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- APPOINTMENT OF DIRECTORS OF A PRIVATE COMPANY: SOME CRITICAL ISSUES

Appointment of Directors of A Private Company: Some Critical Issues

In this article author analyses one of the key provision on, 'Appointment of Directors and proportion of those who are to retire by rotation' under Section 255 of the Companies Act, 1956 in comparison with Section 152 of the Companies Act, 2013 and provides his insights.

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INTRODUCTION

Section 149 of the Companies Act, 2013 (the 2013 Act) mandates every company to have a Board of Directors consisting of individuals as directors and shall have a minimum of two Directors and a maximum of fifteen Directors, and more than fifteen with the approval of shareholders by a special resolution.

The basic provision concerning appointment of Directors of public and private companies, is in section (s.) 152 of the 2013 Act, which was in s. 255 of the Companies Act, 1956 (the 1956 Act).

APPOINTMENT OF DIRECTORS OF A PRIVATE COMPANY

Pre 2013 position

As can be seen, ss. (2) of s. 255 of the 1956 Act was divided into two parts:

- First part dealing with the appointment of Directors other than the Directors liable to retirement by rotation at annual general meetings; and
- Second part dealing with the appointment of Directors generally in the case of a private company which is not a subsidiary of a public company.

The first part applied to public companies (including private companies which were subsidiaries of public companies) and the second part to private companies (which were not subsidiaries of public companies). Both these parts required the appointment of Directors of public as well as private companies, at a general meeting.

The second part of ss. (2), i.e. the requirement that the Directors generally shall be appointed by a private company in general meeting, was a conditional one, the condition was indicated in the phrase "*in default of and subject to any regulations in the articles of the company*".

Companies Act, 1956 – Section 255	Companies Act, 2013 – Section 152
255. Appointment of Directors and proportion of those who are to retire by rotation.—(1) Unless the articles provide for the retirement of all Directors at every annual general meeting, not less than two-thirds] of the total number of Directors of a public company, or of a private company which is a subsidiary of a public company, shall— (*a*) be persons whose period of office is liable to determination by retirement of Directors by rotation; and (*b*) save as otherwise expressly provided in this Act, be appointed by the company in general meeting. (2) The remaining Directors* in the case of any such company, and the Directors generally in the case of a private company which is not a subsidiary of a public company, shall, in default of and subject to any regulations in the articles of the company, also be appointed by the company in general meeting. *Means other than the Directors liable to retirement by rotation at annual general meetings.	(2) Save as otherwise expressly provided in this Act every director shall be appointed by the company in general meeting. ..... (6)(*a*) Unless the articles provide for the retirement of all Directors at every annual general meeting, not less than two-thirds of the total number of Directors of a public company shall— (*i*) be persons whose period of office is liable to determination by retirement of Directors by rotation; and (*ii*) save as otherwise expressly provided in this Act, be appointed by the company in general meeting. (*b*) The remaining Directors in the case of any such company shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.

The expression 'in default of' means in the absence of something; without something; because of lack of something; and the expression 'subject to' means 'depending on something in order to be completed'[1]; conditional upon the observance of the provisions in the articles.[2] This expression seeks to give an overriding effect to the provision in the articles.

So, the second part of ss. (2) of s. 255 would apply only when the articles of a private company lacked a provision regarding appointment of Directors, otherwise than by the shareholders in general meeting. Conversely, the articles of such a company could contain a provision regarding appointment of Directors, in any manner other than by shareholders in general meeting and hence the Directors could be appointed in accordance with that provision in the articles.

The articles could also provide that the first Directors appointed by the articles shall continue to hold office until their office becomes vacant by resignation, removal, death or otherwise, or they are superseded by appointing other Directors in accordance with the provisions of the articles.

With regard to this saving clause in s. 255 of the 1956 Act, it was held by the Supreme Court as follows:

"Section 255 of the Act permits one-third of the total number of Directors of a public company and all the Directors of a private company to be appointed otherwise than by the company at a general meeting, if the articles make provision in this regard. The Act, therefore, expressly permits Directors to be appointed otherwise than by the company.... *In the case of a private company ..., the Directors have to be appointed similarly except to the extent the articles otherwise provide.*"[3] [emphasis supplied]

The Calcutta High Court held that in the case of a private company the Directors are to be appointed at a general meeting as in a public company, but such appointment would be subject to the articles which may provide otherwise. If the articles are silent as to the appointment of Directors in a private company, or do not specifically provide for the appointment of Directors otherwise than at a general meeting, then the Directors of a private company are to be appointed by the shareholders at general meetings.[4]

Thus, the statutory framework of s. 255, as discussed above, as applicable to private companies which were not subsidiaries of public companies, was amply clear, namely that it was not mandatory for these companies to appoint their Directors in general meetings, if their articles of association provided for the authority and the manner of appointment of and the vacation of office of all its Directors. Thus, it was permissible for such a private company to provide in its articles that none of its Directors will be liable to retirement by rotation and, further, vested that power in the Board of Directors of the company (or even any other person or company or a director) and only in the absence of a provision in this regard in the articles of a company their Directors had to be appointed in general meetings.

