Chapter 4 Role of Promoter and Regimes of Directors

4.1 Promoter

Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company. The persons who assume the task of promotion are called promoters. A promoter may be an individual, syndicate, association, partner or company.

Who is a promoter- The expression ‘promoter’ has not been defined under the Companies Act, although the term is used expressly in sections 62, 69, 76, 478 and 519. Even in English law, no general statutory definition of a ‘promoter’ is available. Section 62 of the Companies Act, 1956 defines the expression ‘promoter’ for a limited purpose of that section only. Sec. 62(6)(a) defines the expression ‘promoter’ to mean a promoter who was a party to the preparation of the prospectus or of a portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity in procuring the formation of the company.

Certain attempts have been made by the judiciary to define the term ‘promoter’. Cockburn CJ., in Twycross V. Grant\textsuperscript{75} described a promoter as “one who undertakes to form a company with reference to a given project, and to set it going, and who takes the necessary steps to accomplish that purpose.” Another attempt was made by Bowen,L.J., in Whaley Bridge Printing Co. V. Green\textsuperscript{76}. He observed that the term promoter is “a term not of law but of business”, usefully summing up, in a single word-promotion, “a number of business operations familiar to the commercial world by which a company is brought into existence”.

In USA, the Securities Exchange Commission Rule 405(a) defines a promoter as a person who, acting alone or in conjunction with other persons

\textsuperscript{75} 1877 2 C.P.D. 469 pg.541 C.A.
\textsuperscript{76} [1880] 5 B.D. 109 at pg.111
directly or indirectly takes the initiative in founding or organising the business enterprise.

In Lagunas Nitrate Co. V. Lagunas Syndicate\textsuperscript{77} to be a promoter one need not necessarily be associated with the initial formation of the company, one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter.

In Official Liquidator V. Velu Mudaliar\textsuperscript{78} a person who does not take a prominent part may also have so acted in the formation of a company as to bring himself under the term promoter.

However, the persons assisting the promoters by acting in a professional capacity do not hereby become promoters themselves. Thus, a solicitor who drafts the articles, or the accountant who values assets of a business to be purchased are merely giving professional assistance to the promoter. However, where he goes further than this, for example, by introducing his clients to a person who may be interested in purchasing shares in the proposed company, he would be regarded as promoter. In Palmer’s view, anyone who assists in the promotion, for example, by obtaining the services of director, or agreeing to place shares or negotiating an agreement or merely by bringing a vendor in touch with persons who may form a company to exploit or purchase his goods may find himself as a promoter of a company which is subsequently formed.

In conclusion, it may be said that word “promoter” is used in common parlance to denote any individual syndicate, association, partnership or a company which takes all the necessary steps to create and mould a company and set it going. The promoter originates the scheme for the formation of the company; gets together the subscribers to the memorandum; gets memorandum and articles prepared, executed and registered; find the bankers, brokers and legal advisors; locates the first directors, settles the terms of preliminary contracts with vendors and agreement with underwriters and makes arrangement for preparation,

\textsuperscript{77} [1899]2 Ch.392(p.428, C.A)
\textsuperscript{78} [1938] 8 Comp. Case.7
advertisement and circulation of the prospectus and placement of the capital. In India, the promoter and promoters or the principal of them are usually persons who, in forming the company, secure for themselves the management of the company being formed or are persons who convert their own private business into a limited company, public or private and secure for themselves more or less a controlling interest into the company’s management.  

A person cannot however, become a promoter merely because he signs the memorandum as a subscriber for one or more shares.

### 4.1.1 Legal position of a promoter

While the accurate description of a promoter may be difficult, the legal position is quite clear. The promoters occupy an important position and have wide powers relating to the formation of a company. It is however, interesting to note that so far as the legal position is concerned, he is neither an agent nor a trustee of the proposed company. He is not the agent because there is no company yet in existence and he is not a trustee because there is no trust in existence. But it does not mean that the promoter does not have any legal relationship with the proposed company. The correct way to describe his legal position is that he stands in a fiduciary position towards the company about to be formed. Lord Cairns has correctly stated the position of promoter in Erlanger V. New Sombrero Phosphate Co. “the promoters of a company stand undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company.” They have the power of defining how and when and in what shape and under whose supervision it shall come into existence and begins to act as a trading corporation. Similarly, it was observed in Lagunas Nitrate Co. V. Lagunas Syndicate, that: “The promoters stand in a fiduciary relation to the company they promote and to those persons, whom they induce to become shareholders in it.” Lord Justice Lindley in

---

79 Supra note 1 pg. 117-118 and also see A. Ramaiya, Guide to the Companies Act, 12th edn., p.351.
80 Supra note 78
81 (39 LT 269)
82 Supra note 77
Lidney & Wigpool Iron Ore Co. Bird\textsuperscript{83} described the position of a promoter as follows:

“Although not an agent for the company, nor a trustee for it before its formation, the old familiar principles of law of agency and of trusteeship have been extended and very properly extended to meet such cases. It is perfectly well settled that a promoter of a company is accountable to it for all monies secretly obtained by him from it just as the relationship of the principal and agent or the trustee and cestui que trust had really existed between him and the company when the money was obtained.”

4.1.2 Duties of Promoters

The Companies Act, 1856 contains no provisions regarding the duties of promoters. It merely imposes liability on promoters for untrue statement in prospectus they are parties to (Section 62 & 63), and for fraudulent trading (Section 542). The Courts, however, have been conscious of the possibility of abuse inherent in the promoter’s position and therefore laid down that any one, who can properly be regarded as promoter stand in a fiduciary position towards the company with all the duties of disclosure and accounting. In particular, the two fiduciary duties imposed on a promoter are:

(1) not to make any secret profit out of the promotion of the company.
(2) to disclose to the company any interest which he has in a transaction entered into by it.

\textsuperscript{83} [1866]33Ch.D 85
4.1.2.1 Duty to disclose secret profits

In case of Re Cape Breton Co. the commonest way in which professional promoters used to make secret profit was by purchasing property or business themselves and reselling it to the company at an enhanced price. But the difference between the two prices in such a case shall be a secret profit only if the promoter has begun to promote the company at the time he buys the property or business, so that he owes a duty to the company at the time not to profit on a re-sale to it. In case of Re Coal Economising Gas Co. Gover’s the duty of disclosing the profits does not even extend to a situation where the contract with the vendor provides that the promoters shall form a company to which the property or business shall be transferred.

Promoters may obtain secret profits by other methods that reselling property to company. For example, the vendor may agree to pay a share of profit to the promoter.

A promoter is not forbidden to make profit but to make secret profit. He may make a profit out of promotion with the consent of the company, in the same way as an agent may retain a profit obtained through his agency with his principal’s consent. In Gluckstein V. Barnes a syndicate of persons was formed to buy a property called ‘Olympia’ and re-sell this ‘Olympia’ to a company to be formed for the purpose. The syndicate first bought the company itself £1,40,000. Out of the money provided by themselves, the debentures were repaid in full and a profit of £20,000 made thereon. They promoted a new company and sold Olympia to it for £1,80,000. The profit of £40,000 was revealed in the prospectus but not the profit of £20,000.

Held, profit of £20,000 was a secret profit and the promoters of the company would be bound to pay it to the company because the disclosure of the profits by themselves in the capacity of directors of the purchasing company was not sufficient.

---

84 [1885]29 Ch.D 795
85 [1875] 1 Ch. D 182
86 [1900]AC 240
4.1.2.2 Duty of Disclosure of interest

In addition to his duty for declaration of secret profits, a promoter must disclose to the company any interest he has in a transaction entered into by it. In case of Re Lady Forest-( Murchison) Gold Mine Co. Ltd.\(^87\) where a promoter sells property of his own to the company, but does not have to account for the profit he makes from the sale because he bought the property before the promotion began. Disclosure must be made in the same way as though the promoter was seeking the company’s consent to his retaining a profit for which he is accountable.

