THE POSITION OF DIRECTORS UNDER THE COMPANIES ACT

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"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black
President, World Bank

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BY K. VENKOBA RAO*

THE Companies Act has given a very illuminating definition of a 'director' as including "one who occupies the position of director". This is something like saying a crow is a thing which is usually known as a crow. A director directs and the executives obey. But where there are managing agents, it is doubtful whether directors direct in the real sense. Adopting the analogy of politics, the shareholders are both the electorate as well as the legislature. They are the electorate which elects the directors, and they are the legislature because they debate the conduct of the directors and pass resolutions. The directors are something like a President and also a cabinet. The board is a president because it is directly elected by the shareholders and not appointed by the leader of the majority party in the legislature. It is like a cabinet because it can be removed by the shareholders at any time. A wag has improved upon the definition of managing director in the Companies Act and defined him as one who just manages to direct.

CONSTITUTION OF THE BOARD OF DIRECTORS

After the Amendment Act of 1960, every public company must have at least three directors and every private company at least two directors. Before the Amendment Act, private companies which were subsidiaries of public companies were required to have three directors. Now they need have only two. This Section (252) may cause some difficulty in its application to *deemed public companies* which have been created by the Amendment Act. Under Section 43A(new), where not less than 25 per cent of the

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paid-up capital of a private company is held by one or more private companies, then, subject to certain exceptions, the former is deemed to be a public company. Suppose a deemed public company has only two members, as it might well have, it cannot comply with the provision as to three minimum directors especially if the articles prescribe a share qualification for directors. Mr. Sargant Florence has, in his recent book, *Ownership, Control & Success of Large Companies*, done research into the size of boards of English companies. His conclusions are as follows: Industries making products for other industries like engineering, textiles, paper and, above all, chemicals have large boards. The larger size of the chemical companies' boards may be due to the need of scientists as directors. But the main feature to be noticed is the relative infrequency, generally, of large boards of industrial and commercial companies (Imperial Chemicals had, in 1951, 18 directors and Courtaulds also 18) compared to that of insurance companies, banks (Lloyds Bank had 33 directors in 1951).

Section 255* lays down that in the case of public companies and private companies which are subsidiaries of public companies, not less than two-thirds of the directors shall be liable to retire by rotation; that is, they must be non-permanent directors. This section unlike Section 256 does not say that if the number is not three or a multiple of three, the number nearest to three must be taken. So if Section 255 is strictly construed, if there are 8 directors, 5 1/3 directors must retire by rotation! It is interesting to note that section 287 dealing with quorum adopts a different method for rounding off fractions. Under that section, the number nearest to one-third is not taken, but the fraction contained in one-third is rounded off as one. If there are 8 directors, the number liable to retire will, under S. 255, be 5 applying the rule of Section 256 to Section 255 and the quorum will be 3. Out of the directors liable to retire, one-third must retire at each annual meeting. Thus,

*All references are to the Companies Act 1956 unless the context requires otherwise.

if the strength of the board is 9, six must be liable to retire by rotation and out of the these six, 2 will retire each year. If the place of the retiring director is not filled up at the annual meeting, the meeting is adjourned to the same day the next week and, if at that meeting also, the place of the retiring director is not filled up and the meeting has also not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed unless he is unwilling to act etc. A curious situation will arise if the annual meeting is not held for three or four years. In *Inre Pasari Flour Mills* (AIR 1961 MP 340) Shiv Dayal J has held that in such circumstances there will be no retirement of directors because no annual meeting has been held. Alternatively, they continue in office because of the deeming provision contained in Section 256 (4). It is submitted that if an annual meeting is not held, Section 256 cannot possibly apply, because the section says "at every annual meeting". No doubt Section 159 (1) Explanation defines the date of the annual meeting as the latest day on or before which it should have been held, that is, within six months of the end of the financial year, but this is only a fiction relating to the date of the annual meeting which is different from the actual holding of the meeting to which Section 256 refers. Section 256 (2) says "at every annual meeting" and not "on the date of every annual meeting".

Sections 256, 264 and 266 contain a number of restrictions on the appointment of directors. While Sections 256 and 264 apply to public companies and subsidiary private companies (that is, private companies which are subsidiaries of public companies), Section 266 applies only to public companies. Non-rotational directors must leave at the office of the company notice in writing signifying their candidature not less than 14 days before the meeting; or a member must leave a similar notice proposing their candidature. The company must serve individual notice on members of such candidature; this can also be done by advertising in one English and one language newspaper circulating in the place where the registered office is located.

