Appointment of Additional Director-Some Perspectives

Appointment of an Additional Director in a company would appear, prima facie, to be an innocuous process, given that the Board is empowered under the Statute to appoint Additional Directors by applying the due process as stated in Section 161(1).

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INTRODUCTION

Appointment of an Additional director in a company would appear , prima facie, to be an innocuous process, given that the Board is empowered under the Statute to appoint Additional Directors by applying the due process as stated in Section 161(1), There are however, certain vexatious issues on the subject which have engaged the attention of the fraternity for long.

Besides, where it concerns listed entities, a dichotomy has been created as between the Act and the Listing Regulations through recent amendments therein which has put an end to the conventional period for which the Additional Director can remain in office without the company having to seek the approval of the members.

For the above reasons, an introspection is called for in respect of certain critical aspects relating to the appointment of Additional Directors.

Hence this exposition.

DIRECTORS ARE TO BE APPOINTED IN GENERAL MEETING BARRING STATUTORY EXCEPTIONS IN SECTION 152(2)

Section 152(2) of the Companies Act , 2013(hereinafter referred to as "The Act")provides that save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting.

The above subsection makes it clear that barring exceptions expressly carved out in the Act, it shall be the prerogative of the members of the company to appoint directors at General Meeting. The use of the expression "in general meeting" clarifies that the appointment of directors by members is not endemic to only Annual General Meetings (AGM) and that the Act contemplates such appointments at any General Meeting.

MEANING OF THE EXPRESSION "SAVE AS OTHERWISE EXPRESSLY PROVIDED IN THIS ACT" AS USED IN SECTION 152(2)

The expression "Save as otherwise expressly provided in this Act" as contained in Section 152(2) needs some elaboration. The use of the above expression in a statute indicates that it is in the nature of a saving clause. It seeks to create an exception of a special item out of the general things mentioned in a statute; seeks to save or protect what is provided in any other provision of the Statute on the same subject.

The word "save" as appearing above means except, other than or excluding, to preserve something from harm, injury, loss etc. The above phrase is employed in Statutory drafting when a section using this phrase seeks to protect or exclude the operation of some other section or a section which contains a similar provision.

From the above, it follows that Section 152(2) shall apply for appointment of Directors save and except where an exception has been carved out expressly in the Act as in the case of Section 161.

SECTION 161(1) PROVIDES THE STATUTORY EXCEPTION TO SECTION 152(2)

Section 161(1) in the Act provides the statutory exception to the application of Section 152(2) in that it confers on the Board of Directors, subject to enabling provisions contained in the Articles to appoint any person other than a person who fails to get appointed as a director in a General Meeting, as an Additional Director at any time who shall hold office up to the date of the next AGM or on the last date on which the AGM ought to have been held whichever is earlier.

ARTICLES SHALL HAVE PROVISIONS FOR EMPOWERING THE BOARD TO APPOINT AN ADDITIONAL DIRECTOR

A pre-requisite to the exercise by the Board of the power to appoint an Additional Director is that there should be enabling provisions in the Articles.

Reference may be made in this connection to the decision in *Tapworld v Kerala Chambers of Commerce and Industry*

(135 Taxmann.com 398) where it was held that where the Articles of a company enabled only the appointment of directors to fill up casual vacancies , the appointment of additional directors under the pretext of filling up casual vacancies was against the cardinal principle of corporate law and the appointments so made were bad in law.

ONE WHO HAS FAILED TO GET APPOINTED AS DIRECTOR IN GENERAL MEETING CANNOT BE APPOINTED AS ADDITIONAL DIRECTOR

Section 161(1) makes it clear that whomsoever who has failed to get appointed as director in general meeting cannot be appointed as Additional director. This fetter is intended to ensure that a person does not get an entry into the Board room through the "back door" by the courtesy of the Board where he has failed to get the mandate of the shareholders.

It is necessary to clarify that the above restriction is company specific only and does not bar a person who has failed to get appointed in general meeting in some other company from being appointed as Additional director in another company.