4.1.3 Promoter’s duties under the Indian Contract Act

Promoter’s duties to the company under the Indian Contract Act have not been dealt with by the courts in any detail. They cannot depend on contract, because at the time of promotion begins; the company is not incorporated, and so cannot contract with its promoters. It seems, therefore, that the promoter’s duties must be same as those of a person, who acts on behalf of another without a contract of employment, namely, to shun from deception and to exercise reasonable skill and care. Thus, where a promoter negligently allows the company to purchase property, including his own, for more than its worth, he is liable to the company for the loss it suffers. Similarly, a promoter who is responsible for making misrepresentations in a prospectus may be held guilty of fraud under section 17, of the Indian Contract Act and consequently liable for damages under section 19 of that Act.

\(^{87}\) [1901]ICh.582
4.1.4 Termination of Promoter’s duties

In case of Lagunas Nitrate Co. V Lagunas Syndicate Ltd.\(^88\) a promoter’s duties do not come to an end on the incorporation of the company, or when a Board of directors is appointed. They continue until the company has acquired the property or business which it was formed to manage and has raised its share capital was determined and in case of Twycross V. Grant \(^89\) the Board of directors has taken over the management of the company’s affairs from the promoters was determined. When these things have been done, the promoter’s fiduciary and contractual duties cease, and he is thereafter subject to no more extensive duties in dealing with the company than a third person, who is unconnected with it. In case of Re. British Seamless Paper Box Company\(^90\) thus, where a promoter disclosed the profit which he made out of a company’s promotion to the persons who provided it with the share capital with which it commenced business, it was held that he was under no further duty to disclose the profits to persons who were invited to subscribe further capital a year later, and so the company could not recover the profit for his failure to do so. Nevertheless, a promoter may remain subject to fiduciary and other duties to the company if he becomes a director or agent of it, but the duties are then owed only in that other capacity.\(^91\)

4.1.5 Remedies available to the company against the promoter for breach of his duties

Since the promoter owes a duty of disclosure to the company, the primary remedy in the event of breach is for the company to bring proceedings for rescission of any contract with him or for the recovery of any secret profits which he has made.

Rescission of Contract: So far as the right to rescind is concerned, this must be exercised on normal contractual principles, that is to say, the company must have

---

\(^{88}\) [1899] 2Ch.392 (p.428, C.A.)  
\(^{89}\) 1877 2 C.P.D. 469 pg.541 C.A.  
\(^{90}\) [1981]17 Ch.D 467  
\(^{91}\) Supra note 1 pg.119-122
done nothing to show an intention to ratify the agreement after finding breach involving non-disclosure or misrepresentation.

To recover secret profits: If a promoter makes a secret profit or does not disclose any profit made, the company has a remedy against him. This varies according to the circumstances which may be divided into the following two situations:

(1) Where the promoter was not in a fiduciary position when he acquired the property but only when he sold it to the company: In case of Re Ambrose Lake Tin & Copper Co. 92 it was held, if the property on which the profit was made was acquired before the promoter became promoter, there can be no claim for the recovery of the profits as such. Thus, if a person acquires properties or had it before he takes any active steps in the promotion of a company and sells it to the company at a profit, he is entitled to retain that profit. Here the promoter, as in Solomon’s case must have had the property for a certain length of time. He can hardly be said to be in a fiduciary relation to the company.

(2) Where the promoter was in a fiduciary position when he acquired the property and when he sold it to the company: This may happen in any of the following circumstances:-

(i) Where the promoter bought property with a view to selling it to the company which he intends to promote.

(ii) Where the promoter resells to the company at an increased price, the property which he purchased after he commenced the promotional activities.

(iii) Where a person is a promoter for acquiring the property for the company in the capacity of an agent.

In the aforesaid circumstances, the remedies of the company may include:

(a) rescission of the contract, and if the promoter has made a profit on some ancillary transaction that may also be recovered; or

(b) to retain the property, paying no more that what the promoter has paid for it, thus depriving him of his profits; or

92 [1880]14 Ch.D 390
(c) where the above remedies would be inappropriate, say, where the property has been altered so as to render rescission impossible and the promoter has already received the inflated price, the company may sue for misfeasance (breach of duty to disclose). The measure of damages in such a situation will be the difference between the market value of the property and the contract price.

4.1.6 Liability of Promoters

A promoter is subject following liabilities under the various provisions of the Companies Act:

(1) Section 56 and Schedule II lay down matters to be stated and reports to be set out in a prospectus. A promoter may be held liable for non-compliance of the provisions of the section and the Schedule.

(2) Under section 62 and 63, a promoter may be held liable for any untrue statement in the prospectus to a person who subscribes for shares or debentures on the faith of such prospectus. However, the liability of the promoter in such a case shall be limited to the original allottee of shares and would not extend to the subsequent allottees. The remedies against the promoter may include:
   (a) the rescission of the contract to purchase shares;
   (b) suit for damages;
   (c) prosecution that may lead to imprisonment for a term upto two years or punishment with fine upto Rs. 50,000 or both.

(3) By virtue of section 203, the court may suspend a promoter from taking part in the management of the company for a period of five years if:
   (a) he is convicted of offence in connection with the promotion, formation or the management of a company; or
   (b) in liquidation it appears, that he:
      (i) has been guilty of any offence for which he is punishable (whether he has been convicted or not) under section 542; or
while being an officer of the company he has otherwise been
guilty of any fraud or misfeasance in relation to the company or
of any breach of his duty to the company.

(4) A promoter may be liable to public examination like any other director or
officer of the company if the Court so directs on a liquidator’s report
alleging fraud in the promotion or formation of the company (section 478).

(5) A company may proceed against a promoter on action of deceit or breach
of duty under section 543, where the promoter has misapplied or retained
any property of the company or is guilty of misfeasance or breach of trust
in relation to the company.

4.1.7 Remuneration of Promoters

In case of Re English & Colonial Produce Company\textsuperscript{93} it was held that a
promoter is not entitled to recover any remuneration for his services from the
company unless there is a valid contract, enabling him to do so, between him and
the company. Indeed, without such a contract, he is not even entitled to recover his
preliminary expenses or the registration fees.\textsuperscript{94} In case of Touche V. Metropolitan
Railway Warehousing Company\textsuperscript{95} it was held that the practice, however, recovery
of preliminary expenses and registration fees does not normally present any
difficulty. The Articles generally contain a provision authorising the directors to
pay them. The provision in the Articles does not impose any legal obligation on
the company towards the promoters but as they or their nominees will usually be
the first directors of the company, there is little risk of the power being not
exercised in their favour. It may well be, however, that the promoters will not be
content with merely their expenses; a professional promoter expects to be
handsomely remunerated. It cannot be said to be unreasonable either.

\textsuperscript{93} [1906]2 Ch. 435 CA
\textsuperscript{94} Supra note 1 pg. 122-124
\textsuperscript{95} [1871] L.R. 6 Ch. 671
4.2.1 Meaning of Director

Section 2(13) of the Companies Act, 1956 defines a ‘director’ as including “any person occupying the position of a director by whatever name called.” Thus, it is not the name by which a person is called but the position he occupies and the functions and duties which he discharges that determine whether in fact he is a director or not. In Re, Forest of Dean Coal Mining Co., \(^6\) it was stated that function is everything; name matters nothing. So long as person is duly appointed by the company to control the company’s business and authorised by the Articles to contract in the company’s name and on its behalf, he functions as a director. A company is indeed a person, but a juridical person and the directors as a body endow the juridical person with human face that can act and react. Under the scheme of the Companies Act, the company itself and the directors or the Board of directors are primary agents of the Company to transact its operations. The Companies Act specifies where the company itself is to act both as principal and the agent and where the Board of directors is to act on its behalf. In respect of the properties and assets of the company the directors or the Board of directors act as Trustees. Therefore, the directors have different attributes in relation to the company depending upon the facts of each case.