The provision relating to newspaper advertisement was added by the Amendment Act. A non-rotational director had to file with the Registrar his consent to act as director before the Amendment Act, which has now fixed a time-limit of 30 days after apppointment for filing of such consent. Rotational directors have to file their consent to act as directors with the company. A person shall not, according to Section 266, be named in the articles or prospectus as director unless he has signed and filed with the Registrar a consent in writing to act as director and has taken his qualification shares, if any, or filed with the Registrar an undertaking in writing to take and pay for qualification shares, if any, etc.

KINDS OF DIRECTORS

In *Judah* v *Ramapada Gupta* (AIR 1959 Cal 715) *Mullick* J has distinguished *defacto* directors from usurpers. A *defacto* director is one whose appointment is defective, for example, because he does not have a share qualification, and has to be distinguished from a usurper without any appointment whatsoever. The definition of "director" in Section 2(13) as one who occupies the position of director by whatever name called adds to the difficulty of interpretation. "Occupies the position" — is it lawfully or otherwise? If the latter interpretation were correct, even a usurper who is functioning as a director would be a director within the Act. In some sections like 303 or 307 any person in accordance with whose directions or instructions the board is accustomed to act shall be deemed to be a director of the company. Thus, the chairman of the holding company would, by virtue of this provision, be deemed to be a director of the subsidiary company. While co-opted directors hold office only up to the date of the next annual meeting, directors appointed to fill a casual vacancy, that is, one caused by death, resignation, etc., hold office up to the date up to which the director in whose place they are appointed would have held office. If authorised by the articles, a company can appoint an alternate director to act for

a director during the latter's absence for not less than there months. The alternate director automatically vacates office on the expiry of the term of the original director even if the latter has not returned. This has been clarified by the Amendment Act. A managing director is a director who is entrusted with substantial powers of management.

RESTRICTIONS ON APPOINTMENT OF DIRECTORS

A person cannot hold office as director in more than 20 companies. Private companies which are neither subsidiary nor holding companies of public companies, unlimited companies, associations not carrying on business for profit, etc. are excluded from this computation. If a person is appointed as director in contravention of these provisions, he can choose which of these directorships he shall vacate so as to conform to these provisions. A person who has attained 65 years cannot be appointed as director of a public company or a subsidiary private company unless a resolution is passed by the company in general meeting exempting him from the age limit. A person already appointed as director vacates office on attaining 65 years. By the Amendment Act such a director need not vacate his office within a period of three years after his appointment merely on the ground that he has attained that age within that period.

A person cannot be appointed director if he is of unsound mind, or an undischarged insolvent, or has been convicted by a court whether in India or elsewhere (this amendment was made by the Amendment Act; formerly only conviction by an Indian court was a disqualification) of any offence involving moral turpitude and sentenced to imprisonment for not less than six months, or has not paid calls, etc. A director has to obtain share qualification, if any, fixed by the company within two months after his appointment. The nominal value of the qualification cannot exceed Rs. 5,000 or the value of one share where it exceeds

Rs. 5,000. Declaration of share qualification has to be filed by the director with the Registrar within two months after his appointment. This provision does not apply to private non-subsidiary companies. Section 408(4), added by the Amendment Act, provides that where the Government appoints directors to prevent oppression or mismanagement, such Government directors need not hold any qualification shares. Directors of Government companies are not exempted from the requirement as to holding qualification shares, and this may cause difficulties especially as the directorships in such companies change frequently due to the transfers of officers. At least where senior officials of a company are promoted to directorships, the requirement as to share qualification should be waived so as to infuse the confidence in every company corporal that he can aspire to the field marshal's baton without any impediment being placed in the way.

