

COMPANY LAW

[2017] 137 CLA (Mag.) 19

Can company pay commission on monthly basis to independent directors?

Gaurav N Pingle*



In this article, the author analyses the provisions relating to payment of remuneration to non-executive directors under the Companies Act, 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The article ultimately deliberates on the provisions (and permissibility) of payment of commission on monthly basis to the independent directors.

❖ ❖ EFW ❖ ❖

Cap on total managerial remuneration

1. Section 197 of the Companies Act, 2013 ('the Act') relates to "overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits". The provisions are applicable only to public company and private company which is a subsidiary of the public company. Sub-section (1) of section 197 provides that the total managerial remuneration payable to its directors (executive and non-executive directors) in respect of any financial year shall not exceed 11 per cent of net profits of that company for that financial year. Sub-section (1) of section 197 clarifies, for the purpose of provision, the term "net profit" as computed in accordance with the provisions of section 198 of the Act. The company can authorise the payment of remuneration exceeding 11 per cent of the net profits with the approval of shareholders in general meeting and approval of the Central Government.

Remuneration to non-executive directors

2. The payment of remuneration to non-executive directors is governed by clause (ii) to the proviso to sub-section (1) of section 197. It states that the remuneration payable to directors who are neither managing directors nor whole-time directors (*i.e.*, non-executive directors) shall not exceed –

- (i) 1 per cent of the net profits of the company, if there is managing

* Practising Company Secretary, Pune, gp@csgauravpingle.com / acsgauravpingle@gmail.com.

company nor a managing director (*i.e.*, non-executive director) may be paid remuneration, in either of the following ways :

- ▶ by way of a monthly, quarterly or annual payment with the approval of the Central Government
- ▶ by way of commission if the company by special resolution authorises such payment.

For payment under the 1956 Act, the approval of the Central Government was required. However, under the Act no such approval of the Central Government is required.

Sitting fees

4. Pursuant to the provisions of sub-section (5) of section 197, the director of the company may receive remuneration by way of fee for –

- ▶ attending Board meetings
- ▶ attending Committee meetings
- ▶ for any other purpose whatsoever as may be decided by the Board of directors

Rule 4 of the Companies (Appointment and Remuneration) Rules, 2014 states that a company may pay a sitting fee to a director for attending meetings of the Board or Committees thereof, such sum as may be decided by the Board of directors thereof which shall not exceed Rs. 1 lakh per meeting of the Board or Committee thereof. The rule further clarifies that the sitting fees for independent directors and women directors shall not be less than the sitting fee payable to other directors. It is interesting to note that the sitting fees (under the Act) are paid in any one of the three forms ; however, the sitting fees (under the Rules) relates only to the two forms *i.e.* attending Board meetings or committee meetings and does not include fees “for any other purpose whatsoever as may be decided by the Board of directors”.

Remuneration to independent directors

5. Pursuant to sub-section (7) of section 197, an independent director shall not be entitled to any employee stock options ('ESOPs'). The ESOPs are issued to employees and directors with an objective to retain them. Since such retention of independent directors would amount to dilution of their independence, the companies are restricted from offering ESOPs to independent directors. However, the independent directors can receive remuneration in following ways :

- ▶ Sitting fees

director or whole-time director or manager ;

- (ii) 3 per cent of the net profits in any other case (*i.e.*, where there is no managing director or whole-time director or manager).

Pursuant to the second proviso to sub-section (1) of section 197, the remuneration shall be paid in accordance with the said sub-limits without the approval of the shareholders. Therefore, if the company obtains shareholders' approval, the company can pay remuneration beyond the sub-limits but within 11 per cent of the net profits.

Example 1 : Public company has appointed one managing director and six non-executive directors. In this case, the non-executive directors will be collectively paid 1 per cent, *i.e.*, all of the non-executive directors together.

Example 2 : Public company has appointed 5 non-executive directors and has not appointed any executive directors. In this case, the non-executive directors will be collectively paid 3 per cent, *i.e.*, all of them together. However, this limit can be increased from 3 per cent to 11 per cent (*i.e.*, the maximum limit) with the approval of shareholders in general meeting (in accordance with second proviso to sub-section (1) of section 197 of the Act).

Modes of payment of remuneration to non-executive directors

3. A director or manager may be paid remuneration under sub-section (6) of section 197 in any of the following ways :

- ▶ Monthly payment
- ▶ At a specified percentage of the net profits of the company (in business parlance also termed as "commission on net profits of the company") ;
- ▶ Partly by one way and partly by the other (*i.e.*, combination of monthly payment and specified percentage of the net profits, together).

It is important to note that in sub-section (6) of section 197, there is reference of "monthly payment" and not "monthly salary". Therefore, a company is permitted to pay on monthly basis remuneration to directors of the company. It is also important to note that the provisions of sub-section (6) of section 197 does not distinguish between executive director (director who is in whole-time employment or managing director) and non-executive director (director who is neither in whole-time employment of the company nor managing director). Therefore, in my view, a public company can pay commission (as calculated in accordance with the provisions of section 197) on monthly basis to non-executive directors of the company.

3.1 Under sub-section (4) of section 309 of the Companies Act, 1956 ('the 1956 Act'), a director who is neither in the whole-time employment of the

- Reimbursement of expenses for participation in the Board and other meetings
- Profit related commission as may be approved by the members

In my view, the “reimbursement of expenses for participation in the Board and other meetings” should not be termed as ‘remuneration’ as director is not rendering any specific or extra service against such expense. Also, such expense is reimbursed on cost-basis. There is neither any intention nor any question of generating profits from such reimbursement of expenses.

Remuneration to independent directors under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

6. Regulation 17 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 relates to “Board of directors”. It states that the Board of directors shall recommend all fees or compensation, if any, paid to non-executive directors, including independent directors and it shall require approval of shareholders in general meeting. The regulation further clarifies that such shareholders’ approval shall specify the limits for the maximum number of stock options that may be granted to non-executive directors, in any financial year and in aggregate. However, the independent directors shall not be entitled to any stock option. However, the requirement of obtaining shareholders’ approval shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under Act.

Can company pay commission on monthly basis to independent directors?

7. Taking into account the above discussion and provisions relating to sub-section (6) of section 197 (relating to “modes of payment of remuneration”) and sub-section (7) of section 197 (“remuneration to independent director”), profit related commission can be paid on monthly basis to non-executive directors, including independent directors. Sub-section (6) of section 197 does not distinguish between types of directors for the different modes of payment of remuneration. Therefore, in my view, such arrangement with reference to the remuneration to independent directors by listed company or unlisted public company is feasible. ❖❖❖