As stated earlier, directors apart from being trustees for the assets and properties of the company are also the agents of the company as it is the directors, collectively as Board, act on behalf of the company on all matters except those specifically reserved for the company to act. However, it may be noted that even though the directors for certain purposes can be considered as the agent of the company, yet in respect of such matters for which the director i.e., the Board are empowered to take a decision, the company in any manner, including in the general meeting, cannot direct the directors to take a particular decision. For example, allotment of shares, transfer of shares, investments etc. If the body of the shareholders did not approve the decision, they are free to change the directors in the manner given in the Act. As stated earlier, a director apart from being an

\(^6\) [1878] 10 Ch. D 450
agent and trustee of the company, can also be treated as officer of the company, hence an employee for purposes specified in the Act.

The articles of a company may designate its directors as governors, members of the governing council or the board of management, or give them any other title, but so far as the law is concerned they are simply directors.

Similarly, in the case of associations or other bodies registered as companies under Section 25 the members of the executive committee or the governing body are directors for purposes of the Act, though they may not be called by that name.

Section 303(1) of the Companies Act i.e., though for the limited purpose of maintenance of Register of directors, etc. provides that any person with whose directions or instructions the Board of directors is accustomed to act is also deemed to be a director. In Deen Dayalu V. Sri B.P. Reddy97 Andhra Pradesh High Court held that a manager or any other managerial personnel, is however, not a director.

According to section 2(30) of the Act, the definition of an ‘officer’ includes a director as well as any person under whose directions or instructions the Board or any one or more of the directors are accustomed to act.

4.2.1.1 Deemed Directors i.e., Shadow Directors

Sec.7: For certain purposes, the Companies Act, 1956 treats as director the person in accordance with whose directions or instructions the Board of Directors of a company is accustomed to act. The widened definition of a director, however, merely operates to impose liabilities or prohibition on a person who would not otherwise be classed as a director. Thus, such persons do not thereby acquire any rights or powers in connection with the management of the company. Such persons have been addressed under English Law as ‘shadow directors.’98

97 [1984] 2Comp.L.J 396
98 Section 741 (2), the English Companies Act, 1985
4.2.1.2 Independent Directors

Now-a-days the role of independent director is drawing wide attention specially in the context of public companies. This class of directors are actually elected directors who are not executive directors and who do not participate in day-to-day activities of the company. The Kumarmangalam Birla Committee had defined an independent director an entity who does not have a “material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in judgement of the Board, may affect the independence of judgement.”

4.2.1.3 Full time V. Part time Director

Companies Act does not make any distinction between a full time and a part time director. In Jagjivan Hiralal Doshi V. Registrar of Companies the Bombay High Court observed that the plain meaning of director is the person occupying the position of director- calls him a part time director or a full time director. The rules of construction do not call for any modification or qualification of this meaning. ‘Any director’ is an officer of the company. The legislature which defined the word ‘officer’ has made no distinction based on full time and part time performance of duty.

The powers of the company are exercised by the Board of directors. It shall not exercise any power or do any act which is required to be exercised or done by the company in general meeting. Here again, no distinction founded on part time participation as member of the Board is discernible. The meeting of the Board directors shall be held at least once in three months. In such meetings, every member participates in voting and takes decision without distinction as to whether he is part time or full time director.

99 Supra note 1 pg.516-518
100 [1989] 65 Comp. Cas.553 (Bom.),
At every annual general meeting of the company held in pursuance of section 166, the Board of directors is enjoined to lay before the company a balance sheet. Every balance sheet and every profit and loss account of a company shall be signed in behalf of the Board of directors by not less than two directors of the company, one of whom shall be the managing director where there is one. In this signing requirement also no distinction has been made as regard full time or part time director. In other words, where there is a managing director, he should be one of the signatories and the other being any director. Where there is no managing director, both the signatories can be any director.

In the matter of proceedings of negligence, default, breach of duty, misfeasance and breach of trust, the Act and the rules admit of no distinction between members of the Board of directors based on their part time or full time performance of duties. Their liability for any proceedings for such acts is equal. While all the directors are, in law, liable of their acts, the questions of relieving them are still one of discretion.

When the responsibility of all the directors, both performing part time duties and full time duties is equal, should any of the directors be relieved from liability in respect of negligence, breach of trust, misfeasance, etc., is always a question of judicial discretion.
4.2.1.4 Nominal Director

In case of Kothari (Madras) Ltd. V. My Leaf Tobacco Development Co. (P.) Ltd. 101 it was held that the Act does not provide for a ‘nominal director’. All directors of a company stand on the same footing and their duties, responsibilities, and obligations are uniformly controlled by the provisions of the Act as well as the articles of association of the company concerned. 102

4.2.1.5 Interested Directors

A director who is interested in a transaction of the company must disclose his interest to the Board. Section 297, in this regard provides that a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director, shall not enter into any contract with the company-

(a) for the sale, purchase or supply of any goods, materials or services; or
(b) for underwriting the subscription of any shares in, or debentures of the company.

However, section 297 permits the aforesaid contracts with the consent of the Board of directors by a resolution passed at a meeting of the Board. But, where the paid-up share capital of the company is rupees one crore or more, previous approval of the Central Government shall also be necessary. 103

4.2.1.6 Managing Director

Section 2 (26) defines ‘managing director’ as a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors, or by virtue of its Memorandum or Articles of Association, is entrusted with substantial powers of management which

101 [1985] 57Comp. Cas.690
102 Supra note 1 pg. 524-525
103 Supra note 1 pg. 603
would not otherwise be exercisable by him. The expression includes a director occupying the position of a managing director, by whatever name called.

The definition makes it clear that the managing director’s powers of managing the affairs of the company must be substantial. The power to do administrative acts of routine nature such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to sign any certificate of share shall not be deemed to be included within substantial powers of management.

The managing director exercises his power subject to the superintendence, control and direction of the Board of directors.

The managing director is thus a director who carries on the day to day business of the company. He is an executive head of the company and, subject to the control of the Board of directors of the company, control the company’s affairs.

The managing director has necessarily to be a director. He, like any other director, has no powers of management except when acting as one of the members of the Board and to the extent those powers are delegated to him by the board.

In G. Subba Rao V. Rasmi Die- Casting Ltd. the Andhra Pradesh High Court held that from the definition of ‘managing director’ as per section 2(26), it is clear that the managing director as an agent of the company does not have all the powers to act for and on behalf of the company. He is to act under the superintendence, control and direction of the Board of directors. Moreover, power of routine administrative nature like the power to affix common seal, to draw and endorse any negotiable instrument do not fall within the substantial powers conferred upon the managing director. Therefore, the Court observed that in a given case, the third party must find out as to whether the managing director making any representation for and on behalf of a company had in fact, ‘actual authority’ either in terms of the provisions of the constitution of that company or by virtue of the delegation to such an agent by the Board of Directors.

104 [1998] 93 Comp. Cas. 797
4.2.1.7 Appointment of managing director

In terms of section 2(26), a managing director may be appointed in any of the four ways, namely:

(a) by virtue of an agreement with the company,
(b) by virtue of a resolution passed by the company in general meeting,
(c) by virtue of a resolution passed by the Board of directors, and
(d) by virtue of the Memorandum/ Articles of Association.\textsuperscript{105}

4.2.1.8 Whole time director

In many section of the Companies Act, the term ‘Whole time director’ has been used side by side with that of the ‘managing director’. Confusion is, therefore, likely to arise in respect of their respective position and role.

While the term ‘managing director’ has been specifically defined under section 2(26), no such definition of a whole time director is available. Explanation to section 269, however, states that the expression ‘whole time director’ includes a director in the whole time employment of the company.