VACATION OF OFFICE & REMOVAL

A director vacates office if he is of unsound mind, is adjudged insolvent, fails to obtain qualification shares, fails to pay calls, absents himself from three consecutive meetings of the board, accepts a loan from the company, is convicted of an offence involving moral turpitude and sentenced to imprisonment for not less than six months, or fails to disclose his interest in contracts etc., or he is removed from office etc. Acting as a director after vacating office is a costly luxury because a penalty up to Rs. 500 per day is fixed by subsection (2A) of section 283 added by the Amendment Act. But in order to attract the penal provision, the director must know that his office has been vacated. Special notice, that is, notice of not less than fourteen days before the meeting, must be given to the company by a member who moves a resolution for removing a director. The company then gives notice of that resolution to the members not less than seven days before the meeting. The director concerned may make representations which shall be notified to the members by the Company unless they contain de-

famatory matter. A company can remove a director by an ordinary resolution. A director who is removed does not lose his claim for compensation payable to him in respect of such termination of office.

When a person who is a managing director is removed from directorship by the general meeting, the question arises whether he is entitled to damages for breach of agreement of managing directorship. This depends on the articles of the company. If there is an article on the lines of Regulation 68 of Table A of the English Companies Act 1929: "His appointment shall be automatically determined if he cease from any cause to be a director, or if the company in general meeting resolve that his tenure of the office of managing director be determined," the service agreement must be deemed to be subject to the overriding provision for lawful determination contained in the article. This was decided in *Read* v *Astoria Garage* (*Streatham*) *Ltd.* (1952) (I All E R 922). The Court of Appeal in (1952) Ch 637 (CA) affirmed this decision though on a different ground, namely, that as the agreement was an informal one based on a board resolution not specifying the terms, it must be deemed to be on the terms of the articles with such duration as is provided for therein. This means that if article 68 (corresponding to Regulation 107 of the English Companies Act 1948) has been adopted, service agreements are hardly worth the paper on which they are written on. The managing director can walk out after resigning his directorship, and the company can sack him by ordinary resolution, without, in either case, any claim for damages arising. In well-drawn articles, this point is met by amending the wording so as to make it clear that cessation of office on ceasing to be a director is subject to the terms of any agreement. Having regard to the express provision contained in Section 184 (6) of the English Act of 1948 [corresponding to our Section 284 (7)] that removal from directorship shall not deprive a person of any damages payable to him in respect of termination of any appointment terminating with that as director, it seems probable that it was an oversight

on the part of the draftsman not to amend Regulation 107 in this way. Curiously enough, our Act contains no articles relating to managing directors in Table A. But it is open to an Indian company to adopt Regulation 107 of the English Act 1948. Since Section 9 of our Act gives the Act an overriding effect over the articles, even if an article does not expressly lay down that cessation of office is subject to the terms of any agreement this result will follow from the operation of Section 284(7) which has an overriding effect, and which expressly lays down that the cessation of office is to be subject to the terms of the service agreement. It is significant that Section 284(7) says "compensation or damage" and not "compensation or damage, if any".

POWERS & FUNCTIONS OF DIRECTORS

The main activities of the Board are:—(1) Deciding the rate of dividend, (2) Proposing new capital structure such as issue of shares on the market, bonus shares, preference shares, or debentures after following the procedure of the Act; (3) Reviewing and checking up on the work of the management as the trustee of the shareholders; (4) Asking discerning questions of the management; (5) Forming a link between companies by interlocking, that is, by holding directorships in more than one company; (6) Appointing and dismissing the top managers, determining their salaries and other emoluments ; (7) Organising new, or closing or adapting, old posts at the top of the management structure; (8) Deciding on general lines of policy such as what to make, how much of it, and at what price, with what investment. All the board can do, meeting as it does only at intervals, is to order continuation or change in the direction of the ship of business from time to time. The board, according to Section 291, can do all things which the company can do except those which are required to be done only by the general meeting by the Act.

The list of powers of the general meeting is a long one. Sections 22, 61, 79, 94, 98 are examples. The general meet-