Post 2013 position

In s. 152(2) of the 2013 Act, the clarity of the statutory framework, as pointed out in the preceding paragraph, has been lost due to intermingling and incorrect placement of some parts of s. 255 of the 1956 Act (unless the Legislature has enacted it purposefully). The 2013 Act has dispensed with the provision in ss. (2) of s. 255 (discussed above) and, instead, ss. (2) of s. 152 was inserted which provides that "Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting."

It will be noticed that this provision has been differently worded than ss. (2) of s. 255 of the 1956 Act as applicable to a private company which is not a subsidiary of a public company, and it does not include the expression "*in default of and subject to any regulations in the articles of the company*", with the result that ss. (2) applies to public as well private companies equally regardless of anything to the contrary in the articles of association of a private company. Consequently, one may infer, and quite rightly, that a private company is also required to appoint Directors in general meetings (although it need not follow the provisions of s. 152(6) regarding retirement of Directors by rotation).

The expression "Save as otherwise expressly provided in this Act", in ss. (2) of s. 152 of the 2013 Act, contemplates the need for an express provision in the Act, which is different than what the above expression follows, namely, "every director shall be appointed by the company in general meeting." Therefore, by operation of law, every director of a private company must be appointed by the shareholders in general meetings. This is the result of ss. (2) of s. 152 of the 2013 Act being differently worded than ss. (2) of s. 255 of the 1956 Act, which, as noted already, had excluded the requirement of appointment of Directors of private companies in general meetings, by virtue of the crucial expression "in default of and subject to any regulation in the articles of the (private) company".

The expression "Save as otherwise expressly provided in this Act" seeks to exclude from the requirement that, every director shall be appointed by the company in general meeting. The provisions of the Act which expressly provide for appointment of Directors other than by shareholders, are those which provide for appointment of additional or alternate Directors by the Board or appointment to fill a casual vacancy. There is no express provision in the Act that empowers the Board or anyone else to appoint Directors of a private company; so, it appears that the provision in s. 152(2) would apply in the case of appointment of Directors of a private company (except that the rule of retirement

1. *See Oxford Advanced Learner's Dictionary, 8th edition.*
2. *K. R. C. S. Balkrishna Chetty and Sons & Co v State of Madras AIR 1961 SC 1152.*
3. *Oriental Metal Pressing Works Pvt Ltd v Bhaskar Kashinath Thakoor (1961) 31 Comp Cas 143 (SC): (1961) 3 SCR 329: AIR 1961 SC 573.*
4. *Swapan Dasgupta v Navin Chand Suchanti (1988) 64 Comp Cas 562 (Cal); (1988) 3 Comp LJ 176.*

of Directors would not apply), because the words "and the Directors generally in the case of a private company which is not a subsidiary of a public company" are absent in s. 152. This makes a significant departure from the provision in s. 255(2) of the 1956 Act. While the former covered public as well as private companies, the latter covers only public company (which includes subsidiary of a public company). Thus, inferentially, under the 2013 Act, Directors of a private company need to be appointed in a general meeting regardless of any contrary provision in the articles of such a company. Of course, there will be no limit to the period of the tenure of office, unless the articles or the resolution appointing them limits the tenure.

The policy and scheme of the 1956 Act (of permitting private companies to have the freedom of appointment of all Directors, otherwise than by the shareholders in general meetings) seems to have been wiped out by the 2013 Act, in as much as, on the one hand, ss. (2) of s. 152 requires *every director* to be appointed by the company in general meeting, save as otherwise expressly provided in this Act but there is no express saving provision in the Act making an exception to this requirement, and on the other hand, ss. (6)(b) of s. 152 mandates that the remaining Directors in the case of a public company also to be appointed by the company in general meeting, shall, in default of, and subject to any regulations in the articles of the company.

> Section 161(2) empowers the Board of Directors of a company may, if so, authorised by its articles or by a resolution passed by the company in a general meeting, appoint an alternate director to represent or act for a director during his absence for a period of not less than three months from India.

