

## COMPANY LAW

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### Appointment of managerial personnel under the Companies Act, 2013

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*The provisions relating to appointment of managing director, manager and whole-time director are of strategic importance for any type of company. This article is an analysis of provisions of section 196 of the Companies Act, 2013 that relates to the appointment of these managerial personnel in a company. The article covers the basic concepts, procedure for appointment, tenure of appointment, age limit, disqualifications, etc. The article also covers the case law on some of the critical provisions of section 196 and other related provisions.*

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#### Definitions of MD, WTD and Manager

1. Definitions of MD, WTD and manager have been simplified under clause (54), clause (94) of clause (53) of section 2 respectively as follows :

*Managing director* – Clause (54) of section 2 defines “managing director” (‘MD’) as a director who is entrusted with substantial powers of management of company affairs. The power to do administrative acts of a routine nature when so authorised by the Board of directors shall not be deemed to be included within the substantial powers of management. Following powers shall not be deemed to be ‘substantial powers of management’:

- ▶ Power to affix company’s common seal to any document
- ▶ Power to draw and endorse any cheque on company’s account in any bank,
- ▶ Power to draw and endorse any negotiable instrument
- ▶ Power to sign share certificates
- ▶ Power to direct registration of share transfer. MD may be appointed by virtue of the articles of association or an agreement with the company or a resolution passed in its general meeting or a resolution passed in meeting of Board of directors. MD also includes a director occupying the position of MD, by whatever name called.

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*Whole-time director* – Clause (94) of section 2 defines “whole-time director” (‘WTD’) as a director in the whole-time employment of the company. Such director may include Director (Finance), Director (Marketing), Director (Sales), Director (HR), etc. Where a Vice President (Legal) is promoted to the position of director, such person would be WTD of the company. The concept of WTD was not defined in the Companies Act, 1956 (1956 Act), it was interpreted by the Court with reference to his roles, powers and duties of the director.

*Manager* – Clause (53) of section 2 defines ‘manager’ to mean an individual who has the management of whole, or substantially the whole, of the affairs of a company. Manager’s role and powers are subject to the superintendence, control and direction of the Board of directors. Manager may also include a director or any other person occupying the position of a manager, by whatever name called. It is interesting to note that Manager may be appointed either under a contract of service or not.

#### **Case law relating to appointment of MD, WTD and manager**

2. The courts, in several cases, have interpreted the powers of the MD, Board of directors and the company. Following is a compilation of these cases :

*‘Substantial powers’* – The Karnataka High Court<sup>1</sup> noted that the words ‘substantial powers of management’ in clause (26) of section 2 of the 1956 Act [corresponding to clause (54) of section 2 of the Act] specifically excludes certain acts from its purview. The High Court observed that except the excluded acts, the MD has power and privilege of conducting the business of the company in accordance with the memorandum and articles of association of the company. The High Court ruled that institution of the suit on behalf of the company by the MD is deemed to be within the meaning of ‘substantial powers of management’ as such a power is necessary and incidental to manage the day-to-day affairs and business of the company. In a different case, the Andhra Pradesh High Court<sup>2</sup> interpreted the phrase ‘substantial powers of management’. Andhra Pradesh High Court stated that the MD may derive the ‘substantial powers of management’ to act for and on behalf of the company on the basis of an agreement or by virtue of resolution passed in the general meeting or by way of resolution passed by the Board of directors or by virtue of the memorandum or articles of association of the company. The High Court ruled that “MD as an agent of the company does not have all the powers to act for and on behalf of the company.”

*MD as an agent of company* – In a case under the Income-tax Act, 1961, the question before Supreme Court<sup>3</sup> was - Whether a MD is an agent of company?

1. *Wasava Tyres v. Printers (Mysore) Ltd.* [2008] 86 CLA 455 (Kar.).  
 2. *G Subba Rao v. Rasmi Die-Castings Ltd.* [1999] 32 CLA 183 (AP).  
 3. *Ram Prashad v. CIT* [1972] 42 Comp Cas 544 (SC).



