Mandatory requirement of Retirement of Directors by Rotation under Section 152(6) of the Companies Act, 2013: The conundrum that it is especially for listed Entities - A study

The article critically examines the applicability of Section 152(6) of the Companies Act, 2013 with reference to the Section 255 of the erstwhile Companies Act, 1956 and applicable SEBI LODR regulations on appointment, rotation and retirement of various categories of Directors supported with case laws.

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INTRODUCTION

Section 152(6) of the Companies Act, 2013 (hereinafter referred to as "The Act") has five limbs to it in the form of clauses (a) to (e) and postulates primarily on the need for public companies to fall in line with the requirement of ensuring a Board structure in terms of which not less than two-thirds of the total directors shall be liable to retire by rotation of which one-third shall retire at every Annual General Meeting (AGM).

The above sub-section corresponds to Section 255(1) and (2) of the earlier Companies Act, 1956 and encapsulates substantially the major ingredients in the said Act except for the subtle difference that whereas Section 255(1) of the earlier Act applied to public companies as also to private companies which were subsidiaries of public companies, Section 152(6) applies only to public companies which, by operation of law include private companies which are subsidiaries of public companies as per the law stated in Section 2(71).

It is pertinent to note that under the aegis of the earlier Act, it was held in *Swapan Dasgupta v Navin Chand Suchanti*[1] that when a private company is converted into a public company, the provisions relating to rotation of directors shall automatically become applicable to it upon such conversion.

Therefore, if anything, the change in the sub-section in the Act is only cosmetic and the provisions in Section 255(1) have simply been split into separate clauses yielding to better optics.

SUB-SECTION IS MANDATORY IN APPLICATION

The standard rule applied in statutory interpretation is that whenever an enactment makes use of the expression "shall", it is considered to be a mandatory provision whereas any provision which uses the expression "may" is considered as being only persuasive or discretionary in application.

The Supreme Court observed in *Sainik Motors v State of Rajasthan*[2] that the word "shall" is ordinarily mandatory but sometimes depending upon the intention behind the insert in the law, it may not be so interpreted. The word "shall" is not always obligatory and on occasions it may be deemed to be directory in nature. Notwithstanding the above, having regard to the intent in the law that directors should not be allowed morally to continue for indeterminate lengths of time, it is fair to consider that the sub-section is mandatory in application since it espouses the need for a certain number of directors belonging to a certain category to retire through the process of rotation at every AGM.

CLAUSE (A) IN SUB-SECTION

It contemplates that the Articles could provide for retirement of all the directors.

The Articles of a public company could provide for the retirement of all the directors at every AGM. The existence of such a provision in the articles shall not make the articles inconsistent with the provisions of the Act. In the case of such an insert in the articles, a situation may so arise that no director may remain in office at the AGM. In such a scenario, the members shall be authorized to make fresh appointments.[3]

Having said this, in as much as a provision mandating that all directors shall retire at every AGM could lead to administrative issues as also make the Articles unwieldy as the Board could have executive directors who would hold office for definitive periods, the sub-section provides to

1. *(1988)(64 Comp Cas 562)*

2. *(AIR 1961 at page 1480)*

3. *(Re:Consolidated Nickel Motors Ltd.(1914)(1Ch.883).*

public companies, the facility of identifying for retirement by rotation only two-thirds of the total number of directors of which one-third shall retire at every AGM.

SUB-CLAUSE (II) UNDER SUB-SECTION 6(A)

It provides an exception to the principle that every director shall be appointed in a General meeting.

The above sub-clause is a reiteration of what Section 152(2) postulates. If the Act were to provide that every director would be appointed only at a general meeting, it could prove to be dysfunctional in practice in that the Board would not have the liberty to reinforce its strength by appointing directors in times of urgent need or to fill up a casual vacancy on the Board or to appoint Alternate directors without going through the rigmarole of seeking sanction of members for every appointment.

