



LexUpdate

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Disqualification of Directors – An Update

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The Hon'ble High Court of Delhi in a recent judgment dated November 04, 2019 in the matter of *Mukut Pathak & Ors. vs. Union of India and Anr.* [W.P.(C) 9088/2018 & CM Appln. No. 35006/2018] interpreted the provisions of Section 164(2) of the Companies Act, 2013 ("CA 2013") in detail including disqualification of directors, retrospective applicability of the section and applicability of principles of natural justice and discussed its consequent repercussions under Section 167(1) of the CA 2013.

Facts:

The Petitioners in the present case were directors in various companies who were disqualified under clause (a) of Section 164(2) of CA 2013 for default on the part of the concerned companies in filing the annual returns and financial statements for the financial years 2013-2014, 2014-2015 and 2015-2016 vide a list published by the Registrar of Companies on September 15, 2017 ("**Impugned List**"). The Petitioners, by virtue of the Impugned List, have been disqualified from being appointed/re-appointed as directors for a period of five years under Section 164(2)(a) of CA 2013.

The Petitioners challenged the Impugned List, essentially, on four grounds namely:

- First, it was contended that Section 164 of CA 2013, being penal in nature, could not be applied retrospectively as the said Section came into force on April 01, 2014;



- Second, that the Petitioners were not provided an opportunity to be heard inasmuch as no show cause notice was issued to the Petitioners intimating them about their disqualification as directors and such omission is in violation of principles of natural justice;
- Third, that on a plain interpretation of Section 164(2)(a) of CA 2013, the Petitioners cannot be disqualified to act as directors of the companies which had not defaulted in filing their annual returns and financial statements for a period of three consecutive years; and
- Fourth, that the defaults under Section 164(2) of CA 2013 result in the directors being disqualified from being appointed/re-appointed as directors but does not result in them demitting office as a director.

Analysis:

Issue 1: Whether the provisions of Section 164(2)(a) of CA 2013 are retrospective?

The Impugned List published by the Respondents contained violations for the financial year 2013-2014, 2014-2015 and 2015-2016, and therefore, the controversy essentially related to whether the consideration of the default committed in filing financial statement and annual return for the financial year 2013-2014 would amount to applying the provisions of Section 164(2) of CA 2013 retrospectively.

The High Court clarified that there is no dispute that the Companies Act, 1956 as well as CA 2013 expressly obliges a company to file its financial statements and its annual returns within the stipulated period. As per Section 96(1) of CA 2013, a company is required to hold an annual general meeting (“AGM”) within a period of six months from the end of the financial year and thus the company is obligated to hold its AGM before 30th September of the next financial year following the close of the financial year. In terms of Section 92(4) of CA 2013, the annual return for a financial year is to be filed within a period of sixty days from the AGM or the last date on which the AGM of a company ought to have been held and in terms of Section 137(1) and (2) the financial statement of the company are required to be filed within a period of thirty days from the holding of the meeting and in cases where such meeting has not been held, the financial statements have to be filed within thirty days from the last date of holding of such AGM.

Based on the aforesaid analysis, the High Court was of the view that even though the financial year ending March 31, 2014 had ended prior to Section 164 of CA 2013 coming into force, the AGM in respect of the said financial year was required to be held by September 20, 2014, that is, after the Section 164 of CA 2013 had

come into force and therefore, any default in holding this meeting would invite the consequences under CA 2013. Thus, merely because an enactment draws on events that are antecedent to its coming into force does not render the said enactment retrospective.

Issue 2: Whether a prior notice and an opportunity of being heard was required to be afforded to the Petitioners before including their names in the Impugned List and whether the Impugned List is void as being violative of principles of natural justice?

Relying on the judgment passed by the Hon'ble Supreme Court in the case of *Union of India v J.N. Sinha* [(1970) 2 SCC 458], the High Court noticed that the principles of natural justice is meant to supplement the law to ensure procedural fairness and such principles are to be followed while taking administrative decisions to ensure fairness in action. However, Section 164(2) of CA 2013 merely sets out the conditions, which if not complied with would disqualify an individual from being re-appointed or appointed as a director. In other words, the said Section sets out qualifying criterion for directors to be appointed or re-appointed, in negative terms. Therefore, the provision does not entail any decision-making process on the part of the authorities and as a result in such circumstances the principles of natural justice such as rule of *audi alteram partem* would be inapplicable.

Issue 3: Whether the directors of a company, which in default of clauses (a) and (b) of Section 164(2) of CA 2013, are disqualified from being re-appointed as directors in other non-defaulting companies in which they were directors at the time of incurring the disqualification under Section 164(2) of CA 2013?

The Petitioners contended that they may be disqualified to act as directors of the companies that had committed defaults as contemplated under Section 164(2)(a) of CA 2013 but they should not be disqualified to act as directors of companies that are not in default. However, the Delhi High Court on interpreting the provision of the Section, held that no person who is or has been a director of a company that has defaulted under Section 164(2) of CA 2013 ("**Defaulted Company**") shall be eligible to be re-appointed as a director of 'that company' or appointed in any 'other company'. The expression 'other company' shall mean all companies other than the Defaulted Company and the term 'appointment' shall mean to include any 'reappointment' as well. In other words, the directors of a Defaulted Company shall not be allowed to be re-appointed as director of the said Defaulted Company or be allowed to be appointed as directors of any other company and be re-appointed as directors of such companies (not being a Defaulted Company) in which they were directors at the time when the Defaulted Company had committed default under Section 164(2)(a) of CA 2013.

Issue 4: Whether the directors incurring a disqualification under Section 164(2) of CA 2013, would demit their office as a director in all companies in terms of Section 167(1)(a) of CA 2013?

The Delhi High Court was of the view that the directors would not demit their office on account of disqualifications incurred under Section 164(2) for the period prior to the amendments brought in through the Companies (Amendment) Act, 2018 with effect from May 07, 2018 by virtue of Section 167(1)(a) of CA 2013. However, if they suffer any of the disqualifications under Section 164(2) on or after May 07, 2018, the clear implication of the provisos to Section 164(2) and 167(1)(a) of the CA 2013 are that they would demit their office in all companies other than the defaulting company.

Conclusion:

Considering that the question of disqualification of directors is a serious issue affecting the functioning of the Defaulting Company as well as having serious implications on the disqualified directors, the Hon'ble Delhi High Court dwelt into the contentious issues at length but the matter is far from over as the judgment may be challenged by the affected directors before the Hon'ble Supreme Court for final resolution of the issue.

Feedback

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