Regarding appointment/ re-appointment and remuneration of a whole time director, same provisions as are applicable of the managing director, are applicable. Under section 269, every public company must have a managing director or a whole-time director if its paid-up share capital is Rs. 5 crores or more. Similarly section 267 and 268 providing for disqualification of managing directors and approval of Central Government for their appointment/ re-appointment also make the provisions applicable to whole time directors. Also, the provisions of section 309, 310 and 311 dealing with remuneration of directors and other managerial personnel are applicable to whole time directors.

\textsuperscript{105} Supra note 1 pg. 603
4.2.1.9 Non-executive directors

The term has not been defined in the Companies Act, 1956. However, ever since the businesses started taking the corporate form, the non-executive directors came to be part and parcel of corporate form of management. The distinguishing feature is the fact that they cannot perform any executive function in the company where they are directors. The concept of non-executive directors, with the growing awareness for corporate governance, has now come up in sharp focus, as they constitute an integral part of the Board of directors, which is vested with the power of management of the company. Usually non-executive directors are taken in the Board of Companies for their special skill, professional status or experience guide the Board in taking objective decisions and monitoring performance in unbiased and independent manner. The non-executive directors are often assumed to be independent directors, specially in the context of corporate governance. As the law stands today, the non-executive directors are officers of the company and share the responsibilities of management’s decisions.106

4.2.1.10 Appointment of Director

Section 235 of the Companies Act provides that nobody corporate, association or firm can be appointed director of a company. Only an individual can be appointed as director.

However, no company shall appoint or re-appoint any individual or director of the company unless he has been allotted a Directors Identification Number (DIN) under section 266B.

In Oriental Metal Pressing Works (P.) Ltd. V. B.K. Thakoor107 the Supreme Court pointed out the reason as to why it is necessary that only an individual should be a director of a company. It was held that the office of the director being to some extent an office of trust, there should be somebody readily available who can be held responsible for the failure to carry out the trust, and it might be

---

106 Supra note 1 pg. 612-613
107 [1961] 31 Comp. Cas.143
difficult to fix that responsibility if the director was a corporation or an association of persons.

The aforesaid requirement that only individuals should be appointed as directors does not extend to deemed directors coming within the provisions of section 7 of the Companies Act, for instance, a holding company will be deemed to be a director for purposes of section 7, where all or the majority of the directors of a subsidiary company are accustomed to according to its directions.  

4.2.2 Qualification for Directors

The Companies Act has not prescribed any academic or professional qualifications of directors. Also, the Act imposes no share qualification on the directors. So, unless the company’s Articles contain a provision to that effect, a director need not be a shareholder unless he wishes to be one voluntarily. But the Articles usually provide for a minimum share qualification. As per Reg. 66 of Table A, a director must hold at least one share in a company. Where a share qualification is fixed by the Articles of a public company or a private company which is a subsidiary of a public company, section 270 provides that:

(i) each director must take his qualification shares within 2 months after his appointment.

(ii) the nominal value of the qualification shares must not exceed Rs. 5000 or the nominal value of one share where it exceeds Rs. 5000

(iii) share warrants will not count for purpose of share qualification.

In case Grundy V. Briggs it was held that joint shareholdings, only one of the joint shareholders can be said to possess share qualification except where Articles provide otherwise.

---

108 Supra note 1 pg. 518 and also see A. Ramaiya- Guide to the Companies Act, 11th Edition pg. 773
109 [1910]
4.2.3 Disqualification of a Director

Section 274 of the Companies Act, 1956 provides that the following persons shall not be capable of being appointed as directors of any company:

(a) a person found by competent court to be of unsound mind and such finding remain in force;
(b) an undischarged insolvent;
(c) a person who has applied to be adjudged an insolvent
(d) a person who has been convicted by a Court of an offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of the expiry of the sentence;
(e) a person who has not paid any call in respect of shares of the company held by him, whether alone or jointly with others and six months have elapsed from the last date fixed for the payment of the call; and
(f) a person who has been disqualified by a Court/ Tribunal in pursuance of section 203. Section 203 empowers the Court/ tribunal to restrain fraudulent persons from managing companies, unless the leave of the Court/ Tribunal has been obtained for his appointment;
(g) a person who is already a director of a public company,-

(A). has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April 1999; or
(B). has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

However, a director disqualified under section 274(1)(g) shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns under sub- clause (A) or has
failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause (B).

4.2.4 Undischarged insolvent not to manage companies

Sec. 202 (1) If any person, being an undischarged insolvent, - (a) discharges any of the functions of a director, or acts as or discharges any of the functions of the manager of any company; or (b) directly or indirectly takes part or is concerned in the promotion, formation or management of any company; he shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to [fifty] thousand rupees, or with both. (2) In this section, "company" includes - (a) an unregistered company; and (b) a body corporate incorporated outside India, which has an established place of business within India.

4.2.5 Legal Position of Directors

It is difficult to define the exact legal position of the directors of a company. The Companies Act makes no effort to define their position. They have at various times been described by the judges as agents, trustees or managing partners. In case of Kothari (Madras) Ltd. V. My Leaf Tobacco Development Co. (P.) Ltd. Bowen, L.J.:

“Directors are described sometimes as agents, sometimes as trustees and sometimes as managing partners. But each of these expressions is used not as exhaustive of their power and responsibilities but as indicating useful points of view from which they may for the moment and for the particular purpose be considered.”

---

109 Supra note 1 pg. 518-521
111 [1985 ]57 Comp. Cas. 690
4.2.5.1 Directors as agent

Directors may correctly be described as agents of the company. Cairns, L.J. observed: “The company itself cannot act in its own person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent”. The ordinary rules of agency will, therefore, apply to any contract or transaction made by them on behalf of the company. Thus, where the directors contract in the name and on behalf of the company it is the company which is liable on it and not the directors.

Directors are agents make the company liable even for contempt of court. In Vineet Kumar Mathur V. Union of India the Supreme Court directed the company on 15-1-93 to close the plant w.e.f. 1-4-1993 as the Pollution Control Board (PCB) refused to certify that the plant has attained the prescribed level of antipollution standards. In spite of this the plant was operated between 7-4-1993 and 11-4-1993. The contention of the company was that in the interest of public health and safety the plant had to be run on the basis of technical advice from the PCB. Held that running of the plant purportedly pursuant to the consent of the PCB was a continuing violation of the court’s order even though an affidavit was filed for running the plant. No application had been made to the court for according permission to run; filing of an affidavit did not amount to granting permission nor can it operate to suspend the operation of the court’s order dated 15-1-1993. A compensatory fine of Rs. 5 lakhs was imposed besides costs. The PCB also came to severe stricture for playing clever.

However, directors incur a personal liability in the following circumstances:

(1) In case of Kirlampudi Sugar Mills Ltd. V. G. Venkata Rao it was held that where the contract in their own names. Thus, where chief executive of company executed promissory note and borrowed amount

---

113 [1996] 20 CLA 213 (SC)
114 [2003] 42 SCL 798 (AP)
for company’s sake, it could not be said that amount was borrowed by
him, in his personal capacity.
In case of H.P. State Electricity Board V. Shivalik Casting (P.) Ltd.\textsuperscript{115} it
was held that where surety was furnished by directors in their personal
capacities and not for and on behalf of company, company could not be
sued for amount of surety.

(2) where they use the company’s name incorrectly, e.g., by omitting the
word ‘Limited’;

(3) where the contract is signed in such a way that it is not clear whether it
is the principal (the company) or the agent who is signing; and

(4) In case of Weeks V. Propert\textsuperscript{116} it was held that where they exceed their
authority, e.g., where they borrow in excess of the limits imposed upon
them.

