s 2(54)] [Ref case law: G Subba Rao vs. Rasmi Die Casting Ltd., 1998 and Shanta Shamsher Jung Bahadur vs. Kamani Bros. Pvt. Ltd. 1959].

Appointment

- a) MD or manager cannot be appointed at the same time
- b) Maximum tenure 5 years. reappointment cannot be done before 1 year of expiry
- c) Age range 21-70 (after 70 by passing a special resolution)
- d) Un-discharged insolvent
- e) Suspended payments to creditors
- f) Convicted in court for more than 6 months
- g) Appointment and remuneration of directors are approved in board meeting and finally approved in AGM. Terms and conditions for appointment for appointment and directors' interest should be clearly specified in notice
- h) If appointment is not validated at the AGM, any act done by him will not be deemed as invalid (u/s 196)

Qualifications (Part I, Schedule V of Companies Act, 2013)

- a) He had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under any of the following Acts, (Indian Stamp Act, Excise Act, Industries (Development and Regulations Act, Prevention of Food Adulteration, Essential Commodities Act, Company Law, SCRA Act, Customs Act, Income Tax Act, Wealth Tax Act, Competitions Act, FEMA Act, SEBI Act, Prevention of Money Laundering Act etc.)
- b) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 unless Central Government approves such appointment
- c) The age range should be 21-70. A person can be appointed after 70 after passing a special resolution. Central Government approval will not be necessary
- d) Where he is a managerial person in more than one company, the remuneration drawn from both the companies should not exceed the maximum permissible remuneration in 1 company. Maximum remuneration to all directors and managerial persons should not exceed 11% of the net profit (profit on sale of immovable property, or forfeited shares may not be considered). Remuneration to one MD or whole time director should not exceed 5%, and if there are more than one such director, total remuneration should not exceed 10%. For other types, remuneration should not exceed 1% of net profit. If the effective capital (share capital + Reserves and surplus + long term loans – investments) of the company is less than Rs. 5 crore, maximum remuneration is Rs. 30 lakh; 5-100 crores: 42 lakhs, 100 -250 crores 60 lakhs, more than 250 crores 60 lakh + .01% of the additional amount. If the managerial person is not a security holder of the company for 5 lakh or more, director or related to director of promoter, 2.5% of net profit; a newly incorporated company for a period of 7 years from the date of incorporation or a company whose liquidation has been ordered by BIFR may double the above remuneration; SEZ companies may pay up to Rs. 2.4 crores. Other perquisites and allowances: PF, Gratuity, leave encashment, children allowance (12000/ months), holiday passage allowance, LTC, etc.
- e) He draws remuneration from one or more companies subject to 11% of net profit of those other companies (Section 197)
- f) He is resident of India (stayed in India for last 12 months and who has come to India for taking up employment or carrying on a business vacation). The provision is not applicable for companies in SEZ notified Department of Commerce. If the person is a

non-resident coming to India, then in his VISA application form, he should mention the profile of the company, principal employer and terms and conditions of appointment.

6. Whole time director

Whole-time director includes director in whole time employment of the company [u/s 2(94)]. The appointment procedure and qualification of whole time director is same as that of MD.

7. Company Secretary

A CS is a person who is a member of the ICSI and not a body-corporate or firm [u/s 2(1)(c) of Company Secretaries Act 1980]. The person who is appointed to perform the role of a secretary as per the provisions of the sections is known as CS [u/s 2(24)].

8. Chief Financial Officer

CFO means a person appointed as CFO of a company [u/s 2(19)].

9. Resident Director

Every company should have at least 1 director who stayed in India for a period of not less than 182 days in the previous calendar year. He is called a resident director (u/s 149).

10. Independent Director

At least 1/3rd of the total directors should be independent. In case of fraction, the number should be rounded off to nearest one.

Qualifications for independent directors

1. having required integrity and expertise
2. not promoter of the company*
3. not related to promoters or directors
4. does not have any pecuniary relationship during last 2 financial years
5. whose relatives does not have any pecuniary relationship with the company, its promoters or directors to extent of 2% of gross turnover or Rs. 50 lakh (whichever is lower) in the immediately preceding financial year
6. he or any of his relative should not hold the key managerial position of the company in the immediately preceding year
7. he or any of his relative should not be an employee, proprietor or partner of an audit firm, CS firm or CMA firm appointed in the company in the last 3 years
8. holds 2% or more of the voting rights together with relatives
9. he or his relative is CEO or director of a non-profit organization, 25% of whose earnings come from the company

Appointment of Independent Director [Part IV of Schedule V]

A body, institutions, or organization notified by the Central Government may maintain a database in their website of person qualified to be independent directors of the board subject to fulfillment of conditions in Section 149 (6) and (7) of the Companies Act 2013. At the time of appointing independent directors, the company may select the appropriate person from such databank subject to the condition laid down in Section 152 (2) of Companies Act 2013. The procedure for appointment may be notified by the central government [Section 150]

Appointment of independent directors should be independent of the company management. The board should be well balanced in terms skill, expertise and experience. The person to be appointed as independent director should fulfill the independence criteria mentioned in Section 149 of this act. An explanatory statement with regard to such fulfillment should be

presented at the AGM. Subject to approval of the members, the independent director is appointed. The terms and conditions for appointment of independent directors should be open for inspection by any member during the normal business hours and it should also be put on the website of the company. The appointment letter should contain (a) the terms of appointment; (b) code of ethics (c) functions forbidden (d) remuneration, periodic fees and reimbursements; (d) the expectation of the board; (e) board-committees where the independent director should work; (f) liabilities of the independent directors [Part IV of Schedule V].

11. Women director

Every listed company and other public companies having paid up share capital of Rs. 100 crores or more or turnover of Rs. 300 crores or more as per the last audited financial statements should have at least 1 woman director (u/s 149). The companies must comply with this provision within 6 months of incorporation. An intermittent vacancy by a woman director should be filled up by the board within 3 months or in the next board meeting whichever is later [u/s 3 of Companies (Appointment and Qualifications of Directors) Rules 2014].