It is only pursuant to the gateway provided under Section 152(2) and sub-clause (ii) under sub-section (6)(a), that the Board is able to take recourse to the appointment of directors to tide over exigencies as provided in Section 161, subject, however, to regularization of such appointments subsequently by members of the company in the manner laid down in Section 160.

SUB-CLAUSE (C) UNDER SECTION 152(6)

One-third of the Directors liable to retire shall retire at every AGM.

Sub-clause (c) under Section 152(6) makes it imperative that one-third out of the directors who are liable to retire by rotation shall retire at every AGM and if their number is neither three nor a multiple of three, the number nearest to one-third shall retire from office.

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It follows from the above that if the articles of the company provides that one-third of the directors for the time being or if their number is not three, then the number nearest to one-third shall retire, one of the two directors in the Board should retire at the AGM as held in *B.N. Vishwanathan v Tiffin's Barytes Asbestos & Paints Limited*[4]. The above ruling makes it clear that if, in a given situation, the number of directors liable to retire is neither three nor nearest to three, the number nearest to one-third shall retire.

The above sub-clause (c) as referred to above also has the consequence of negating the ruling made by the Delhi HC in *Shrimati Jain v Delhi flour Mills Co.Ltd (1974)*[5] where the Court held that where the Articles of the company provided that out of the total number of directors, two directors shall retire every year, in a particular year where there were only two directors in office in the company, neither of them shall retire. The above decision must be considered as *per incuriam* in the face of the mandatory force of Section 152(6) of the Act as also the erstwhile provisions in Section 255 of the previous Act[6].

[4] *(23 Comp Cas 29)(1953)*
[5] *(44 Comp Cas 228)*
[6] *The Companies Act, 1956*

DETERMINATION OF DIRECTORS LIABLE TO RETIRE BY ROTATION

Clause(d) under Section 152(6) stipulates that directors who shall be liable to retire by rotation at the AGM shall be those who have been longest in office since their last appointment. As between directors who have become directors on the same date, the convention is to decide, subject to any agreement between themselves, by drawing lots.

ADDITIONAL DIRECTOR

An Additional Director appointed by the Board is not to be considered as a retiring director.

Subject to the existence of enabling provisions in the Articles, as contemplated under section 161(1), the Board is empowered to appoint as Additional director, a person who has not failed to get appointed as director in a general meeting. The Additional director holds office until the next AGM and in view of this, he cannot be considered as one who is liable to retire by rotation. Admittedly, after his appointment is regularized at the AGM, the director may become liable to retire if he belongs to the category of directors who are liable to retire. The above view is consistent with the ruling given in *Eyre v Milton Proprietary Ltd*[7].

COMPLIANCE WITH THE REQUIREMENT OF COMPULSORY ROTATION

It has been rendered arduous in the face of other changes in the Act and the evolution of Regulations pertaining to listed companies.

It is pertinent to note that the Act has for the first time in the annals of corporate law in this country ushered in the need to appoint independent directors. Section 149(4) provides that every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe in terms of Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the minimum number of independent directors in the case of any class or classes of public companies.

An independent director, in terms of sub-section (6) of Section 149 shall, *inter alia*, mean a director other than a managing director or a whole-time director or a nominee director. In addition, he cannot be the promoter of the company or its holding, subsidiary or associate company and shall not also be a relative of the promoters of the company, holding/subsidiary or associate company.

Over and above the above attributes, the independent director must satisfy the long list of attributes set out in the above sub-section which are extraneous for this discussion.

[7] *(1936)(2 Ch.244).*

An Independent director shall have a fixed tenure of office and as amplified by sub-section (11) of Section 149 he can be appointed for a term up to five consecutive years on the Board and shall, *ceteris paribus,* be entitled to a second term subject to the re-appointment being approved by special resolution.

Rule 4 of the Companies (Appointment of Directors) Rules, 2014 mandates that in the case of an unlisted public company which satisfies the financial thresholds stated therein, there shall be a minimum of two independent directors.