Ratification of unauthorised acts of directors: In case of Bhajekar V.
Shinkar\textsuperscript{117} it was held that a transaction by the directors which is beyond their
powers but within the powers of the company can be ratified by a resolution of the
company or even by acquiescence. In SriBalasaraswathi Ltd. V. A. Parameswara
Aiyer\textsuperscript{118} held that shareholders can by their assent ratify acts of directors which are
intra vires company, though they may not be intra vires the board of directors.

\textbf{4.2.5.2 Directors as trustees}

A trustee is a person in whom is vested the legal ownership of the assets
which he administers for the benefit of another or others. Directors are regarded as
trustees of the company’s assets, and of the powers that best in them because they
administer those assets and perform duties in the interest of the company and not
for their own personal advantage. In Ramaswamy Iyer V. Brahmayya & Co.\textsuperscript{119} the
Madras High Court held that “the directors of a company are trustees for the
company, and with reference to their power of applying funds of the company and

\begin{itemize}
\item \textsuperscript{115} [2003] 115 Comp. Cas. 310(H.P.)
\item \textsuperscript{116} [1873] LR 8 CP 427
\item \textsuperscript{117} [1934] 4 Comp. Cas. 434 (Bom.)
\item \textsuperscript{118} [1956] 26 Comp. Cas. 298 (Mad.)
\item \textsuperscript{119} [1996] 1 Comp. LJ 107
\end{itemize}
for misuse of the power they could be rendered liable as trustees and on their death the cause of action survives against their legal representatives.”

Besides, almost all the powers of directors, e.g., allotting shares, making calls, forfeiting shares, accepting or rejecting transfers, etc., are powers in trust. “They have been made liable to make good money which they have misapplied, upon the same footing as if they were trustees.”

Gujarat High Court in Smt. Shantandevi Pratapsingh Gaekwad V. Sangramsinh P. Gaekwad\textsuperscript{120} held that power of the directors to issue shares to the members of the company is a fiduciary power to be exercised by them bona fide for the general advantage of the company and the directors are not entitled to use their power of issuing shares merely for the purpose of maintaining their control over the affairs of the company or merely for the purpose of altering a majority shareholding.

In Dale & Carrington Investment (P.) Ltd. V. P.K. Prathapan\textsuperscript{121} held that fiduciary capacity, within which directors have to act, enjoins upon them a duty to act on behalf of a company with utmost good faith, utmost care and skill and due diligence and in interest of company they represent. In case of Nanelal Zaver V. Bombay Life Ass. Co. Ltd.\textsuperscript{122} held that the directors owe no fiduciary duty for strangers to the company, i.e., entities other than the shareholders and the company itself.

\textsuperscript{120} [2002] 37 SCL 339
\textsuperscript{121} [2004] 54 SCL 601 (SC)
\textsuperscript{122} [1950] SCR 391
4.2.5.3 Directors as managing partners

The persons holding this view consider a company as a large partnership, directors being charged with the responsibility of managing the affairs. The other shareholders are virtually dormant partners. By virtue of the various provisions in the Memorandum and Articles, they enjoy vast powers of management and act as the supreme policy and decision making body.

4.2.5.4 Directors employees of the company

Ordinarily, a director is elected by the shareholders in general meeting, and once so elected, he enjoys well-defined rights and powers under the Act or the articles. Even the shareholders who elect them cannot interfere with their rights or powers except under certain circumstances. An employee appointed by the company under a contract of service is a servant of the company. He does not enjoy any powers other than those vested in him by the employer, who can always direct his actions and interfere in his work.

In Lee Behrens & Co., 123 it was observed that directors are elected representatives of the shareholders engaged in directing the affairs of the company on its behalf. As such directors are agents of the company but they are not employees or servants of the company. In case of R. R. Kothandaraman V. CIT 124 held, there is nothing in law to prevent a director from accepting employment under the company under a special contract which he may enter into with the company.

Accordingly, where a director accepts employment under the company under a separate contract of service, in addition to the directorship, he is also treated as an employee or servant of the company. He shall, in such a case, be entitled to remuneration and other benefits admissible to employees, in addition to his remuneration as Director under the Act. The Companies Act recognises situations of this nature. Sections 314 and 318, for instance, provide for a director holding an office or place of profit under a company.

123 Re [1932] 2 Comp. Cas. 588
124 (1957)
Besides, directors are also treated as officers of the company for certain matters and are bracketed with the manager, secretary, etc. for this purpose. As ‘officers in default’ they are liable to certain penalties for failure to comply with the provisions of the Act.

To sum up, we may quote Jessel, M.R., in Forest of Dean Coal Mining Co.,\textsuperscript{125} who observed: “Directors have sometimes be called as trustees or commercial trustees, and sometimes they are called managing partners; it does not matter much what you call them so long as you understand what their real position is, what is that they are really commercial men managing a trading concern for the benefit of themselves and of all the shareholders in it. They stand in a fiduciary position towards the company in respect of their powers and capital under their control.”\textsuperscript{126}

\textbf{4.2.6 Appointment of Directors}

In case of Indian States Bank Ltd. V Kunwar Sardar Singh\textsuperscript{127} it was held that the success of a company depends, to a very large extent, upon the competence and integrity of its directors. It is, therefore, necessary that management of companies should be in proper hands. The appointment of directors is accordingly strictly regulated by the Act. There are now special provisions for preventing management by undesirable persons.

In New Zealand case of Commercial Management Ltd V.ROC\textsuperscript{128} it was held one evil which has been abolished by the Act is that of a company or a firm acting as a director of another company. Now, according to Section 253, only an individual can be the director of the company. No company or firm or association can be appointed as a director. A proviso has been added to the section by the amendments of 2006 which says that no company is to appoint any individual as a director unless he has been allotted a Director Identification Number under Section 266-B.

\textsuperscript{125} Re [1878] 10 Ch. D 450
\textsuperscript{126} Supra note 1 pg.525 - 528
\textsuperscript{127} See, the judgement of Young J, AIR 1934 All 855
\textsuperscript{128} [1987] NZLR 744
4.2.6.1 First Directors

Sec. 254: The first directors of a company are to be appointed by the subscribers of the memorandum. They are generally listed in the articles of the company. If they do not appoint any, all the subscribers who are individuals become directors. The very fact of incorporation makes them the first directors of the company. The first directors, howsoever appointed and in case of Usha Chopra (Dr) V. Chopra Hospital (P) Ltd it was held that the first directors hold office only up to the date of the first annual general meeting of the company and the subsequent directors must be appointed in accordance with the provisions of Section 255.

4.2.6.2 Appointment at general meeting

Sec. 255: Annual rotation- “Election of directors is the primary managerial function of stockholders in business corporations, and one that needed careful regulation in their interest.” According to Section 255, directors must be appointed by the company in general meetings. In the case of a public company and its subsidiary private company, of the total number of directors, only one-third can be given permanent appointment. The office of the rest of them must be liable to determination by rotation. The articles can provide for all the directors to be rotational. The effect of sub-sections (1) and (2) is that the rotational directors have to be appointed at general meetings except where the Act provides otherwise and other directors of a public and all the directors of a private company which is not subsidiary of a public company have also to be appointed at general meetings subject only to the regulations in the company’s articles.

129 Such director have to file with the company their consent to act as a director but they do not have to file their consent with the Registrar. [Sec. 264]
130 (2006) 130 Comp Cas 483 CLB
In Oriental Metal Pressing Works Ltd. Bhaskar Kashinath Thakoor\textsuperscript{132} it was held that the provision is designed to eradicate the mischief caused by self perpetuating managements. At an annual meeting only one-third of such directors shall go out.\textsuperscript{133}

In the first place those directors will retire who have been longest in the office since their last appointment. As between persons who became directors on the same day, retirement is to be determined either by mutual agreement, or, in default, by lot.\textsuperscript{134}

It has been held by the Delhi High Court in B.R. Kundra V. Motion Pictures Assn,\textsuperscript{135} that directors cannot prolong their tenure by not holding a meeting in time. They would automatically retire from office on the expiry of the maximum permissible period within which a meeting ought to have been held. If no de jure directors are left in office to call an annual general meeting, the Company Law Board may call a meeting to appoint directors, which will not be an annual meeting, nor conduct the business of such meeting, for the court did not have the power to call an annual meeting. Now both the powers, namely, the power of calling the annual general meeting and that of calling the extraordinary general meeting are vested in the Company Law Board.