The expression 'such company' in s. 152(1) obviously refers to 'public company' in ss. (6)(a). In a nutshell, private companies (which are not subsidiaries of public companies) are governed by ss. (2) of s.152 according to which "Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting." There is nothing else in the Act which can come within the expression "otherwise expressly provided in this Act." Thus, private companies have been put at a disadvantage compared to public companies in this regard.

Curiously, while public companies are allowed to appoint one-third of the total number of Directors in any manner and by anyone other than the shareholders in general meetings (as provided in s.152(6) and was pointed out by the Supreme Court in *Oriental Metal* case), private companies are required to appoint all their Directors by the shareholders in general meetings. Thus, private companies have been put at a disadvantage compared to public companies in this regard.

RETIREMENT OF DIRECTORS BY ROTATION: ANALYSIS AND INTERPRETATION OF SECTION 152(6)

The provision with regard to retirement of Directors by rotation, which is in s. 152(6)(a) of the 2013 Act was there in the 1956 Act in s. 255(1) and the provision in s. 152(6)(b) was in s. 255(2). In substance, the provisions in the 2013 Act and the 1956 Act are virtually identical in this regard, the only difference being that s. 152(6)(b) is silent about the appointment of Directors in a private company unlike s. 255(2).

In a nutshell, the consequence of s. 152(6) is as follows:

- In terms of ss. (6)(a)(i), the articles of a public company may provide for the retirement of all Directors at every annual general meeting. But if the articles are silent, at least two-thirds of the total number of Directors (excluding Independent Directors) must be Directors whose period of office is liable to determination by retirement by rotation (means the Directors who are liable to retirement by rotation at annual general meeting).
- In terms of ss. (6)(a)(ii), the Directors liable to retirement shall, save as otherwise expressly provided in this Act, be appointed by the company in general meeting.
- According to clause (b) of ss. (6), the remaining Directors in the case of any such company shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.
- The phrase "the remaining Directors" means the Directors who are not liable to retirement by rotation under clause (a) of ss. (6), i.e. one-third of total number of Directors. Thus, the Directors not liable to retirement by rotation must also be appointed in general meeting unless the articles of the company provide for any other mode of appointment. The expression "in default of, and subject to any regulations in the articles of the company" seek to create an exception. For example, the Articles of Association may provide that the Directors not liable to retirement by rotation shall be appointed by the Board or any other person such as a joint venture partner.

IS A PRIVATE COMPANY REQUIRED TO HAVE DIRECTORS LIABLE TO RETIREMENT BY ROTATION?

The words "a public company" in s. 152(6) are noteworthy. They mean that the requirements under s. 152(6) apply only to a public company. By necessary implication, those words mean that those requirements do not apply to private companies.

The words "public company" clearly indicate that ss. (6) is inapplicable to private companies. Needless to mention, the expression "public company" does include a private company which is a subsidiary of a public company; such

a private company is not a private company but it is a public company [see the definitions of public company and private company in s. 2]. Consequently, the requirements under s. 152(6) are applicable to the private companies that are subsidiaries of public companies, besides the public companies that have been incorporated as public companies, and those requirements are not applicable to private companies that are not subsidiaries of public companies and, therefore, it is not mandatory for these companies to have Directors who are liable to retirement by rotation although they can voluntarily adopt the rotational retirement rule by making a suitable provision in their articles of association; if the articles do not contain any such provision, all Directors of such companies are non-retiring Directors.

It will be noticed that, clause (a) of ss. (6) of s. 152 contains a provision dealing with two different situations. The first situation is dealt with in the words "*Unless the articles provide for the retirement of all Directors at every annual general meeting*". The second situation is dealt with in the words "*not less than two-thirds of the total number of Directors of a public company shall be persons whose period of office is liable to determination by retirement of Directors by rotation.*"

Consequently,

- Firstly, if the articles of a company provide that all Directors of the company shall retire at every annual general meeting, then all Directors have to retire at every annual general meeting, and they hold office up to the date of the following annual general meeting, but they may be reappointed at such meeting; and
- Secondly, if the articles of a company do not provide for the retirement of all Directors at every annual general meeting, then the provision of subclause (i) of clause (a) shall come into play and, as a result, not less than two-thirds of the total number of Directors of a company shall be liable to retirement by rotation at annual general meetings.