APPOINTMENT OF ADDITIONAL DIRECTOR TO MAKE UP THE QUORUM OF THE BOARD IS VALID

The need to appoint an Additional Director may be triggered off by a host of reasons. There may be an urgent need to bolster the strength of the Board by appointing persons of pre-eminence who would lend quality to the Board and it may not be efficacious for the company to wait until the General Meeting for making such appointments. The requirement for such appointment also arises to ensure the availability of the required quorum for meetings of the Board.

In *Maharashtra Power Development Corporation Ltd v Dabhol Power Co.(52 SCL 224)* it was held that the decision of the Board to appoint an Additional director to ensure a quorum was held valid.

ADDITIONAL DIRECTOR -TILL WHEN DOES HE HOLD OFFICE -CONFLICTING VIEWS

Section 161(1) provides , *inter alia*, that an Additional Director shall hold office up to the date of the next AGM or the last date on which the AGM ought to be held whichever is earlier.

We would hasten to add that the above proposition does not hold good any longer for listed companies since Regulation 17(1C) of the SEBI (LODR)Regulations , 2015 as introduced with effect from 1.1.2022 makes it necessary that the listed company shall ensure that the approval of the shareholders for the appointment of a person on the Board is taken at the next general meeting or within a period of three months from the date of appointment whichever is earlier.

Notwithstanding the above, where unlisted companies are concerned, it is still important to understand the connotation of the words "up to the date of the next annual general meeting" as appearing in Section 161(1) as conflicting views emerge as to when the tenure of appointment of the additional director ends.

One view is that he demits office before the commencement of the AGM.

It is pertinent to note that the Department of Company Affairs had issued under the 1956 Act a letter (letter no.8/3(260)163-PR dated 5.2.1963 which clarified that the director vacates office once the proceedings of the Annual General meeting commence.

The above Departmental view was based on a decision of an English Court in *Eyre v Milton Properties Limited (1937)(7 Comp Cas(CA)* where it was held that an additional director ceases to hold office before the commencement of the AGM.

The above view has been contradicted in a decision in Syed *Musharaf Hussain v Agha Munawar Ali Khan (AAR 1940 Leh.7)* where the Court has interpreted the expression " up to" to mean that it may include the last date or may not and if it is in consonance with justice , to interpret it in one of the ways permissible, there can be no compliant.

The above interpretation of the expression "up to" has also been reproduced in P.Ramanathan Aiyar's Concise Law Dictionary -Seventh Edition at Page No.1504.

As per the Lexicon ,the expression " up to" when used as a functional word indicates a limit or a boundary.

Considering the fact that the Act speaks about the Additional director holding office up to the date of the AGM, it would not be correct to limit his tenure till only the commencement of the AGM.

One must also consider the fact that if for some reason the AGM is not held , the Additional director remains in office till the last date on which the AGM ought to be held as per the Act. Hence it would be appropriate to state that he holds office until the conclusion of the AGM.

ADDITIONAL DIRECTOR VACATES OFFICE AUTOMATICALLY WHERE THE AGM IS NOT HELD

Failure on the part of the company to hold an AGM in time cannot be used as an excuse for extending infinitely the tenure of an Additional director. If for some reason, the AGM is not held , he has to vacate office on the last date on which the AGM ought to be held as per the Act.

In *P.Natarajan v Central Govt.(51 SCL76)(Mad.)*it was observed that Section 260 in the Act (1956 Act)was not meant to enable a company to keep on board a person indefinitely as an additional director by not holding an AGM.

CAN AN ADDITIONAL DIRECTOR BE APPOINTED BY THE BOARD THROUGH A CIRCULATION RESOLUTION

Except in the case of a director who is proposed to be appointed to fill up a casual vacancy which decision can be taken by the Board only at its meeting, there is nothing

in the Act that prevents the appointment of an Additional director with the approval of the Board being obtained through a circular resolution. Secretarial Standard 1(SS1) which has mandatory application also does not say that such an appointment would be irregular.