In Swapan Das Gupta V. Navin Chand Suchanti\textsuperscript{136} it was held that where a director is to be rotated out is also holding the office of managing director, the latter office will also go with the former, but expiry of the term of, or removal from managing directorship, does not entail the cessation of his office as a director.

\textsuperscript{132}(1961) 31 Comp Cas 143; AIR 1961 SC 573; 1960 63 Bom LR 505
\textsuperscript{133}Sec. 256(1). If their number is not three or a multiple of three, then the number nearest to one-third shall retire
\textsuperscript{134}Sec. 256 (2)
\textsuperscript{135}(1976) 46 Comp Cas 339 Del
\textsuperscript{136}(1988) 64 Comp Cas 562; [1988] 3 Comp LJ 76 Cal.
4.2.6.3 Reappointment i.e., deemed reappointment

Sec. 256: The vacancies this created should be filled up at the same meeting. But the general meeting may also resolve that the vacancies shall not be filled up. If it has done neither, the meeting shall be deemed to have been adjourned for a week. If at the reassembled meeting also no fresh appointment is made, nor there is a resolution against appointment, the retiring directors shall be deemed to have been reappointed, except in the following cases: ¹³⁷

(a) Where the appointment of a particular director was put to vote, but the resolution was lost

(b) Where the retiring director has, in writing addressed to the company or its board, expressed his unwillingness to continue

(c) Where he is unqualified or has incurred a disqualification

(d) In case of Cardamon Marketing V. N. Krishna Iyer⁷ it was held that where a special or ordinary resolution is necessary for his appointment by virtue of any of the provisions of the Act.

(e) A motion to appoint two or more persons are directors by a single resolution, if passed without unanimous consent, being void under Section 363 (2), it shall not have the effect of reappointing rotated out directors.

¹³⁷ Supra note ¹³⁵
¹³⁸ (1982) 52 Comp. Cas 299 Ker.
4.2.6.4 Fresh appointment

Sec. 257 if it is proposed to appoint a new director in place of retiring one the procedure prescribed by Section 257 must be followed. Sec. 257(1) a notice in writing for his appointment should be left at the office of the company at least fourteen days before the date of the meeting along with a deposit of Rs 500 which shall be refunded to such person or member, if the candidate gets elected as a director. Sec.257 (1-D) notice may be given by the proposed director himself or by anyone intending to propose him. The company is required to inform the members at least seven days before the meeting about the candidature.

4.2.6.5 Appointment by nomination

Section 255(2) leaves scope for appointment to be made in accordance with the company’s articles without being routed through the company’s general meeting. In case of Bharat Bhushan V. H.B. Portfolio Leasing Ltd\(^\text{139}\) it was held that an agreement among the shareholders may be imbibed in the articles to the effect that every holder of 10% shares shall have the right to nominate a director on the board. Lending institutions also insist on putting upon a company’s board of directors some of their nominees for watching their interest. The phenomenon of nominee director is now a part of the corporate scenario.

4.2.6.6 Appointment by voting on individual basis

Sec. 263 the appointment of every director is required to be made by voting at the general meeting. The candidates cannot be put to vote en bloc. Rather each candidate has to be voted on individually.\(^\text{140}\) In case of Raghunath Swarup Mathur V. Dr. Raghuraj Bahadur\(^\text{141}\) held that wishes of shareholders in relation to each proposed director should be obtained. If two or more persons are appointed directors by a special resolution, the same is void and non-existent in the eyes of law. But if the meeting has unanimously so resolved, more than one person may

---

\(^{139}\) (1992) 74 Comp Cas 20 Del
\(^{140}\) S. 263 (1)
\(^{141}\) [1966] 2 Comp LJ 100: (1967) 37 Comp Cas 802
be elected by a single resolution. A person who has been appointed as a director for the first time is required to submit within thirty days of his appointment a written consent to act as a director to the Registrar of Companies.¹⁴²

In case of B. Sivaraman V. Egmore Benefit Society Ltd¹⁴³ it was held that where the candidates are greater in number than the posts, the first appointment will go to the top scorer and further in the descending order from among those in whose favour the number of votes cast are more than those cast against them.

4.2.6.7 Appointment by proportional representation

Sec. 265 it is apparent from the above provisions that the basic method adopted by the Act for the appointment of directors is election by simple majority. All the directors of a company can, therefore, be appointed by a simple majority of shareholders and a substantial minority cannot succeed in placing even a single director on the board. “Section 265 was, therefore, enacted by the Legislature so that the minority may have an opportunity of placing their representative on the board.”¹⁴⁴ This section enables a company to provide in its articles the system of voting by proportional representation for the appointment of directors. This system of voting is devised to make minority votes effective. It is thus explained by BALLETINE in his book on CORPORATIONS:

“Cumulative voting is the privilege, where several directors are to be voted for at the same time, of casting votes of the whole number of shares held, multiplied by the number of directors to be elected, for the candidate, for distributing the votes among part of the vacancies to be filled.”¹⁴⁵

“Cumulative voting is a voting procedure which permits a substantial minority of stockholders to elect one or more directors. A group owning one-

¹⁴² S. 264
¹⁴³ (1992) 75 Comp. Cas 198 Mad
¹⁴⁴ For a remarkable account of the importance of this system see Justice P.N. Bhagwati’s Right of Minority Shareholders, published in Current Problems of Corporate Law Management and Practice of the Indian Law Institute, New Delhi.
¹⁴⁵ Para 177 (1946 Edn)
seventh of the shares can always elect one-seventh of the directors.”  
146 Under this system each shareholder’s vote is more important than under straight voting. It also facilitates the removal of an inefficient management. “Thus in some cases in the United States companies were salvaged by a single director placed on the board by cumulative voting and who brought out correct information.  
147

4.2.6.8 Casual Vacancies

Sec. 262 a casual vacancy occurs when the office of a director is vacated before the expiry of his term. Such a vacancy may be filled in accordance with the procedure prescribed by the articles. In the absence of any such clause in the articles, power is given to the directors to fill the vacancy at a board meeting. Any person so appointed holds office until the expiry of the period for which the outgoing director would have held office.  
148

4.2.6.9 Additional Directors

Sec. 260 additional directors can be appointed by the board if there is a power to that effect in the articles, provided that the total number of directors shall not exceed the maximum fixed by the articles. In Shailesh Harilal Shah V. Matushree Textiles Ltd, 149 it was held, where the strength of directors fell below the legal minimum, the appointment of an additional director by the remaining directors was held to be valid. Such additional directors shall hold office only up to the date of the next annual general meeting. They are exempted by Section 264 from the requirement of filing consent to act as director.

146 John G. Sobieski, In Support of Cumulative Voting, 1960 JBL 316  
147 Ved Prakash Juneja, Proportional Representation on Boards of Companies,[1969] 2 Comp LJ 29  
148 Supra note 2 pg.274-279  
149 AIR 1994 Bom.20
4.2.6.10 Appointment by Board

While the general power to appoint directors is vested in the general meeting of shareholders, there are at least two cases when the board can also appoint new directors. Firstly, articles may empower the directors to appoint additional directors subject, of course, to the maximum number fixed therein and, secondly, the Act itself by Section 262 authorises the directors to fill casual vacancies. This may occasionally result in a conflict between the general meeting and the directorate. This kind of situation developed in Viswanathan V. Tiffins B.A. & P.Ltd

A clause in the articles of a company authorised the directors to fill casual vacancies and also to increase the number of directors within the maximum number fixed in the articles. Some casual vacancies occurred but they were promptly filled at a general meeting of the shareholders. This was challenged on the ground that once the power to appoint was delegated to the board, it could not have been exercised at a general meeting.

