Part - II

Key Managerial Personnel: Section 203 of the Companies Act, 2013 - Two Controversial Issues

While section 203 is the key operating provision, the definition in section 2(51) is only to define the meaning of the expression; the term KMP used in first and second proviso to subsection (3) of section 203 will mean nothing but a KMP appointed on whole time basis as per the requirement of that section. In my opinion, the term 'key managerial personnel' wherever it occurs in the Act or Rules must be understood to mean whole-time key managerial personnel.All the KMPs of a listed company and a public company having a minimum paid-up share capital of Rs. 10 crores or more, must be appointed as such only on whole-time basis and such companies are required to comply with section 203 with respect to such appointment; they must also comply with the restrictions stated in that section regarding appointment of KMP of the company as KMP of another company on whole-time basis.

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Issue 1: One individual holding two positions of KMP in one company

PRINCIPAL RULES OF INTERPRETATION OF STATUTES

The first and principal rule of construction of statutes, which is elementary, is that the words used in the section must be given their plain grammatical meaning.[1] This is the 'literal rule' (called the 'golden rule of interpretation') is the basic and cardinal rule of interpretation of statutes, according to which words that are reasonably capable of only one meaning must be given that meaning whatever may be the result. If the words used are capable of one construction only then it would not be open to the Courts to adopt any other hypothetical construction on the ground that such construction is more consistent with the alleged object and policy of the Act.[2]

The intention of the Legislature must be gathered from the words used by the Legislature, for the words declare best the intention. The Legislature might have intended to do a certain thing, but if the words employed do not express that intention, it is not for the courts to assume the role of legislators and give effect to the unexpressed intention. No confusion must be made … between what the draftsman might have intended to do and the effect of the language which in fact was employed by him. If the words, which are a medium of expressing intention, fall short of declaring the intention, it is for the Legislature to amend the language of the section.[3]

However, the literal rule of giving undue importance to grammatical and literal meaning has, of late, gave place to "rule of legislative intent". While interpreting statutory provisions, the courts should keep in mind the objectives or purpose for which statute has been enacted. In several cases, the Supreme Court has applied the principle of purposive construction. A classic exposition of the two rules is the *Sussex Peerage* case.[4] It was said:

"The only rule for the construction of Acts of Parliament is that they should be construed according to the intent of the Parliament which passed the Act. If the words of the statute are in themselves precise and unambiguous, then no more can be necessary than to expound those words in that natural and ordinary sense. The words themselves alone do, in such case, best declare the intention of the lawgiver. *But if any doubt arises from the terms employed by the legislature, it has always been held a safe means of collecting the intention, to call in aid the ground and cause of making the statute….*" [emphasis supplied]

Having regard to the above basic principles of interpretation, let us examine the relevant statutory provisions under the Companies Act 2013 (the Act).

STATUTORY FRAMEWORK

The expression key managerial person is defined in section 2(51) of the Act. Section 203 of the Act, deals with the manner of appointment of a whole time key

1. *Madanlal Fakirchand Dudhediya v Shree Changdeo Sugar Mills Ltd AIR 1962 SUPREME COURT 1543*
2. *Kanailal Sur v. Paramnidhi Sadhu Khan, AIR 1957 SC 907; State of Maharashtra v. Nanded Parbhani Z.L.B.M.V. Operator Sangh 2000 AIR SCW 261.*
3. *Madanlal Fakirchand Dudhediya v Shree Changdeo Sugar Milla Ltd [1958] 28 Comp Cas 312 (Bom).*
4. *(1844) 11 CI&F 85.*

managerial personnel in the companies prescribed under that section. It also lays down the abilities and disabilities in respect of appointment of a whole time Key Managerial Personnel (KMP).

Section 203(1) of the Act states that every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time KMP:

(i) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;

(ii) Company Secretary; and

(iii) Chief Financial Officer.

According to subsection (3), a whole-time KMP shall not hold office in more than one company except in its subsidiary company at the same time.

As per Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have whole-time KMP.

ANALYSIS

While section 203 is the key operating provision, the definition in section 2(51) is only to define the meaning of the expression; the term KMP used in first and second proviso to subsection (3) of section 203 will mean nothing but a KMP appointed on whole time basis as per the requirement of that section. In my opinion, the term 'key managerial personnel' wherever it occurs in the Act or Rules must be understood to mean whole-time key managerial personnel.