Having said this, one must consider that in the case of listed and other unlisted public companies which satisfy the financial criteria prescribed to constitute a Nomination and Remuneration Committee(NRC), the appointment of a director has to carry the recommendation of the NRC and the Board shall approve the appointment based on such recommendation. The NRC may consider the candidature of several persons for the appointment and the Board may wish to have an interaction with the potential candidate before taking a call on the appointment.

Given the above requirements it would not be a wise decision to appoint an Additional director based on a circular resolution.

However, where the appointment has been made at a meeting of the Board it is necessary to ensure that the quorum for the meeting is validly formed .

It was held in *Murari Mohan Kejriwal v Shree Hanuman Cotton Mills ltd (41 Taxmann,com 191)(CLB)(Delhi)* that where the appointment was made at a meeting of the board at which the quorum was not available, the appointment was bad in law.

ADDITIONAL DIRECTOR HAS TO SUBMIT HIS CONSENT IN DIR2

An Additional director is like any other director except for the fact that his appointment is at the behest of the Board subject to regularization by the shareholders. Hence he has to provide his consent for the appointment in DIR2 and upon his appointment by the Board , the company shall file DIR12 together with DIR2 within thirty days from the date of appointment.

It is pertinent to note that once the appointment is regularized in general meeting there is no need to file his consent in DIR 2 again but DIR12 will have to be filed since there is a change in the category of directorship depending upon whether the regularization is as a non-executive director, liable to retire by rotation or as an Executive director with a specified tenure in office.

ADDITIONAL DIRECTOR NOT TO BE COUNTED FOR DETERMINATION OF DIRECTORS LIABLE TO RETIRE BY ROTATION

Considering that the law contemplates that an Additional director shall have a term which is co-terminous with the holding of the AGM, he is not to be considered as a director liable to retire by rotation. However, once his appointment has been approved by members , he shall form a part of the category of directors liable to retire by rotation. Of course, if his regularization as director is in an executive capacity for a fixed tenure , he may not be liable to retire by rotation yet.

BOARD CAN APPOINT AN INDEPENDENT DIRECTOR IN THE CATEGORY OF AN ADDITIONAL DIRECTOR

The law does not come in the way of the Board of directors appointing an Additional director in the capacity of an Independent director.

Regulation 25(2A) of the Listing Regulations which has come into force by Notification dated 3.8. 2021 provides that the re-appointment or removal of an independent director shall be subject to the approval of the shareholders by special resolution.

The term "appointment" includes "re-appointment" as clarified by the Explanation under Section 139(1) of the Act.

In view of the fact that Regulation 25(2A) as above does not provide for the prior approval of the shareholders for the re-appointment or removal, it would be therefore in order for the Board to appoint an Independent director in the capacity of an Additional Director subject to the appointment being approved at General meeting by special resolution.

Having said this, it should be borne in mind that as an Independent director holds office for a fixed tenure in cases where he has been appointed by the Board as Additional director, his tenure shall be determined with reference to the date on which he was appointed by the Board originally.

CAN AN ADDITIONAL DIRECTOR BE ALSO APPOINTED AS MANAGING DIRECTOR

The above question has cropped up in professional circles quite often.

It may be noted that the Act does not prohibit in any way the appointment of a person as Additional Director as the managing director even at the first meeting at which he is appointed as Additional director.

However, the process to be adopted for this purpose is two fold. Considering that under Section 2(54) a Managing Director is a director in the first place, firstly the Board has to appoint him as a director, albeit as an Additional Director and then proceed to appoint him as Managing Director subject to the approval of the shareholders in general meeting.

As already explained, in view of Regulation 17(1C) of the Listing Regulations, in the case of such appointment, approval of shareholders has to be obtained in general

meeting to be held within three months from the date of appointment. Two resolutions shall be required one for regularizing his appointment as Additional director and another to approve his appointment as Managing Director together with the terms thereto.