To ascertain whether the first or the second of the abovementioned two situations is applicable to a company, one has to necessarily refer to the articles of association of the company. The Articles of a company usually contain the following provision where all Directors are liable to retirement at every annual general meeting:

"All Directors shall retire at the conclusion of every annual general meeting and shall be eligible for re-appointment."

If the articles or a resolution provides for less than one-third of the total number of Directors not liable to retirement, all the remaining Directors shall be liable to retirement. For example, if a company has ten Directors and the articles/ resolution provides for only one director not being liable to retirement, all the remaining nine Directors will be liable to retirement, and out of them one-third (three) will

retire at every annual general meeting. In other words, in the absence of any specific provision regarding one-third of the Directors' non-retirable Directors, all the Directors are liable to retirement and if any provision for less than one-third of Directors being non-retirable exists, all the remaining Directors are liable to retirement.

If a company does not have any specific provision in the articles or in a resolution of the board or shareholders stating that the particular Directors shall not be liable to retirement by rotation (except in the case of managing director), a view may be taken that in the absence of specific provision, all Directors (except managing director) are liable to retire by rotation and one-third of such number should retire at every annual general meeting.

It is therefore desirable to have specified in the articles the Directors not liable to retire by rotation (maximum one-third). This may be done by specifying it in the resolution of the board or of shareholders when a managing/whole-time director is appointed. Alternatively, all Directors (except the managing director) may be made liable for retirement and one-third of such number should retire in accordance with this section.

The words "a public company" in ss. (6) are noteworthy. They mean that the requirements under s. 152(6) apply only to a public company. By necessary implication, they mean that those requirements do not apply to private companies. Under the Companies Act, public company and private company are two distinct types of companies incorporated and they are mutually exclusive. Some of the provisions of the Companies Act do not apply to private companies. By using the words "public company" ss. (6) has been made inapplicable to a private company and made applicable only to public companies.

WHETHER SECTION 160 SHOULD BE COMPLIED WITH BY A PRIVATE COMPANY?

Section 160 (corresponding to s. 257 of the 1956 Act) contains provisions regarding the right of persons other than the retiring Directors to stand for Directorship and provides for the machinery for the election of such persons. It enables any (whether a member of the company or not) person to stand for Directorship at any general meeting and not necessarily only at an annual general meeting.[5]

This section is mandatory for public companies and Articles of Association of a public company cannot make a provision contrary to the section or rendering it ineffective. Section 160 does not apply to private companies which are not subsidiaries of public companies, by virtue of the Notification No. GSR 464(E), dated 5 June, 2015 under s. 462 of the 2013 Act. The precise effect of this exemption is that a private company which is not a subsidiary of a public company, is not required to comply with s. 160 regarding notice in writing by a person who is not a retiring director or by a member intending to propose such person as a director, along with a deposit of one lakh rupees.

5. *Re Motion Pictures Association (1974) 44 Comp Cas 298 (Del).*

APPOINTMENT OF ADDITIONAL DIRECTOR

As per s. 161(1) of the 2013 Act, the articles of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director in a general meeting, as an additional director at any time who shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

This power can be exercised by the Board of a private company, if its Articles contain a specific provision empowering the Board to do this. An additional director so appointed can hold the office until the forthcoming annual general meeting at which the shareholders appoint such a director. However, as discussed earlier, a private company must appoint Directors at general meetings and hence there is no need to appoint a person as an additional director and then appoint him at the forthcoming annual general meeting; instead, the company can appoint a person as director directly at a general meeting, either for a limited tenure or indefinite period of tenure. In other words, there is no need to resort to the provision of appointment of additional Directors. Instead, a private company may appoint a new director directly at a general meeting at any time, without going through the rigmarole of appointment of an additional director and thereafter getting it confirmed at an annual general meeting.

APPOINTMENT OF ALTERNATE DIRECTOR

Section 161(2) empowers the Board of Directors of a company may, if so, authorised by its articles or by a resolution passed by the company in a general meeting, appoint an alternate director to represent or act for a director during his absence for a period of not less than three months from India. An alternate director has a limited tenure, and for a period longer than that permissible to the director in whose place he has been appointed and shall vacate the office if and when the director in whose place he has been appointed returns to India. A private company which is not a subsidiary of a public company may (if its Articles of Association authorise) may resort to this provision whenever an occasion arises.

APPOINTMENT OF DIRECTOR TO FILL CASUAL VACANCY

Section 161(4), provides that if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board which shall be subsequently approved by members in the immediate next general meeting. This provision is similar to an additional director and hence a private company need not adhere to it whenever the company wants to appoint a new director. ❐