All the KMPs of a listed company and a public company having a minimum paid-up share capital of Rs. 10 crores or more, must be appointed as such only on whole-time basis and such companies are required to comply with section 203 with respect to such appointment; they must also comply with the restrictions stated in that section regarding appointment of KMP of the company as KMP of another company on whole-time basis.

CONNOTATION OF THE EXPRESSION 'WHOLE-TIME'

Section 203 requires appointment of 'whole-time' KMP. Let us consider the significance of the expression 'whole-time' and ascertain its true implication. The term 'whole-time' is analogous to 'full-time' and this term has been defined in several dictionaries. The Webster's Third New International Dictionary page 2612 gives the meaning of the words 'whole-time' as full time. The words 'full time' (adj) on page 919 mean employed for or working the amount of time considered customary or standard e. g. full time clerks; involving or operating the amount of time considered customary or standard. e. g. Full time teaching. The Shorter Oxford English Dictionary, 5th Edition page 3633 also gives the meaning of words 'whole time' as full time. According to this dictionary, page 1047, the term 'full time' (adjective) means the total normal working hours. In the American Heritage Dictionary of the English Language, it is defined as employed for involving a standard number of working time. The Advance Law Lexicon by P Ramanatha Aiyar 3rd Edition 2005, page 1945, states 'full time employment' as: long-term employment that entails an employee putting in a full working week.

The expression "whole-time" was considered by the Bombay High Court in the context of whole-time director and it has been held that the expression "whole-time director" must refer to a director who spends his whole-time in the management of the company.[5]

INTERPRETATION OF 'AND'

As noted above, the definition of KMP in section 2(51) specifies in its five clauses, five categories of key managerial personnel and each of them is connected with the next one by 'and' because after each category there is semicolon and clause (v) uses 'and' after the semicolon at its end.

The same pattern of drafting is adopted in section 203(1) as its first two clauses have a semicolon at the end and clause (ii) ends with semicolon and 'and'.

As stated in the Maxwell's Interpretation of Statutes, in ordinary usage, 'and' is conjunctive (that connects words, phrases and clauses in a sentence) and 'or' is disjunctive (that separates words, phrases and clauses in a sentence). Thus 'and' connects two or more items and makes a cumulative group of them whereas 'or' separates two or more items and makes them alternative to one another. Normally the word "and" should be given its ordinary meaning and should be understood in a conjunctive sense.[6]

Conjunctive means serving to connect; connective. Disjunctive means serving or tending to disjoin; separating; dividing; distinguishing. The Supreme Court has held that "and" has generally a cumulative sense, requiring the fulfilment of all the conditions that it joins together and herein it is the antithesis of 'or' Sometimes, however, even in such a connection, it is, by force of a context, read as "or". Sometimes to carry out the intention of the legislature it is found necessary to read the conjunctions "or" and "and" one for the other.[7]

The use of 'and' before clause (vi) in section 2(51) and also before clause (iii) in section 203(1), makes it clear that the five items of the definition and the three items in section 203(1), are cumulative and not alternative. In other words, each of the five categories of key managerial personnel must have an independent individual holding one of these offices and one person cannot hold two or more offices.

5. *Ramaben A Thanawala v Jyoti Ltd. (1957) 27 Comp Cas 105 (Bom)*

6. *Maharaja Sir Pateshwari Prasad Singh v State of Uttar Pradesh [1963] 50 ITR 731 (SC)*

7. *Ishwar Singh Bindra v. State of U.P. AIR 1968 SC 1450.*

The Company Law Committee had recommended in its Report (February 2016) as follows: "At the same time, **the Committee also recommended enabling a whole time key managerial personnel, holding necessary qualifications, to hold more than one position in the same company at the same time,** so as to reduce the cost of compliance for such companies, and also to utilise the capacities of these officers to the optimum level." However, this recommendation of the Committee has not been implemented by inserting an express provision in section 203.

Subsection (3) of section 203 further makes it clear that "A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time". This clearly indicates that a KMP of a company appointed in terms of section 203 cannot hold the office of KMP in any other company to which section 203 is applicable, except that such other company is its subsidiary. The, first proviso to subsection (3) states that nothing contained in this sub-section shall disentitle key managerial personnel from being a director of any company with the permission of the Board.