ing can also give directions to the board. The board of directors of a public company, or a private subsidiary company, cannot do the following things without the consent of the general meeting :— (1) Selling, leasing etc. the whole or substantially the whole of the undertaking of the company (2) Remitting or giving time for the payment of a debt due by a director. But according to an amendment introduced by the Amendment Act, renewal or continuance of an advance made by a banking company to its director in the ordinary course of business is outside this subclause, (3) Investing otherwise than in trust securities the compensation received by the company in respect of the compulsory acquisition of the undertaking of the company (4) Borrowing moneys, where the moneys to be borrowed, together with the moneys already borrowed, will exceed the aggregate of the paid-up capital of the company and its free reserves. Temporary loans like cash credit arrangements, discounting of bills, etc are outside the above restrictions. The limits of borrowing have also to be fixed by the shareholders' resolution under the Amendment Act (5) Contributing to charitable and other funds not directly relating to the business of the company, amounts the aggregate of which will in any financial year exceed Rs. 25,000, or five percent of the average net profits during the immediately preceding three financial years, whichever is greater. According to new Section 293A, added by the Amendment Act, even the general meeting cannot authorise the contribution to the funds of political parties, or for any political purpose, of an amount in excess of Rs. 25,000 or five percent of the average net profits for the immediately preceding three financial years, whichever is greater. The limits up to which contributions can be made to charitable and other funds have also to be fixed by the general meeting under the Amending Act. If the average net profits of a company are less than Rs. 25,000, it is the practice with some companies to pass a resolution authorising contribution of total sum of, say, Rs. 50,000 out of which Rs. 25,000 were to be earmarked for contributions to political parties. It is doubtful whether contributions to political parties and other contributions can be clubbed together

in one resolution having regard to the fact that there are two separate sections, 293 and 293A, dealing with these two different types of contributions. The effect of the Amendment Act is practically to bring contributions to political parties within the ambit of board resolutions and to require shareholders' resolution for contributions to charity in excess of Rs. 25,000 etc. The contributions made to political parties have to be disclosed in the profit and loss account giving particulars of the total amount contributed, and the name of the party. The public is interested more in the total contributions made to various parties rather than in the individual contributions. This information can be got only by perusing the profit and loss accounts of all the companies throughout India, and it is a safe bet that no one will have the patience to do this laborious piece of research. Unless these political contributions are banned, and simultaneously the election law is tightened up, the prospect for real democracy in this country will indeed be very bleak.

BOARD MEETINGS

A board meeting shall be held at least once in every three calendar months, and not more than two months shall intervene between the last day of the calendar month in which such meeting is held and the date of the next meeting. There is nothing very mysterious about this provision which has been rendered complicated by the interpretation, or rather mis-interpretation, at the hands of some. This misinterpretation arises from the notion that company law must always be complicated and can never be simple. Since Section 285 says "not more than two months", it is implied that two months can elapse between two board meetings. If a meeting is held on 31st January another can be held on 31st March. The most sensible interpretation would be to hold that if a meeting is held on 25th August, another meeting can be held before 25th November and at least four meetings should be held in a year.

The quorum for a board meeting is one-third of its total strength, or two directors, whichever is higher. For

calculating one-third, fractions are rounded off as one. Where the number of interested directors is equal to or exceeds two-thirds of the total strength, the number of remaining directors who are not interested and are present at the meeting, being not less than two, shall be the quorum. If the total strength is 9 and if 6 directors are interested, two of the non-interested directors present at the meeting can form a quorum. If there is no quorum, as per Section 288, the meeting is adjourned to the same day in the next week, or if that is a public holiday, till the next succeeding day which is not a public holiday. The articles can, however, provide that if there is no quorum the meeting shall stand dissolved, or that those present shall form the quorum at the adjourned meeting. There is no provision corresponding to our Section 288 either in the English Act of 1948 or in Table A of that Act. The reason is that as compared with meetings of shareholders, it is easy to convene board meetings and, therefore, the provision that if there is no quorum the meeting will stand dissolved will not cause any hardship.

As regards general meetings, if there is no quorum the meeting stands dissolved if convened upon the requisition of members, and in other cases it stands adjourned to the same day in the next week as per Section 174. If at the adjourned meeting there is no quorum, the members present form the quorum. Section 288, on the other hand, does not tell us what is to happen if at the adjourned board meeting there is no quorum. Because of the absence of a provision in the section corresponding to Section 174(5), it can be presumed that the intention is that the adjourned meeting shall stand dissolved in such cases unless the articles provide that those present shall form the quorum. Resolutions can be passed by circulation by circulating the resolution in draft together with necessary papers to all the directors in India, not being less in number than the quorum and to all the other directors at their usual address in India, and obtaining the approval of such of the directors as are then in India, or of a majority of such of them as are en-

