



## Cos. Amendment Bill, 2016 - Proposed amendments in provisions relating to Managerial Remuneration

### Introduction:

With an objective of addressing and resolving the 'shoe-pinching' issues in Companies Act, 2013 ('the Act'), the Government on June 4, 2015, constituted 8 members' Company Law Committee. The said Committee was headed by Secretary, Ministry of Corporate Affairs. On February 1, 2016, Committee submitted 138-pages detailed Report and suggested 100+ amendments to the Act. Based on the Company Law Committee Report, Government prepared the Companies (Amendment) Bill, 2016 ('Amendment Bill, 2016') and presented the same in Lok Sabha on March 16, 2016. The Bill has suggested 87 amendments to the Companies Act, 2013 and such suggestion are in addition to the already issued clarifications, circulars, notifications, amendment in Rules, removal of difficulty orders and Companies Amendment Act, 2015. This article is a compilation and analysis of the proposed amendments to the Companies Act, 2013 relating to managerial remuneration under Section 197 of the Act.

### Recommendations of the Companies Law Committee relating to managerial remuneration

The Companies Law Committee recommended that Schedule V of the Act may be amended to substitute the requirement to pass a special resolution by shareholders with an ordinary resolution, in cases where the managerial person was not a promoter, and a professional with domain knowledge / relevant experience; and was not related to any director or promoter of the company and did not hold more than 2% of the paid-up equity share capital of the company or its holding company. In other cases, however, the requirement for special resolution of the shareholders should be retained. The Committee further recommended that the limits of yearly remuneration prescribed in the Schedule be enhanced. Further, the Committee also recommended that the requirement for government approval may be omitted altogether, and necessary safeguards in the form of additional disclosures, audit, higher penalties, etc. may be prescribed instead.

### Proposed amendments on the total managerial remuneration payable:

Pursuant to the provisions of sub-section (1) of Section 197 of Companies Act, 1956, the total managerial remuneration payable by a public company, to its directors (including executive and non-executive directors), and its manager in respect of any financial year shall not exceed 11% of the net profits of that company for that financial year. The computation of the net profits shall be in the manner laid down in Sec. 198. Pursuant to the proviso to sub-section (1) of Section 197, the company in general meeting may, with the approval of the Central Government, authorise the payment of remuneration exceeding 11% of the net profits of the company, subject to the provisions of Schedule V. The proviso to sub-section (1) of Section 197 of the Act is proposed to be amended vide the Amendment Bill, 2016, whereby the approval of the Central Government will not be required for payment of managerial remuneration by public company

beyond the prescribed threshold of 11%. Therefore, in other words, it is proposed that the company may pay managerial remuneration beyond the prescribed threshold of 11% with the approval of members only.

#### **Proposed amendments on remuneration to MD / WTD / non-executive directors:**

Pursuant to the second proviso to sub-section (1) of Section 197, the internal limits relating to managerial remuneration shall be as follows (without the approval of the company in general meeting):

- (i) Remuneration payable to any 1 Managing Director (MD) or Whole-Time Director (WTD) or Manager shall not exceed 5% of the net profits of the company
- (ii) Remuneration payable to more than 1 MD or WTDs or Manager, then remuneration shall not exceed 10% of the net profits to all such directors and manager taken together;
- (iii) Remuneration payable to directors who are neither MD or WTDs shall not exceed,—
  - A. 1% of the net profits of the company, if there is a MD or WTD or Manager;
  - B. 3% of the net profits in any other case.

In accordance with the extant provisions, the internal limits (as prescribed above) may be varied, within the maximum threshold of 11% as prescribed in Sec. 197(1), with the approval of company in general meeting i.e. Ordinary Resolution. Pursuant to the Amendment Bill, 2016, it is proposed that the internal limits may be varied, within the maximum threshold of 11% as prescribed in Sec. 197(1), by Special Resolution. Therefore, vide the proposed amendment, the nature of shareholders approval is proposed to be changed. However, such approval of shareholders vide the Special Resolution is also subject the approval of bank or public financial institution or debenture holders or any other secured creditor.