Section 203 itself provides for some exception to the abovementioned requirement. For example, sub-section (3) provides that a KMP of a company may act as a KMP in a subsidiary of the company at the same time. The first proviso to sub-section (3) states that nothing contained in this sub-section shall disentitle a KMP from being a director of any company with the permission of the Board:

On a combined reading of sub-section (1) and sub-section (3), it is, therefore, clear beyond doubt that, subject to the exceptions provided in section 203 itself, a KMP means a person who devotes the whole of his time for the company of which he/she is a KMP and who cannot work (full-time or part-time) for any other company or do any other profession or vocation, business or any similar activity, even with the permission of his employer.

If section 203(1) is interpreted to mean that one individual can work in the position of more than one category specified in it, then it can go to the extent that one individual can hold the position of KMP all the three categories in one company at the same time. For example, a person who is a Chartered Accountant and also a Company Secretary and is a director of the company can hold the position of Whole-time Director or CEO and also CFO and CS. Such an interpretation would be incongruous and incompatible with the legislative intent.

CLC'S RECOMMENDATION

The Company Law Committee had recommended in its Report (February 2016) as follows:

"At the same time, **the Committee also recommended enabling a whole time key managerial personnel, holding necessary qualifications, to hold more than one position in the same company at the same time**, so as to reduce the cost of compliance for such companies, and also to utilise the capacities of these officers to the optimum level."

However, this recommendation of the Committee has not been implemented by inserting an express provision in section 203.

CONCLUSION

To conclude, although there is no express prohibition under section 203 for one individual to hold two or three KMP positions, there is no express permission either. In such a situation, the statutory provision must be interpreted having regard to the object and purpose of the provision and the legislative intent as discernible from the object and purpose. Therefore, the correct interpretation consonant with the object and purpose of section 203 seems to be that for each of the three categories of KMP, there must be three independent individuals holding any one of the three offices of key managerial personnel. One individual cannot hold more than one position of KMP at the same time. The words 'shall have the following whole-time key managerial personnel' in subsection (1) must be interpreted to mean that there must be three different individuals holding the three different offices and one individual cannot hold more than one office of a KMP.

Issue 2: Whether section 203 applies to Private Companies

As noted above, every company falling within the ambit of section 203 read with Rule 8, is required to appoint a KMP within the meaning of that section in accordance with the requirements of that section, and a company which does not fall within the mandatory requirement of section 203 need not comply with the provisions of the section nor is it necessary to comply with any or all of the provisions of the company if a company voluntarily opts for appointment of a KMP. There is nothing in section 203 requiring compliance by such a company. The definition of KMP cannot be taken to interpret the section requiring such compliance.

From the language of subsection (1) of section 203, it is clear that only those companies which belong to such class or classes of companies as may be prescribed are required to have the whole-time KMP. There is nothing in section 203 to the effect that a private not required to comply with that section must comply with it chooses to voluntarily designate an officer as Chief Financial Officer.

It is against the principle of statutory interpretation to insert any words in a statute. No words can be added in,

or deducted from, a statute. It is a corollary to the general rule of literal construction that nothing is to be added to or taken out from a statute unless there are adequate grounds to justify the inference the legislature intended something which it omitted to express.[8] The intention of the legislature is required to be gathered from the language used and, therefore, a construction, which requires for its support with additional substitution of words or which results in rejection of words as meaningless has to be avoided.[9]

Any company can use the designation Chief Financial Officer for an officer who is the head of financial function of the company. There is nothing in the Act prohibiting its use by a company which is not required to mandatorily appoint a KMP. But by virtue of such designation, that officer does not become key managerial person in terms of section 203 of the Act, nor can he be treated as officer who is in default. But the designation "key managerial personnel" can be used only by a company which is so required to appoint KMP under section 203.

CLASSES OF COMPANIES TO WHICH SECTION 203 APPLIES

While section 203 provides that every company belonging to such class or classes of companies as may be prescribed shall have the KMP, Rule 8 prescribes two classes of companies, i.e. (i) every listed company; and (ii) every other public company having a paid-up share capital of ten crore rupees or more.

8. *Maxwell on the Interpretation of Statutes, 12th edn, page 33*

9. *State of Maharashtra v. Nanded Parbhani Z.L.B.M.V. Operator Sangh 2000 AIR SCW 261.*

Section 2(68) of the Act defined 'private company' and section 2(71) defines 'public company'. The Act clearly distinguishes between public company and private company and the definition of 'public company' specifically states that 'public company means a company which is not a private company'. The three expressions, 'company', 'private company' and 'public company', have been used throughout the Act to signify the intention of the legislature as to the applicability of various provisions to all companies or to only private companies or to only public companies.