titled to vote on the resolution. Certain powers of the board cannot be exercised by circular resolutions. They are: Making of calls; issuing debentures; borrowing money otherwise than on debentures; investing the funds of the company; making loans. The Amendment Act has now permitted the power to borrow, to make loans, and to invest to be delegated to a committee of the board, the managing agent, managing director etc. It has also excluded from the operation of the section acceptance of money on deposit by a banking company in the ordinary course of business, or placing of money on deposit by one banking company with another banking company, loans by one banking company to another banking company or by the Reserve Bank, State Bank etc. to a banking company. "Borrowing", it has been clarified by the Amendment Act, means only the arrangement between the company and its bankers for overdraft and not the actual day-to-day operation of the overdraft. Disclosure of director's interest in contract (Section 299), disclosure of director's shareholding (Section 308), appointment of managing director in more than one company (Section 316) are some other examples of matters which cannot be dealt with by circular resolutions and which require a board meeting.

Minutes of board and committee meetings must be kept by making, within fourteen days of the conclusion of the meeting, entries thereof in books kept for the purpose and consecutively numbered. The Amendment Act has prohibited typewritten minutes which are affixed to the minutes book by pasting. Minutes should now be handwritten. Each page of the minutes book should be initialled, and the last page signed and dated, by the chairman of the meeting, or the chairman of the next succeeding meeting. The chairman of the meeting is given absolute discretion to prevent inclusion of defamatory, irrelevant etc. matter. According to the strict letter of the law, the chairman and the secretary can finalise the minutes and the former can sign it within fourteen days of the meeting. The current practice of circulating the minutes and confirming it at the next meeting is an anachronism and not warranted by the terms

of the Amended Act. Acts done by a director are valid notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification, or had terminated by virtue of any provision contained in the Act or in the articles. But there is a distinction between a defective appointment and no appointment. For example, if there is no meeting and the minutes of a purported meeting at which the director is appointed are a forgery, this is a mere nullity and not a defective appointment, and the acts of such a director will not be valid (*Morris* v *Kanssen* 1946 AC 459).

DISABILITIES OF DIRECTORS

Except with the previous approval of the Central Government, no public company or a subsidiary private company shall directly or indirectly make a loan or give a guarantee in connection with a loan, to any director, firm in which such director is partner, private company of which such a director is a director or member etc. Loans guaranteed by banking companies, by managing agents to the companies managed by them, and by holding companies to their subsidiaries are exempted from the operation of the section (Section 295). The borrower is punished with a fine which may extend to Rs. 5,000, or imprisonment for a term up to six months, if the loan is made in contravention of the section. But the section is silent as to whether such a loan can be recovered by the company. After all a loan in contravention of Section 295 cannot be worse than an *ultra vires* transaction and, in respect of *ultra vires* transactions, it has been held in *Sinclair* v *Brougham* (1914 AC 398) that money paid to a company for the purchase of land which the company had no power to sell can be recovered from the company. The implied promise to pay such an amount would form no part but would be merely collateral to the *ultra vires* contract. A similar principle can be applied to uphold the recoverability of loans made in contravention of Section 295. This section says that the company shall not lend to any other company not less than 25 per cent

of whose total voting power is controlled by the directors of the former company without the previous approval of the Central Government. If the managed company satisfies this condition, the managing agency company cannot make a loan to the managed company. But sub-section 2 exempts loans by managing agents to companies managed by them. Such a loan would also require a special resolution under Section 360 which deals with contracts between a company and its managing agent for the supply of services other than that of the managing agent. The Department has held that loans also amount to supply of services. In such a case as that stated above, there is a conflict between the two sections, Section 360 requiring a special resolution and Section 295 exempting the loan. Section 295, it may be noted saves sub-section (2) of that Section and other sections. Section 295 does not open with the words "subject to the provisions of the Act". The inference is that if a loan is exempted under Section 295, it need not comply with any other section.

Sections 297, 299 and 300 deal with contracts in which the directors are interested. While Sections 297 and 299 apply to all companies, Section 300 applies only to public companies and private companies which are subsidiaries or holding companies of public companies. Section 297 provides that except with the consent of the board, a director, his relative, firm in which such director or relative is partner, any other partner in such firm, and any private company in which the director is a director or member, shall not enter into a contract with a company for the sale, purchase or supply of goods or services, or underwriting of shares in the company. Sales etc. for cash at prevailing market prices are outside the section as also contracts for the sale, supply, of goods, services, etc. in which the director etc. regularly trades or does business, if the value of the goods services etc. does not exceed Rs. 5,000 in any year. Transactions by banking and insurance companies in the ordinary course of business are also exempted. In urgent cases, contracts for over Rs. 5,000 can be entered into without