In case of an unlisted company the regularization process can be held back until the date of the next AGM as the law contemplates that the Additional director shall hold office until the next AGM.

REGULATION 17(1C) OF LISTING REGULATIONS SHALL PREVAIL OVER SECTION 161 FOR LISTED ENTITIES

As stated above Regulation 17(1C) which has been introduced in the Listing Regulations effective from 1.1.2022 has caused a major shift in the law applicable to listed companies in the matter of seeking approval of their shareholders in respect of appointment of directors by the Board of directors.

The above Regulation envisages that approval of the shareholders shall be obtained in respect of appointments of directors made by the Board at the next general meeting or within a period of three months from the date of appointment whichever is earlier.

Listing Regulations being in the nature of specific regulations endemic to listed Entities . they shall carry greater precedence and force over the provisions in the Act .Hence listed companies are required to seek approval of the members within three months from the date of their appointment as Additional directors instead of complying with the provisions in Section 161.

IN THE CASE OF UNLISTED COMPANIES, CAN THE ADDITIONAL DIRECTOR'S RE-APPOINTMENT BE REGULARIZED AT ANY GENERAL MEETING WHICH INTERVENES BEFORE THE DATE OF THE NEXT AGM

It is pertinent to note that Section 161(1) clearly contemplates that an Additional director shall hold office until the date of the next AGM. That being so would it be appropriate to regularize his appointment at a General Meeting which precedes the next AGM.

In our view in as much as the Act itself provides that the director continues till the date of the next AGM there is little justification in collapsing the tenure of his office by seeking approval of the members in the General meeting which takes place before the AGM.

We are aware that many unlisted companies are resorting to the practice of seeking regularization of the appointment at the General meeting without waiting for the next AGM. We are respectfully of the view that the above procedure is irregular and disrespects the provisions of Section 161.

Our views on the above stand fortified by an old English decision in *Blair Open Hearth Furnace Company Ltd v Reigart (1914)(1Ch.290).*

> One feature which has become conspicuous particularly in the wake of the introduction of Regulation 17(1C)in the Listing Regulations is that there is heterogeneity in the matter of seeking approval of shareholders for regularization of the appointments.

APPOINTMENT OF ADDITIONAL DIRECTOR SHOULD BE APPROVED BY SHAREHOLDERS AND IT CANNOT BE DELEGATED

The right of the shareholders to appoint a director is a valuable right . This right has to be used judiciously and invariably in the interest of the company. The Supreme Court has held that this right has to be exercised by the shareholders and the same cannot be delegated to others. *(Charanjitlal Choudhury v UOI(21Comp Cas33).*

ADDITIONAL DIRECTORS' LIABILITIES END ONCE HE CEASES TO BE IN OFFICE

In the case of unlisted companies, as the Additional director holds office until the date of the next AGM, it follows that his liabilities as director end upon the conclusion of the AGM.

Of course if his appointment is approved by the members, there is no change in the position. However, as held in *G,N.Shridharan v ROC(110 CLA 29)* his liabilities cannot be extended to any date beyond the date on which his appointment terminates under law.

CONCLUSION

We have tried in the above exposition to find answers to some of the contentious issues on the subject. One feature which has become conspicuous particularly in the wake of the introduction of Regulation 17(1C)in the Listing Regulations is that there is heterogeneity in the matter of seeking approval of shareholders for regularization of the appointments. Even unlisted companies are rushing to seek approvals for such appointments in general meetings which are being held within three months of the appointment although there is really no legal compulsion to do so considering the time lines allowed for regularisation under Section 161(1).

The first and primary rule of interpretation is to give effect whatever be the consequences ,to the words provided in the Statute since the words in the Statute speak about the intention of the Legislature. If the language of the Act is clear and unambiguous, we have to only expound the words in their natural and ordinary sense. This being so we need to respect the plain words used in Section 161(1) and seek members' approvals for regularizing the appointment of Additional Directors only at the next AGM.