The Supreme Court stated that the MD may have a dual capacity – director and employee. The Court stated that whether or not a MD is a servant of the company, apart from his being a director, can only be determined by the articles of association and the terms of his employment. The Court observed that If the company is itself carrying on the business and the managing director is employed to manage its affairs in terms of its articles and the agreement, and he could be dismissed or his employment could be terminated by the company if his work is not satisfactory, it can hardly be said that he is not a servant of the company. The Court took into consideration a different aspect, *i.e.*, whether MD is an agent of the company if the Board of directors is required to manage company's business and have every right to control and supervise his work (whenever they deem it necessary). The Court observed that every power which is given to MD emanates from the articles of association which prescribes the limits of the exercise of that power and held that this is indicative that MD is the servant of the company.

*Inter-se relationship between company, Board of directors and MD* – The Bombay High Court<sup>4</sup> observed that where articles of association authorised the Board of directors to appoint from 'time-to-time' a MD, then the relationship *inter-se* is that company is principal, while Board is agent and MD is the sub-agent. The question before the High Court was : Can the Board of directors of the company withdraw powers of MD? The High Court interpreted the phrase 'time to time', as given in the articles of association of the company, and held that the directors are given the power not only to appoint a MD and to vest powers but also to reverse the same, *i.e.*, revoke his appointment or withdraw all or some of the powers vested in him. The High Court held that revocation of all powers of an agent tantamounted to removal and, therefore, even on this position the Board of directors of the company had under the article, a power to remove the MD, although such a power of removal had not been expressly given by that article.

#### **Appointment of MD, WTD and manager**

3. Pursuant to section 196, a company (private company or public company) shall not appoint or employ at the same time MD and manager. However, there is no restriction on the appointment of MD and WTD at the same time or WTD and manager at the same time. A company can appoint MD for the period of financial year 2014-18 and manager for the period financial year 2018-21. There is prohibition on simultaneous appointments, but there is no prohibition on subsequent appointments.

4. *Major General Shanta Shamsher Jung Bahadur Rana v. Kamani Bros. (P.) Ltd.* [1959] 29 Comp Cas 501 (Bom.).

### Tenure for appointment of MD, WTD and manager

4. Pursuant to the provisions of section 196, a company (private company or public company) shall appoint or re-appoint any person as its MD, WTD or manager for a term of 5 years at a time. It is further clarified that the re-appointment shall not be made earlier than one year before the expiry of his term. *i.e.*, If the tenure of MD (or WTD or manager) is from 1<sup>st</sup> September, 2014 to 1st October, 2018, the company can propose a resolution for re-appointment of the said MD (or WTD or manager) during 1st October, 2017 to 30th September, 2018.

### Age limit

5. Sub-section (3) of section 196 prescribes certain qualifications and disqualifications for the appointment of MD, WTD and manager and places restriction on the age of MD, WTD or manager of the company. A company cannot appoint or continue employment of such managerial personnel who is below the age of 21 years or has attained the age of 70 years. However, a company may appoint a person as managerial personnel who has attained the age of 70 years by passing a special resolution. The company is also required to give justification in the explanatory statement for appointing such person as managerial personnel of the company. However, the proviso is not applicable where the age of the proposed appointee is below 21 years.

5.1 The Division Bench of Bombay High Court<sup>5</sup> interpreted sub-section (3) of section 196. It held that legislative intent in introducing clause (a) of sub-section (3) of section 196 is quite clear. It stated that the intention was to change earlier position by providing that person who has been appointed as MD before he was 70 years old is prohibited from continuing as MD once he has attained the age of 70 years. The High Court rule that the language of that clause is plain, simple and unambiguous and it applies to all MDs who have attained the age of 70 years and there is no distinction between MD who have been appointed before 1<sup>st</sup> April, 2014 and those after 1<sup>st</sup> April, 2014". Earlier, the Single Judge of Bombay High Court had held that "sub-section (3) of section 196 does not operate to interrupt the appointment of any director made prior to the coming into force of the 2013 Act and it also does not interrupt the appointment of a MD appointed after 1st April, 2014 where at the date of such appointment or re-appointment the MD was below the age of 70 years but crossed that age during his tenure". However, the ruling of the Single Judge of Bombay High Court was struck down by the Division Bench of the Bombay High Court.