Given that the independent directors hold office for a specified period it goes without saying that they shall not be considered as being liable to retire by rotation as contemplated under Section 152(6), notwithstanding that they can only hold a non-executive position in the company.

The above position has also been made abundantly clear by the Explanation under Section 152(6) which stipulates that the "total number of directors" shall not include independent directors appointed under the Act or under any other legislation.

STATUS OF AN INSTITUTIONAL NOMINEE DIRECTOR

Whether he can be considered for retirement by rotation.

Explanation under Section 149(7) defines a Nominee director to mean a director nominated by any financial Institution in pursuance of any law for the time being in force, or of any agreement or appointed by any Government or any other person to represent its interests.

Sub-section (3) under Section 161 facilitates the appointment of a nominee director nominated by any Institution or in terms of an agreement or by the Central Government subject to existence of enabling provisions in the company's Articles.

A Nominee director, again being one who does not hold an executive position in the Board, is theoretically liable to be considered as one who retires by rotation, although the interplay between the Act and the legislation in terms of which he is nominated by the financial institution does raise a pertinent question on which we need to ponder-whether he can be considered as one liable to retire by rotation as contemplated under Section 152(6)?

LEGISLATION UNDER WHICH INSTITUTIONAL NOMINEE IS APPOINTED

It carries greater precedence over the Act. Where a person is nominated by a public financial institution based on the strength of the legislation under which it has been set up, the Nominee holds office at the pleasure of the Institution and he can be removed or substituted by another institution based only on the decision of the appointing Institution.

A nominee's appointment on the Board is simultaneous with the decision of the Institution to appoint him and there is no need for his co-option on the Board. Reference may be made on this point to the decision in *British Murac Syndicate Ltd v Alperton Rubber Co. Ltd*[8].

In addition, the special legislation under which the person is nominated, the Nominee is also subject to indemnity by the Institution against losses if any, sustained by him in the discharge of his duties except where such losses are attributable to his own neglect.

It is also a settled position in the law that when there is a conflict between a special provision and a general provision on some aspect, the general provision must yield to the specific provision.

The above principle has been elaborated by the Supreme Court *in J.K. Cotton Spinning and Weaving Mills Co. Ltd v State of U.P*[9].

The above construct in the law finds its origin in the Latin maxim-*generalia specialibus non derogant,* i.e, the general law yields to special law should they operate in the same field on some subject.

Thus, one can say with authority that Institutional nominees appointed as directors on Boards under special statutes cannot be considered for retirement by rotation. However, where such nomination flows through an agreement, it can be forcefully argued that the nominee may be considered for retirement since an agreement, albeit being binding on the company, cannot conceivably carry greater precedence over the Act.

DIRECTOR APPOINTED TO REPRESENT SMALL SHAREHOLDERS IS AN INDEPENDENT DIRECTOR UNDER SECTION 151-A PARADOX

In the case of listed companies, small shareholders (those who hold shares for a nominal value not exceeding a face value of Rupees Twenty thousand) are allowed the liberty to appoint as their representative on the Board subject to compliance with the requirements of Rule 7 of the Companies (appointment And Qualification Of Directors) Rules, 2014. The person so appointed is considered as an independent director, albeit, with a reduced term not exceeding three years and he shall protect the interests of the minority whilst in office.

It is paradoxical that whereas the representative of the small shareholders is an independent director under the Act, the institutional nominee on the Board is not considered as independent even though he too is representing the constituency of a particular stakeholder. He ought to have been also considered independent.

8. *(1915)(2Ch.186).*
9. *(AIR 1961 SC 1170).*

Be that as it may, the small shareholder director cannot be reckoned for the purposes of computing the number subject to retirement.

BOARD COMPOSITION REQUIRED UNDER SEBI LISTING REGULATIONS

Regulation 17 of the SEBI (LODR)Regulations, 2015 contemplates that the Board of a listed company shall have an optimum combination of executive and non-executive directors with at least one woman director who shall be independent in the case of the top 1000 listed companies based on their market cap and not less than fifty percent of the Board shall comprise of non-executive directors.