obtaining the board's consent, but such consent must be obtained within three months of the date on which the contract was entered into. The consent of the board must be given at a meeting and not by a circular resolution. Contravention of the section makes the contract not void, but voidable at the option of the board. Every director who is directly or indirectly interested or concerned, in any contract or arrangement, entered into by the company, must disclose the nature of his concern or interest at a board meeting as per Section 299. It is also permissible to give a general notice that a director is a member or a director of a specified body corporate, or a member of a specified firm, and is to be regarded as concerned or interested in contracts with that body corporate or firm. Such general notice can be given for a financial year and may be renewed for successive financial years.

Subsection 6 added by the Amendment Act provides that where the directors hold not more than two per cent of the paid-up share capital of another company, they need not disclose their interest in contracts with such other company. This provision is intended to prevent the operation of the section in a vexatious manner and to withdraw petty matters from its purview. There is a curious result due to the combined operation of Sections 299 (6) and 300 (2) (d). If a director holds not more than 2 per cent of the paid-up capital of another non-subsidiary private company, he can under Section 300(2)(d) vote on contracts with that other company, but he need not disclose his interest in that other company under Section 297(6). Particulars of all contracts falling within Section 297 or 299 have to be entered in a register kept for that purpose. Contracts for the sale, supply of goods, services etc. not exceeding Rs. 1,000 in any year need not be entered in the register. Even though transactions involving Rs. 5,000 or less are exempted from Section 297 and do not require a board resolution, they have to be entered in the register of contracts under Section 300, if they exceed Rs. 1,000 in value in any year. Any other interpretation does not seem correct. If

transactions not exceeding Rs. 5,000 in value do not require a board resolution, then automatically they are exempted from Section 301 which refers to "contracts to which Section 297 etc. applies" and the fixing of a lower limit of Rs. 1,000 in Section 301 (3A) has no meaning. Section 300 lays down that no interested director shall take any part in the discussion of, or vote on, any contract etc. in which he is directly or indirectly interested and, if he votes, his vote shall be void. This section does not apply to private companies which are neither subsidiaries nor holding companies of public companies; a private subsidiary company in respect of its contract with its holding company; contracts of indemnity against any loss which directors may suffer by becoming sureties for the company; contracts entered into with public companies and subsidiary private companies in which the director holds not more than two per cent of its paid-up share capital or not more than qualification shares. For promoting industry, the Central Government can exempt individual public companies and subsidiary private companies from the operation of the section by notification.

The nature of the director's interest in the appointment of managers, managing directors, managing agents, secretaries and treasurers has to be notified to members as per Section 302. Section 314 lays down that except with the previous consent of the company accorded by a special resolution, no director can hold any office of profit, and no partner or relative of such director, firm in which such director or relative is partner, no private company of which such a director is a director or member, and no director, managing agent, secretaries and treasurers and manager of such a private company, can hold any office of profit under the company or its subsidiary, carrying a total monthly remuneration of Rs. 500 or more. Managing directorship, managing agency, managership, legal or technical advisership and bankers and trustees are outside the scope of the section. Where a time-scale is fixed by the special resolution, no further special resolution is required

for each subsequent increment above the Rs. 500 limit. If an appointment of a relative is made by mistake, the defect can be cured by passing the special resolution within three months of such appointment. A director who holds an office of profit in contravention of the section shall be deemed to have vacated his office and shall refund to the company the remuneration received by him in respect of the office of profit. Remuneration is defined by Section 198(4) Explanation as including rent-free accommodation, any other amenity provided free of charge or at a concessional rate, expenditure incurred in respect of service which would have been incurred by the director, insurance premia and expenditure incurred on pension, annuity, gratuity etc. This definition is only for the purposes of Sections 309, 310, 311, 348, 352, 381 and 387 and does not apply to 314. Therefore, perquisites should be excluded in calculating the remuneration under Section 314. If an officer of a company gets a salary of Rs. 499 and perquisites whose value is Rs. 300, no special resolution is necessary on the above interpretation. No doubt sub-sections (3) (b) of Section 314 refers to perquisities but this is only for the purpose of finding out whether an office of profit is held under the company. The word "remuneration" is nowhere defined in Section 314, and as pointed out above, the definition of that term in Section 198 is not applicable to Section 314.