The expression 'listed company' is defined in section 2(52) as follows:

"listed company" means a company which has any of its securities listed on any recognised stock exchange: Provided that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies.

Rules 2A of the Companies (Specification of Definitions Details) Rules, 2014 excludes the following classes of companies from the ambit of the definition of 'listed company."

(a) Public companies which have not listed their equity shares on a recognized stock exchange but have listed their–

 (i) Non-convertible debt securities issued on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008; or

(ii) Non-convertible redeemable preference shares issued on private placement basis in terms of SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations 2013; or

(iii) Both categories of (i) and (ii) above.

(b) Private companies which have listed their non-convertible debt securities on private placement basis on a recognized stock exchange in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008;

(c) Public companies which have not listed their equity shares on a recognized stock exchange but whose equity shares are listed on a stock exchange in a jurisdiction as specified in sub-section (3) of section 23 of the Act.

ARE PRIVATE COMPANIES REQUIRED TO APPOINT KMP?

One thing that is conspicuous from Rule 2A of the Companies (Specification of Definitions Details) Rules, 2014, is that its clause (b), excludes from the ambit of 'listed company' private companies which have listed their non-convertible debt securities on private placement basis on a recognized stock exchange in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008.

Private are not eligible to list their equity shares. Thus, none of the private companies falls within the purview of 'listed company'; and it is also not within the purview of 'public company'.

Thus, reading section 203(1) and Rule 8 together clearly indicates that private companies (which are not subsidiaries of public companies) are not obliged to comply with the requirement of mandatory appointment of KMP.

NCLAT'S ORDER IN *HAMLIN TRUST CASE*

Some observations in the NCLAT's order in *Hamlin Trust v LSFIO Rose Investments S.A.R.L.* [2022] 235 Comp Cas 158 (NCLAT) create an impression that a private company voluntarily choosing to designate one of its officers as CFO must comply with section 203. But those observations would seem mainly influenced by a provision in the articles of association of a company and a term in the shareholders' agreement, which had provided in article 140 that "(i) Rose Investments shall, from time to time, have the right to nominate a person to the position of chief financial officer of the company ('CFO'). In the event that the JV partners reject the appointment of such nominee to the position of CFO, Rose Investments shall have the right to nominate another person to the position of CFO."

This case was, in the first instance, decided by the NCLT [*LSF 10 Rose Investment S. A. R. L. v. Rattan India Finance P. Ltd.* [2022] 235 Comp Cas 151 (NCLT)] in which it was submitted to the NCLT that section 203 was not applicable to the company which was a private company. But the NCLT did not dwell upon this point.

In the NCLAT also, it was submitted that section 203 was not applicable to the company being a private company.[10] The NCLAT order also does not contain any meaningful discussion on the point. The NCLAT would seem to have proceeded on the assumption that section 203 was applicable to the company, and only observed:

"… the position of CFO is included as a KMP in sub-section (51) of section 2 of the Act. Section 6 of the Companies Act provides that the provisions of this Act shall override anything to the contrary contained in the memorandum or articles of association of the company. …

Section 203 of the Act lays down that the CFO is a whole-time KMP and is prohibited from holding office in more than one company except in its subsidiary company at the same time. There are other elements of conduct that are provided in the Act as being relevant to the functioning of a KMP….

In the absence of any specific mention regarding eligibility and the method of selection of the CFO in the articles of association, it would be logical to take recourse to section 203 of the Companies Act, 2013 in the selection and appointment of CFO, … even though the *company is a private limited company, and the provisions of the Companies Act, 2013 do not apply thereto, the principles governing the appointment and qualification of the KMP under section 203 can be taken for guidance de hors article 140 of the articles of association of the company.* Thus, we are of the view that the appellants are not precluded from arguing the applicability of section 203 at the stage of appeal."

It will be noticed that the NCLAT's observations on the applicability of section 203 to private companies are ambiguous and confusing. We cannot read anything in section 203 which would have the effect of making the section applicable to a private company when Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014clearly and unambiguously uses the expression 'public company'.

CONCLUSION

Consequently, NCLAT's order needs reconsideration for the sake of clarity and correct interpretation of section 203 read along with the Rules. A private company cannot be brought within the ambit of section 203 by reading the words 'private company' as including public company.

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10. *Hamlin Trust v LSFIO Rose Investments S.A.R.L. [2022] 235 Comp Cas 158 (NCLAT).*