After an extensive review of English authorities, Venkatrama Iyer J upheld the appointment and said: “The principle can be summed up thus: A company has inherent power to take all steps to ensure its proper working and that, of course, includes the power to appoint directors. It can delegate this power to the board and such delegation will be binding upon it, but if there is no legally constituted board which could function or if there is a board that is unable or unwilling to function then the authority delegated to the board lapses and the members can exercise the right inherent in them of appointing directors.”

The authorities reviewed by the learned Judge were Blair Open Hearth Furnace Co Ltd V. Reigart the court found that at the time of the general meeting there was no director validly in office and, therefore, the members had the

---

150 S.260
151 AIR 1953 Mad 520; [1953] 1 MLJ 346; (1953) 23 Comp Cas 79
152 (1913) 108 LT 665
right to elect. A similar appointment was upheld by the Privy Council in Ram Kissendas V. Satya Charan\textsuperscript{153} but their Lordships added:

The articles may, however, be so expressed as to delegate the power of appointing new directors to the board to the exclusion of the general meeting. It follows, therefore, that the question turns upon the construction of the language used in the articles.\textsuperscript{154}

4.2.6.11 Appointment by Central Government

Sec. 408: The Central Government has the power under Section 408 to appoint directors for the purpose of prevention of oppression and mismanagement. This power comes into play when a petition has been made to the National Company Law Tribunal for prevention of oppression and mismanagement.

4.2.6.12 Appointment by Company Law Board

Sec. 402: The Company Law Board has the power to appoint directors for prevention of oppression and mismanagement.

4.2.6.13 Right to increase number of directors

Sec. 258-259: A company may increase the number of its directors by passing an ordinary resolution at a general meeting. But the total number of directors must not exceed the limits fixed by the company’s articles. However, an increase shall not have any effect unless approved by the Central Government and shall be void so far as it is disapproved. But in the following cases, the sanction of the Central Government is not necessary:

(a) In the case of a company in existence on July 21, 1951, for an increase which was within the permissible maximum under its articles as in force on that date.

\textsuperscript{153} AIR 1950 PC81
\textsuperscript{154} Supra note 2 pg, 281
(b) In the case of other companies an increase which is within the permissible maximum under the articles of a company as first registered.

(c) Where the permissible maximum is twelve or less and the proposed increase does not make the total number of directors more than twelve.\textsuperscript{155}

In case of Rolta India (P) Ltd V. Venire Industries Ltd,\textsuperscript{156} an agreement between groups of shareholders not to increase the number of directors and capital of the company and also not to do anything disturbing the existing pattern of management was held to be not binding on the company so as to prevent it from doing any of those things.

4.2.7 Number of Directorships:

As per Section 275 of the Companies Act, 1956, a person cannot hold office at the same time as a director in more than fifteen companies.\textsuperscript{157} However, section 278 provides that in computing this number of fifteen directorship, the directorship of,

i) private companies [other than subsidiaries or holding companies to public companies],

ii) unlimited companies,

iii) association not carrying on business for profit or which prohibit payment of dividend, and

iv) alternate directorships (i.e., he is appointed to act as a director only during the absence or incapacity of some other director) will be omitted.

In case any company ceases to fall in the category under (i), (ii), or (iii) above, the directorships shall continue to remain excluded up to a period of three months form such cessation [Section 278(2)].

\textsuperscript{155} Id at 154

\textsuperscript{156} (2000) 100 Comp Cas 19

\textsuperscript{157} As per the Companies (Amendment ) Act, 2002
Foreign Companies- Directorships in foreign companies shall not be counted for the aforesaid ceiling of 15 companies under section 275 as they do not come within the definition of ‘company’ in the Act.

Choice to be made by director of more than fifteen companies at commencement of the Companies [Amendment] Act, 2000 [Sec. 276]- Any person holding office as director in more than fifteen companies immediately before the commencement of the Companies (Amendment) Act, 2000 (i.e 14-12-2000), shall, within two months from such commencement-

(a) choose not more than fifteen of those companies, as companies in which he wishes to continue to hold the office of director;
(b) resign his office as director in other companies; and
(c) intimate the choice made by him under clause(a) to each of the companies in which he was holding the office of director before such commencement, to the Registrar having jurisdiction in respect of each such company, and also to the Central Government.

Choice by person becoming director of more than fifteen companies after commencement of the Companies (Amendment) Act, 2000.

If a person who is already a director of fifteen companies, excluding those covered by section 278, is appointed a director in any other company not covered by section 278, the appointment will not be effective unless within fifteen days thereafter, the director has vacated his office in any of the companies in which he was already a director so as to keep the number within the maximum allowed. None of the new appointments of a director shall take effect until such choice is made; and all the new appointments will become void if the choice is not made within fifteen days of the day on which the last of them was made [277(1)].

Where a person is already holding the office of a director in 14 companies or less and is appointed as a director of other companies making the total number of directorships to more than 15, he must, out of new and old directorships, choose
15 companies within 15 days or else all his new appointments shall become void [Section 277(2)].

4.2.8 Vacation of office of a director

Section 283 provides for the office of a director becoming vacant on the happening of certain events. It provides that the office of a director shall become vacant if:

(a) he fails to obtain within the time specified in sub-section (1) of section 270 (two months after the date of appointment as a director), or at any time thereafter ceases to hold, the share qualification, if any required of him by the Articles of the company;
(b) he is found to be of unsound mind by a Court/ Tribunal of competent jurisdiction;
(c) he applies to be adjudicated as insolvent;
(d) he is adjudged and insolvent;
(e) he is convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months;
(f) he fails to pay any calls in respect of shares of the company held by him, whether alone or jointly with others, within six months from the last date fixed for the payment of the call under the Central Government has, by notification in the Official Gazette, removed the disqualification incurred by such failure;
(g) he absents himself from three consecutive meetings of the Board of directors or, from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board;

In case of D. Srinivasan V. H.S. Vishwanath held that where a director absented himself from the Board meeting held on 12-1-2005, 4-2-2005 and 5-3-2005, his disqualification as envisaged in section 283(1)(g) would not arise

158 Supra note 1 pg. 552
159 [2007] 75 SCL 59 (CLB- Chennai)
without completion of a continuous period of three months from the date of the first meeting.

(h) he (whether by himself or by any person for his benefit or on his account), or any firm in which he is a partner or any private company of which he is a director, accepts a loan, or any guarantee or security for a loan from the company in contravention of section 295;

(i) he acts in contravention of section 299[Disclosure of interest by the directors]

(j) he becomes disqualified by an order of Court under section 203;

(k) he is removed in pursuance of section 284;

(l) having been appointed a director by virtue of his holding any office or other employment in the company, he ceases to hold such office or other employment in the company; or

(m) where a director or any other officer of a company has been convicted of an offence under section 209A, he shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified for holding such office in any company, for a period of five years from such date [Section 209 A (9)].

A private company which is not a subsidiary of a public company may, by its articles, provide that the office of director shall be vacated on any grounds in addition to those specified above, for example, when a directors activities appear prejudicial to the bonafide interest of the company, the remaining members of the Board may require such director to vacate his position/ resign, by writing a letter to him, signed by all of them. Articles of private company simpliciter may contain a clause to this effect.