Where any term loan of any bank or public financial institution is subsisting or the company has defaulted in payment of dues to non-convertible debenture holders or any other secured creditor, then the company is required to obtain the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting. It is noteworthy that the term loan of any bank or public financial institution is subsisting and not defaulted, however, in the second part, it is necessary that the company has defaulted in payment of dues to non-convertible debenture holders or any other secured creditor i.e. not just subsisting.

#### **Remuneration to MD / WTD, where company has no profits or has inadequate profits:**

Pursuant to sub-section (3) to Section 197, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors (including any MD or WTDs or Manager), except in accordance with the provisions of Schedule V and if it is not able to comply with such provisions, with the previous approval of the Central Government. Sitting Fees are excluded from the limits prescribed in Schedule V of the Act. Pursuant to the Amendment Bill, 2016, it is proposed that the previous approval of Central Government is not required, where remuneration is paid by the company that has no profits or its profits are inadequate.

#### **Remuneration to MD / WTD, where company has no profits or has inadequate profits:**

Pursuant to sub-section (9) of Section 197, if any director (MD or WTDs) or Manager or any non-executive director) draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed or without Central Government's prior sanction (wherever required), then the director

shall refund such sum to the company and until such sum is refunded, the director shall hold it in trust for the company. Pursuant to sub-section (9) of Section 197, the company shall not waive the recovery of any sum refundable to it, unless permitted by the Central Government.

Pursuant to the Amendment Bill, 2016, if any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without approval required under Section 197, then the director shall refund excess sum to the company, within 2 years of such lesser period as may be allowed by the company, and until such sum is refunded, hold it in trust for the company. Therefore, it is proposed that the Central Govt.'s approval is to be replaced with the company approval by special resolution within 2 years from the date the sum becomes refundable.

Vide the Amendment Bill, 2016, it is further proposed that such company approval by special resolution is subject to the condition that where any term loan of any bank or public financial institution is subsisting or the company has defaulted in payment of dues to non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by company before obtaining approval of such waiver.

#### **Statutory Auditor's responsibility in reporting in the Report:**

The Amendment Bill, 2016 proposes to introduce a provision, wherein the company's statutory auditor shall, in his report under Section 143 of the Act, make a statement as to whether the remuneration paid by the company to its directors is in accordance with the provisions of Section 197. Pursuant to the proposed amendment, the statutory auditor is under obligation to report whether remuneration paid to any director is in excess of the limits laid down under Section 197 and give such other details as may be prescribed. The details relating to such disclosure by Statutory Auditors will be introduced in the Rules.

#### **Transition provisions:**

The Amendment Bill, 2016 proposes to introduce transition provision relating the applications made to Central Government under the Companies Act, 2013 and the non-requirement of Central Government approval pursuant to the Bill. According to the proposed provision, after the commencement of Companies (Amendment) Act, 2016, any application made to the Central Government under Section 197 and which is pending, shall stand abated. However, the company shall, within 1 year from the commencement of the Amendment Act, obtain the approval in accordance with the provisions of Sec. 197 this section, as so amended. It is noteworthy that the approvals relate to shareholders, any bank or public financial institution, non-convertible debenture holders or any other secured creditor, as may be required to comply with the provisions of amended Section 197 of the Act.

#### **Conclusion:**

Some of the proposed amendments relating to the managerial remuneration are in alignment with the Companies Law Committee Report. The Central Government approval is proposed to be totally eliminated. However, the approval of other stakeholders, like bank or public financial institution, non-convertible debenture holders or any other secured creditor, is proposed to be introduced. At the same time, the responsibility of statutory auditor is proposed to be increased due to proposed inclusion of the provision relating to the reporting in the Auditors Report. It is noteworthy that the Government will not have any intervention in deciding and finalizing the managerial remuneration of public company.