Disqualification of Directors Under the Amended Section 274

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< EXECUTIVE SUMMARY >

◆ Companies (Amendment) Act, 2000 introduced a plethora of changes of changes in the Companies Act, 1956. One of the many important changes is the introduction of clause (g) to sub-section (1) of section 274. It came to fame and at the same time created confusion and uncertainties. Author hereby tries to resolve the same within the framework of present Act and tries to address various issues which have been left open by the Legislature. The author has attempted to clarify the confusion keeping in mind the intention as well as the objective of the Legislature.

INTRODUCTION

Section 274 of the Companies Act, 1956 as amended by the Companies (Amendment) Act, 2000 provides for disqualifications of directors of the company. This section came to fame and at the same time created confusion and uncertainties with the insertion of clause (g) to sub-section (1) by the Companies (Amendment) Act, 2000 promulgated w.e.f. 13.12.2000. It is not just because of the importance or impact of the newly inserted provisions, that people all around corporate India are interpreting it in more than one way but also due to the ambiguity created by the language of the statute. Let us have an analysis of the section with emphasis on clause (g) of sub-section (1) of section 274 of the companies Act.

PROVISION

Section 274(1) reads as under:

A person shall not be capable of being appointed director of a company, if-

(a) he has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been convicted by a court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence;

(e) he has not paid any call in respect of shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call; or

(f) an order disqualifying him for appointment as director has been passed by a court in pursuance of section 203 and is in force, unless the leave of the court has been obtained for his appointment in pursuance of that section;

(g) such person is already a director of a public company which-

(A) has not filed the annual accounts and annual

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returns for any continuous three financial years commencing on and after the first day of April, 1999; or

(b) has failed to repay its deposits or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more:

Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns under sub-clause (A) or has failed to repay its deposit or interest or redeem its debentures on due date or paid dividend referred to in clause (B).

MEANING

There is absolutely no lack of clarity in clauses (a) to (f) but in clause (g) there appear to be anamalies It is settled that the office of the director will not get vacated due to the application of Section 274; instead he will become incapable of being re-appointed. A plan reading of clause (g) of sub-section (1) gives the meaning that where a person is a director of a public limited company which has committed the violation as specified in sub-clause (A) and (B), he shall not be capable of being re-appointed as director after the expiry of his tenure. But the proviso to clause (g) says that such director shall not be eligible to be re-appointed as director of any other public company for a period of five years from the date on which such violation was committed by the public limited company, in which he is a director.

ANALYSIS

The question that arises is that, whether such director becomes eligible to be re-appointed as director in the defaulting company before the expirty of five years period, when the default no longer exists. Though the literal interpretation gives the answer in the affirmative, but it is also capable of an opposite interpretation. In this regard the words 'any other' in the proviso to clause (g) are of significance.

Now let us look at it in totality, considering the clauses (a) to (g) in order-

1) A person of unsound mind becomes re-eligible as soon as the finding of the court becomes ineffective;

2) An undischarged insolvent person becomes re-eligible once he has discharged his liabilities;

3) A person who has applied to be adjudicated as an insolvent becomes re-eligible, once his application is rejected;

4) A person convicted by a court for any offence involving moral turpitude and sentenced in respect thereof to impirsonment for not less than six months becomes re-eligible after the expiry of five years from the date of expiry of the sentence;

5) A person who has not paid the call on shares becomes re-eligible once he pays it;

6) A person disqualified by an order of the court becomes re-eligible once the order becomes ineffective;

7) Similarly, the director of a defaulting public company should become eligible to be re-appointed, once the default no longer exists. However, he will not be eligible to be appointed as director of any other public company for a period of five years from the date of the default.

Another pertinent question is that, whether the section itself is applicable in case of non-rotational directors. Since, the office of the directors of the defaulting company does not get vacated due to the occurrence of the default, but only makes such directors ineligible for re-appointment, it can very well be argued that the section itself is not applicable to the non-rotational directors in as much as such directors are not going to seek re-appointment.

Furthermore, the simultaneous disqualification of all the directors may have grave impact on the functioning of the company and may ultimately cause a loss to the investors. In some situations it may result in an escape route being provided to unscrupulous directors. On the other hand in some genuine cases, the defaulting directors having bona fide intention may not get the opportunity to rectify their mistakes. Hece, such a blanket rule should be avoided and the matter should be dealt with on a case-to case basis by the Central government or any other Authority/Body.

CONCLUSION

A clarification on the subject is required to understand the intention as well as objective of the Legislature and to avoid any misinterpretation. In case, the intention of the Legislature is different than what can be reasonably construed then the clause needs to be suitably amended. ■