REMUNERATION OF DIRECTORS

The remuneration payable to directors of public and subsidiary private companies shall be determined either by the articles, or by an ordinary or special resolution of the company. If the resolution authorises the board to pay directors within certain limits as they might think fit, it is doubtful whether the shareholders' resolution determines the remuneration of the directors. Determination means fixing the quantum and not allowing it to be fixed by the board. But it is also possible to take the other view, namely, that such a shareholders' resolution as the above determines the directors' remuneration. After the Amendment

Act, only whole-time and managing directors can receive a monthly salary. Directors who were paid sitting fees on a monthly basis before the commencement of the Amendment Act on December 28, 1960, can be paid on that basis only for two years after the above date, or for the remainder of their term of office, whichever is less. Whole-time and managing directors can be paid either a monthly salary or a percentage of the net profits, or partly by the one and partly by the other method. Except with the approval of the Central Government, such remuneration shall not exceed five per cent of the net profits for one such director and, if there is more than one such director, ten per cent for all of them together. The position of managing and whole-time directors appears to be better than that of managing agents under the Amendment Act. In the case of non-wholetime and non-managing directors, if they are not paid on a monthly basis, they can be paid up to one per cent of the net profits as commission if the company has a managing or whole-time director, and up to three per cent of the net profits in other cases, by a shareholders' resolution. But this requires a special resolution. Payment in excess of this rate requires an ordinary resolution and the sanction of the Central Government. It is usual for the articles to provide that directors may also be paid all travelling, hotel and other expenses incurred by them in attending and returning from meetings of the directors, or any committee of the directors, or general meetings of the company, or in connection with the business of the company.

Any director who serves on any committee, or who devotes special attention to the business of the company, or who otherwise performs services which in the opinion of the directors are outside the scope of the ordinary duties of a director may, if the articles so provide, be paid such extra remuneration by way of salary, percentage of the profits or otherwise, as the directors may determine. Directors are not entitled to remuneration except by virtue of the articles etc., for it is not implied from the fact that a person is a director that he is to be paid, and he cannot recover on a

quantum meruit. Thus in *George A Bond & Co. Ltd.* v *Bond* (1930) (NSWLR 207, an Australian case) it was held that a director could claim only out-of-pocket expenses and could not claim occupation rent of his premises in which he carried out *inter alia* the work for the company under a contract. Only managerial remuneration is within Section 309 and not remuneration paid for technical services, which is not to be included in calculating the ceiling fixed by the section. But under Section 348, dealing with remuneration of managing agents, even remuneration paid to a managing agent for technical services is included in the ceiling fixed by that section. While Sections 198 and 309 deal exclusively with managerial remuneration, Section 348 deals with both managerial as well as non-managerial remuneration.

LEGAL POSITION OF DIRECTORS

Directors are, in the eyes of the law, agents of the company and the general principles of the law of principal and agent regulate, in most respects, the relationship of the company and its directors. Directors are not personally liable on contracts entered into on behalf of the company unless they undertake personal liability. For example, Section 147(c) says that if an officer of the company signs on behalf of a company a cheque wherein its name is not mentioned, he shall be personally liable to the holder of the cheque. Rules relating to bribery of an agent apply to bribery of a director. A director cannot sue for a bribe. The company can sue the briber for the amount. Directors are not only agents but they are in some sense, and to some extent, trustees, or in the position of trustees. No doubt their position differs considerably from that of ordinary trustees. Thus, they are not bound to invest surplus funds in trustee securities unless so directed. They are trustees of money which comes into their hands, or which is actually under their control. But this fiduciary position of directors does not extend to them as shareholders in their individual capacity and they are not in fiduciary