Where the chairperson is a non-executive director, at least one third of the Board shall be independent. Where the chairperson belongs to the category of promoters or related to the promoters one half of the Board shall comprise of independent directors.

The above structure does not provide much elbow room for a listed company to structure its Board such that it answers to the requirement of having the required number of directors liable to retire as provided in section 152(6).

Besides, the Board necessarily must have a Managing Director who has to be the CEO as per the Regulations and since they are appointed for a specified time duration, they too are not normally subject to retirement during their tenure although there is nothing in the law which prevents them from being considered for retirement by rotation during their time duration.

Further if one adds to the above mix, nominee directors of institutions who cannot be considered for retirement due to reasons explained above, the Company Secretary would be at his wit's end while trying to balance the requirements of the listing regulations and Section 152(6).

More often than not, it is found that the Board composition falls short of the "two-thirds liable to retire" formula prescribed under the Act.

It is pertinent to note that the maximum size of the Board as per Section 149(1) is fifteen and if that number has to be exceeded, the shareholders will have to provide their approval through special resolution. Having a fifteen-member Board itself could make it "top heavy". To satisfy the Section 152(6) requirements, Boards may have to be enlarged to have the required condiment of directors liable to retire by rotation.

Failure to comply with the requirements of Section 152(6) brings with it the unsavory prospect of the company and its directors being saddled with penalty proceedings under Section 159. Hence listed companies should not fall foul of Section 152(6).

Having said this, with the Board structure having to answer the prescription under Regulation 17 and Section 152(6) as well, balancing it appropriately becomes a veritable "tight rope walk" for the Company Secretary.

Consider typically the scenario in a listed company which has a promoter non-executive chairperson, as is the case with most companies in India. It follows that 50% of them shall comprise of Independent directors. In addition there is requirement of an Executive Director/CEO who is normally not subject to retirement during his tenure. To this mix, if we throw in a sprinkle of institutional nominees, one would end up with a deadly concoction which would hardly pass muster under Section 152(6). If the Board has say 12 Directors, 50% being independent, the balance 6 alone would be the ones liable to retire by rotation which by itself falls short of the requirement under Section 152(6)(a) that two-thirds of the total number of directors shall be those that will be liable to retire by rotation.

The fact that the Explanation under Section 152 provides that for the purposes of this Section and Section 160, the expression "retiring directors" means a director retiring by rotation implies that the 2/3rd proportion shall have to be calculated with reference to those who are liable to retire and not based on the total number of directors on the Board as Section 152(6)(a) postulates. Hence in the above example, apart from the 6 Independent Directors, if one assumes that there is a single institutional nominee, he too would not be subject to retirement. That leaves us with five of which the Managing Director could be eliminated from rotation due to his tenure. Thus, only out of the total 12 directors, potentially only four would be retiring directors of which one-third namely only one being longest in office would retire at every AGM.

The above position is contrary to what Section 152(6)(a) propagates and the knives could well be sharpened by the Regulators for launch of penal proceedings under Section 159.

Many of the Proxy Advisory Agencies, it has been observed in practice are oblivious to the compulsions that go into the mechanism of a Board structure of a listed company and point out in their advisory to the voting public about companies not being in line with the requirements of Section 152(6)(a). This observation opens up a veritable pandora's box. The way out of this predicament for listed companies is to enlarge the Board further providing for more non-executive directors while being conscious of the need to have the optimum number of independent directors.

CONCLUSION

From the above discussion one can say that for listed companies there is a catch-22 situation under which they cannot compromise either on the requirements under the Act or under the listing regulations. The only way by which this embroglio can be broken is to have a softer regime for listed companies under Section 152 providing for a lesser proportion of directors to retire by rotation. Otherwise, the struggle to balance the requirements under the Act and the Listing Regulations shall continue unabated.

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