However, sub section (2) of section 283 provides that the disqualification referred in clauses (d), (e) and (j) above shall not take effect:

(a) For thirty days from the date of the adjudication, sentence or order;

(b) Where any appeal or petition is preferred within the thirty days aforesaid against the adjudication, sentence or conviction resulting in the sentence, or
order until the expiry of seven days from the date on which such appeal or petition is disposed of; or

c) Where within seven days aforesaid, any further appeal or petition is preferred in respect of the adjudication, sentence, conviction, or order, and the appeal or petition, if allowed, would result in the removal of the disqualification, until such further appeal or petition is disposed of [section 283(2)].

Penalty: If a person function as a director after his office has become vacant on account of any of the disqualifications specified in (a) to (l) above, he shall be punishable with fine upto Rs. 5,000 for every day during the period he so functions [sections 283(2A)].

4.2.9 Removal of Directors

4.2.9.1 Removal by Shareholders

Section 284 provides that “a company may, by ordinary resolution, remove a director before the expiration of his period of office.” Section 184 of the English Companies Act, after providing the same, adds “notwithstanding anything in its [company’s] articles or an agreement between it and him.” But despite the absence of these words from the Indian provision, the same effect would follow as any provision in the company’s articles or in any agreement between a director and the company by which articles or in any agreement between a director and the company by which the director is rendered irremovable by an ordinary resolution would be void, being contrary to the Act. In case of Tarlok Chand Khanna V. Raj Kumar Kapoor the section is intended to do away with arrangements under which directors were either irremovable or removable only on extraordinary resolutions. “The field over which [the section] operates is thus extensive.” But it admits of the following exceptions:

---

160 Supra note 1 pg. 553-554
161 (1983) 54 Comp. Cas 12 Del
(a) It does not apply to the case of a director appointed by the Central Government in pursuance of section 408. [S. 284(1)].

(b) It does not, in the case of a private company authorise the removal of a director holding office for life on April 1, 1952 [proviso].

(c) It does not apply to the case of a company which has adopted the system of electing two-thirds of its directors by the principle of proportional representation. [proviso] 162

A special notice of a resolution to remove a director is required, that is, notice of the intention to move the resolution should be given to the company not less than fourteen days before the meeting. 163 This is to enable the company to inform the members beforehand. As soon as the company receives the notice, it must furnish a copy of it to the director concerned who will have the right to make a representation against the resolution and to be heard at the general meeting. If the director submits a representation and requests the company to circulate it among the members, the company should, if there is time enough to do so, send a copy of the representation to every member of the company to whom notice of the meeting is sent. If this is not possible, the representation may be read out to the members at the meeting. 164

In case of LIC V. Escorts Ltd, 165 held, where a meeting is requisitioned by the shareholders for the very purpose of removing a director, the Supreme Court laid down that it is not necessary for the requisitionists to state the reasons on which they wish to proceed against the director.

Earlier the Bombay High Court had expressed the opinion that a notice of removal which does not mention the grounds would be against the meaning and intent of the Companies Act because it would defeat the director’s statutory right of representation in the sense that it would be impossible to write a representation

162 The section also does not apply to nominated directors and those of a Government Company. The matter of appointment and removal is in the realm of contract and therefore cannot be challenged under writ jurisdiction.

163 This privilege of members to propose by special notice the appointment or removal of a director cannot be subjected to the requirement of S. 188 relating to the circulation of members resolutions.

164 S. 284(2)

without proper information.\textsuperscript{166} This proposition was not accepted by the Supreme Court.

\textbf{4.2.9.2 Removal by Central Government}

Sec.388-B to 388-E: A director may also be removed at the initiative of the Central Government. A special chapter to the Companies Act enables the Central Government to remove managerial personnel from office on the recommendation of the Company Law Board. In case of Union of India V. Standard Distilleries & Breweries (P) Ltd,\textsuperscript{167} it was held, the Government has the power to make a reference to the CLB against any managerial personnel.

In case of Central Government V. Premier Automobiles Ltd,\textsuperscript{168} held, the power can be exercised where, in the opinion of the Central Government, there are circumstances suggesting:

(a) That any managerial personnel is or has been guilty of fraud, misfeasance, persistent negligence or default on carrying out his legal obligations or functions or breach of trust; or
(b) That the business of the company has not been conducted in accordance with sound business principles or prudent commercial practices; or
(c) That the company has been managed by the person concerned in such manner which has caused or is likely to cause serious injury to the interest of the trade, industry or business to which the company belongs; or
(d) That the person concerned has conducted the business with intent to defraud creditors or members or any person or for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

In case of S.P. Jain V. UOI\textsuperscript{169} held, the reference is made by stating a case against the person with a request that the CLB may inquire into the case and record its decision whether he is a fit or proper person to hold the office of a director or other managerial office. The person against whom a case is presented is

\textsuperscript{166} Surpa note 2 pg. 288-290
\textsuperscript{167} (2005) 128 Comp Cas 383 CLB
\textsuperscript{168} (2005) 125 Comp Cas 508 CLB
\textsuperscript{169} [1966] 1 Comp LJ 42 Bom.
joined as a respondent to the application. The application should contain a concise statement of the circumstances and materials necessary for the purpose of the inquiry. The CLB has the power to direct by an interim order that the respondent shall not discharge the duties of his office until further orders. [S. 388-C (1)] The CLB may appoint a suitable person in his place and he shall be deemed to be a public servant.

At the conclusion of the inquiry the CLB has to record its decision.[S. 388-D] If the decision is against the respondent, the Central Government may by order remove him from office.[S. 388-E] But, before making its order, the Government has to give him a reasonable opportunity to show cause against the same. But he cannot raise any matter which has already been decided by the CLB. The person removed is disabled from holding a managerial office for five years, unless the period is remitted. No compensation is payable to him. The company may, with the previous approval of the Central Government, appoint another person to the office[S.388 E(5)].

4.2.9.3 Removal by Company Law Board

Sec. 402: When, on an application to the CLB for prevention of oppression and mismanagement, the CLB finds that a relief ought to be granted, it may terminate or set aside any agreement of the company with a director or managing director or other managerial personnel. When the appointment of a director is so terminate he cannot, except with the leave of the CLB, serve any company in a managerial capacity for a period of five years. Neither he can sue the company for damages or compensation for the loss of office.
4.2.10 Resignation

In case of S.S. Lakshmana Pillai V. ROC\textsuperscript{173} before Madras High Court, of the two directors of a company, one died and the other wanted to resign. There was no provision in the company’s articles about resignation. Nor is there anything in the Companies Act as to whether, and by what procedure, a director can resign. The Act, however, indirectly recognises resignation by the provisions in Section 318 one of which is that no director is entitled to compensation if he resigns his office. If there is a provision in the articles, resignation will take effect in accordance with such provisions and, if there is no provision, resignation will take effect in accordance with its terms. Notice may be written or oral. In case of Mother Care (India) Ltd. V. Ramaswamy P. Aiyar\textsuperscript{174} the court accordingly held that the resignation was effective even when no other director was in office, but added that no resignation can avail a director to evade his obligation by severing his connection with the company.

In case of Glossop V. Glossop\textsuperscript{175} held, once a director has given a notice of resignation of his office, he is not entitled to withdraw that notice, but, if it is withdrawn, it must be by the consent of the company properly exercised by their managers who are the directors of the company.\textsuperscript{176}

\textsuperscript{173} (1977) 47 Comp Cas 652 Mad.
\textsuperscript{174} (2004) 51 SCL 243 Kant
\textsuperscript{175} [1907] 2Ch. 370
\textsuperscript{176} Supra note 2 pg. 294-295
4.3 Conclusion

Thus, in this chapter the role of the promoter, director, managing director has been scrutinised and overall the Companies Act 1956, has significantly highlighted the definition of independent director but has not imbibed the role, duties, powers of the independent directors. The next chapter will make an inquiry into conventional set of liabilities and duties imposed upon directors in the context of historical corporate collapses and scandals and how these duties can be further extended to address ever increasing expectations and claims of stakeholders other than shareholders.