relationship to individual shareholders. It follows from the fiduciary relationship that no director can make a profit from his position without sanction either under the articles, or of a resolution of the company in general meeting. If he makes a profit without any such sanction, he must account for it to the company. In *Regal Hastings Ltd.* v *Gulliver* 1942 I All ER 378, the appellant company which owned a cinema house wished to acquire the shares of two other cinema houses but had insufficient funds to do so. The directors themselves supplied the balance and, on the sale of the cinemahouses, the company and the directors made a substantial profit. It was held by the House of Lords that they must account to the company for the profits they had made. The rule of equity which insists on those who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud or absence of bonafides, or upon such questions or considerations as whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether the plaintiff has, in fact, been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well intentioned, cannot escape the risk of being called upon to account. Because directors are fiduciary agents, they must not attempt to fetter their discretion by entering into agreements binding them to vote as directors in some particular way. There is a dearth of English authorities on this problem but a wealth of American authorities. For instance, Columbia Law Review Vol 50, page 52. A director can be a servant of the company. Thus in *Catherine Lee* v *Lee's Airfarming Ltd.* (81 Comp Cas 233) (appeal to the Privy Council from New Zealand) the appellant's husband was the governing director of an aerial topdressing company and also employed as chief pilot of the company at a salary. While piloting an aircraft belonging to the company in the course of aerial topdressing operations, the aircraft crashed and he was killed. Section 3(1) of the New Zealand Workmen's Compensation Act 1922 provides that if personal injury is

caused to a workman by accident arising out of, and in the course of employment, his employer shall be liable to pay compensation. It was held that his position as sole governing director did not make it impossible for him to be a servant of the company in the capacity of chief pilot, for he and the company were separate and distinct legal entities which could enter, and had entered into, a valid contractual relationship which was not invalidated by the circumstances that the deceased was sole governing director in whom was vested the full government and control of the company, and also the controlling shareholder. The deceased was, therefore, a worker within the statutory definition.

DIRECTORS' DUTY OF CARE

Directors are bound to use fair and reasonable diligence in the discharge of their duties and to act honestly, but they are not bound to do more. One must credit directors of a commercial company with reasonable intelligence and acquaintance with the ordinary habits and rules of business by which fairly prudent men are guided in the conduct of their own affairs. Omission to use that intelligence, or the disregard without good cause, capable of statements and explanation, of those habits and rules, is inconsistent with honesty. On the other hand, one must be careful not to judge them by the easy but fallacious standard of subsequent events; and apart from the distinction which has often been insisted on between the conduct of commercial business and that of the more ordinary affairs of life, one must also remember that in a strange and difficult situation, different men are apt to come to conclusions as wide as the poles asunder and yet, without any suspicion of dishonesty. If the director fails to observe this standard of care, he is liable for misfeasance under the summary procedure prescribed by Section 543. The directors' duty of care has been well explained by Romer J in *Re City Equitable Fire Insurance Co.* 1925 Ch 407 thus: (1) A director need not exhibit in the performance of his duties a greater degree of skill than may be reasonably expected from a person of his knowledge and

experience. (2) A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at any meetings of any committees of the board upon which he happens to be placed. He is not however, bound to attend all such meetings though he ought to attend whenever in the circumstances he is reasonably able to do so. Neglect or omission to attend meetings is not the same thing as neglect or omission of a duty which ought to be performed at those meetings. (3) In respect of all duties that, having regard to the exigencies of business and the articles of association may properly be left to some other official, a director is, in the absence of grounds of suspicion, justified in trusting that official to perform such duties honestly.

The third principle is illustrated by a recent Calcutta case, *Inre Central Calcutta Bank* AIR 1959 Cal 625. In that case, the articles authorised the managing director to advance monies on approved securities subject to the approval of the Board. By a power of attorney, the managing director was authorissed to make advances even without security in certain cases. The managing director made advances without security at various dates in 1946, 1947, 1949, etc. and did not bring up the question of advances before the board. It was held that the directors appointed before 1947 who had knowledge about the advances were not justified in shirking all responsibilities in respect of the affairs of the bank and leaving everything to be done by the managing director at his own sweet will. It was true that if the directors appointed in 1947 had been more vigilant and had called for monthly statement of accounts from the managing director, or had themselves cared to look into the books, they might have detected the irregularities or the wrongful acts of the managing director and his associates. But the failure on their part to observe this standard of care did not make them guilty of reckless indifference and wilful misconduct. These directors had passed a resolution for appointment of an investigating committee as soon as they had knolwedge of

the unsound nature of the investment. Another director who was in the board in 1943-45 and was reappointed in 1947, was also exonerated because he thought he was not responsible for advances made before his time and, therefore, he did not take any further interest in the matter.

The views expressed in this booklet do not necessarily represent the views of the Forum of Free Enterprise

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"Free Enterprise was born with man and shall survive as long as man survives."

—**A. D. Shroff**

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