



R. Sridharan
PRESIDENT

MCA:2014

April 24, 2014

Dear *Mr. Mr. J. Joseph*

Sub: Rules under section 203(1) of the Companies Act, 2013

This is in continuation of our letters of even number dated April 2, 2014 and April 7, 2014 on the above subject. During the discussion today with you, we were reassured that our representations on the above subject are receiving active and sympathetic attention.

2. We have examined the legal position carefully. We are writing this to share our understanding of the law and the background and legislative intention behind section 203. We are fully convinced that **every company** is required to have a company secretary and it is permissible to make such a prescription under section 203 of the Companies Act, 2013.

3. The legislative intention of section 203 is gathered from the following:

a. The Standing Committee on Finance had examined the Companies Bill, 2009. Para 13.23 to 13.28 (enclosed) deal with key managerial personnel (KMP). The said Bill had proposed every company belonging to such class or description of companies as may be prescribed shall have whole-time KMP. ICSI had then suggested that the Bill may be specific and suggested that every company with a paid up share capital of Rs.5 crore should have KMP. The Ministry had then replied that there may be a need for revising the limit from time to time and hence the limit may not be specified in the Act. If the limit has to be specified, it had suggested an alternate formulation that every company having a paid up capital of Rs.5 crore or more or such other amount as may be prescribed from time to time shall have KMP. The Ministry has, therefore, committed before the legislature that companies above a threshold in terms of capital will have KMPs. Based on this understanding, the Companies Act, 2013 has been enacted. The requirement of KMP is, therefore, necessarily linked to size of capital.

b. The draft rules notified in August / September 2013 under the Companies Act, 2013 carried this intention and reiterated the paid up capital as the basis of classification. These Rules specified that the companies with a threshold of capital shall have KMP. These did not distinguish between private companies and public companies.

c. This approach is essentially continuation of the approach followed in the Companies Act, 1956 under which companies with a threshold of capital were required to have company secretaries.

d. Section 203 aims at having KMPs. As specified elsewhere in the Act, KMPs have specific responsibilities. For example, the responsibilities of company secretary, as specified in section 205, is ensuring compliance and governance. The rules do not require KMPs in over 99.5% of companies. Therefore, the responsibilities of company secretary are not required to be performed in these companies. It gives an impression that the Companies



Act, 2013 has been enacted only for less than 0.5% of companies which may reduce to zero if the proposed regulatory arbitrage is allowed.

4. The extant rule 8 of the Companies (Appointment and Remuneration) Rules, 2014 does not seem consistent with the section 203 of the Act for the following reasons:

- a. The purpose of section 203 is promotion of compliance and governance by requiring companies to have key managerial personnel who have specified obligations under the Act. The rule has kept out more than 99.5% of companies from the purview of KMP. Such regulatory arbitrage would distort economic choice which is not in the interest of the economy.
- b. The Act envisages classification, not grouping of companies. A company chooses to be private company or public company. Whether a company is a private or public reflects its character, and, therefore, grouping, not classification. For example, we do not classify people on the basis of first alphabet of names of the individuals; we classify them based on their level of income, kind of health, etc.
- c. The subordinate legislation aims to further the objects of legislation. The classification must, therefore, have a nexus with the purpose. There is no nexus in grouping companies as private or public as regards compliance or governance is concerned. It is not that private companies are immune from misdemeanour. It is not that private companies are not important for the economy or country.

5. There is a feeling in some circles that private and small companies would not afford penalty under section 203(5) if they are required to have KMPs and they do not engage KMPs. The penalty under 203(5) is nominal in comparison to penalty on failure to comply with other provisions of law such as those relating to related party transactions. If there is no KMP/company secretary, a company would end up paying much higher penalty. In any case, the object of law is not to save companies from penalty, but to ensure compliance and governance in companies which are critical for the growth of the economy. If Government wishes to reduce cost on companies, it may exempt small companies and one person companies from the requirement of KMPs or some kinds of KMPs.

6. The law casts various obligations on companies. For example, section 118 requires every company to observe secretarial standards. Section 205 requires a company secretary to ensure compliance with secretarial standards. This means that every company must have at least a company secretary, if not all kinds of KMPs.

7. Though company secretary is bracketed as KMP, it is a unique kind of KMP. The law specifies that only a member of ICSI, who is a qualified and a regulated professional can be a company secretary. No such qualification or regulation is required to be any other KMP. Further, the law specifies the functions and responsibilities of a company secretary.

A handwritten signature in blue ink, followed by a horizontal blue line that extends across the page.



Most of these functions are compliance and governance. The law, therefore, treats company secretaries on a footing different from that of other kinds of KMPs.

8. The law needs to be so interpreted as it furthers the legislative intention and not negates the same. Section 203 requires every company belonging to such class or classes of companies to have KMPs. Section 204 requires a company belonging to other class of companies to annex secretarial report. The connotation of the words 'every company' in section 203 and the words 'a company' in section 204 is different. Section 203 requires every company to be classified. Each class may have different requirement / entitlement of KMPs depending on the policy objective or the need. It is possible to have a class of companies which needs to have all three kinds of KMPs, another class which needs only two kinds of KMPs, another class which needs only one kind of KMPs and still another class which may not need any.

9. Keeping the above in view, we strongly urge you to amend the rule 8 to put companies in different classes and prescribe requirement of KMPs as may be warranted for each class. While a very big company may need to have all three kinds of KMPs, companies of with at least Rs.5 crore of paid up capital must have at least a company secretary.

With best regards,

Yours sincerely,

(R. Sridharan)

Shri M. J. Joseph
Additional Secretary to Government of India
Ministry of Corporate Affairs
Shastri Bhawan, New Delhi.

Encl. As above.

• **Clause 178 – Appointment of Key Managerial Personnel**

13.23 This clause seeks to provide that every company belonging to such class or description of companies, as prescribed by the Central Government, shall have whole-time key managerial personnel.

13.24 Clause 178 (1) read as follows:

“Every company belonging to such class or description of companies as may be prescribed shall have whole-time key managerial personnel.”

13.25 ICSI in their written memorandum submitted to the Committee suggested as follows :-

The Bill may be specific in respect of the class or description of companies which shall be required to have whole time key managerial personnel. It is suggested that every listed company and every other company having paid-up share capital of Rupees Five crores or more should mandatorily be required to employ whole-time key managerial personnel.

13.26 Reply of the Ministry on this suggestion is given as under:

The suggestion is to specifically indicate in clause 178(1,) the paid-up share capital of Rs. 5 crore or more as the class or description of companies to whom the requirement of this clause shall be applicable.

It is felt that since there may be need for revising the limit under clause 178(1) from time to time, the provisions proposed in the clause may not be considered to be modified and the flexibility proposed in the Bill on this matter may be continued.

13.27 However, the Ministry have also suggested an alternate clause to clause 178(1) which is given as follows:

“178. (1) Every company having a paid up share capital of Rs. 5 crore or more or such other amount as may be prescribed by Central Government from time to time shall have whole-time key managerial personnel:

Provided that an individual shall not be the Chairman of the company as well as the Managing Director or Chief Executive Officer of the company at the same time.

Provided further that every company existing on or before the commencement of this Act shall comply with the requirements of this sub-section within one year from the date of commencement of this Act.”

13.28 The Committee are of the view that the proposal originally contained in the Bill in clause 178 (1) regarding appointment of KMP may be retained with a view to providing flexibility to decide the threshold limit of companies which shall compulsorily have whole-time KMP. The other modifications proposed above in Clause 178 (1) regarding appointment of KMP may be duly incorporated.