5. *Sridhar Sundararajan v. Ultramarine & Pigments Ltd.* [2016] 131 CLA 203 (Bom.)



**Other disqualifications of MD, WTD or manager**

6. A company (private company or public company) shall not appoint or continue the employment of any person as MD, WTD or manager if –

- (i) such person is an undischarged insolvent or has at any time been adjudged as an insolvent ;
- (ii) such person has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them ; or
- (iii) such person has at any time been convicted by a court of an offence and sentenced for a period of more than 6 months.

**Conditions to be fulfilled for the appointment of MD, WTD or manager – Schedule V**

7. Part I of Schedule V to the Act prescribes conditions which are required to be fulfilled for the appointment of MD, WTD or manager. If the company fulfills all the conditions in Part I of Schedule V, the approval of the Central Government is not required. However, if the company does not comply with any of the conditions in Part I of Schedule V, the company will be required to obtain the approval of Central Government. The conditions for appointment as MD or WTD or manager are as follows:

- ▶ He had not been sentenced to imprisonment for any period, or to a fine exceeding Rs. 1,000, for the conviction of an offence under any of the prescribed 14 Acts
- ▶ He had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974
- ▶ He has completed the age of 21 years and has not attained the age of 70 years
- ▶ Where he is a managerial person in more than one company, he draws remuneration from one or more companies subject to the ceiling as prescribed (in Section V of Part II of Schedule V)
- ▶ He is resident of India

**Whether Schedule V of the Act applies to private company and public company?**

8. The Ministry of Corporate Affairs (MCA) had issued a Notification, whereby the provisions of sub-sections (4) and (5) of section 196 are not applicable to private company<sup>6</sup>. The reference of Schedule V is only there in sub-section (4). Therefore, in my view the provisions relating to Schedule V are not

6. GSR 463(E) and GSR 464(E) dated 5th June, 2015.

applicable to private company. MCA has also issued another Notification<sup>7</sup> whereby the said provisions are not applicable to specified IFSC Public Companies. However, Schedule V is entirely applicable to a private company which is a subsidiary of a public company. Therefore, a private company which is a subsidiary of a public company is required to comply with the provisions of section 196 and Schedule V for appointment or re-appointment of MD, WTD and manager.

#### **Procedure for appointment of MD, WTD or manager**

9. Pursuant to the provisions of section 196 and Schedule V, MD, WTD or manager shall be appointed on the terms and conditions as approved by the Board of directors. Such approval shall be at a meeting of Board of directors only i.e. not by way of circular resolution. The appointment of MD, WTD or manager shall be subject to approval by a resolution at the next general meeting of the company. Such general meeting can be annual general meeting or extra-ordinary general meeting of the company. The approval of the Central Government is required if there is any variance to the conditions specified in that Schedule V. The notice convening Board or general meeting for considering the appointment of MD, WTD and manager shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or directors in such appointments, if any. The company is required to file a return [Form MR-1 under rule 3 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014] within 60 days of such appointment with the Registrar of the Companies. Here the date of appointment means the date of appointment as decided by the Board of directors in its meeting. If the shareholders, in its general meeting, do not approve the appointment of MD, WTD or Manager, then any act done by such MD, WTD or Manager shall be deemed to be valid during the said tenure.

#### **Conclusion**

10. Taking into consideration the provisions of section 196 and its applicability / non-applicability, a corporate law professional ought to have separate checklist for the appointment / re-appointment of MD, WTD and manager. The corporate secretarial documents relating to appointment and filing of eForms with the Registrar of Companies will also vary from the type of company. The professionals are also required to ensure prescribed disclosures to the Board of directors (in board meeting, at the time of appointment) and shareholders (in the explanatory statement and directors' report). The company is also required to ensure appropriate disclosures in the annual return.❖❖❖

7. CSR 08(E) dated 4th January, 2017.