

## Key Managerial Personnel: To be or not to be

### Introduction

A lot has been written about the changes introduced in corporate India since the enactment of the Companies Act, 2013 (“**CA 2013**”) which came into force on April 1, 2014. As on date, most of the new law is in force barring a handful of provisions, where the old law continues to apply. While the number of statutory provisions have reduced under CA 2013, yet the work has not diminished largely because the new act is more rule based and, apart from focusing on the substantive provisions of the statute, there is a dire need to adhere to the different rules formulated for different subject matters. This has placed onerous obligations on the management and the much coveted top positions come with their own set of onerous responsibilities.

CA 2013 introduced the concept of key managerial personnel or KMP and the focus of this newsletter is to highlight the role of and expectations from a KMP in a company and the corresponding responsibilities and liabilities.

### The KMPs

Section 2(51) of CA 2013 introduced the concept and defines KMP to mean

- a managing director or CEO or manager and, in their absence, a whole-time director;<sup>1</sup>
- company secretary;
- CFO; and
- “such other officer as may be prescribed.” Currently, no other officer has been prescribed.

Each of the foregoing six positions have been defined specifically in the Act. Section 2(54) defines **MD** as a director entrusted with substantial powers of management either by an agreement with the company, or through a resolution of shareholders or Board and includes a director who may be called by a name other than MD. Section 2(18) defines **CEO** as one who has been designated as such by the company. Section 2(53) defines a **manager** who, subject to the superintendence, control and direction of the Board is responsible for the management of the entire or substantially the whole of a company’s affairs. It includes a director or another person occupying the manager’s position but may be called by another name too and whether such person is working under a contract of service or not. Ostensibly, there appears to be very little distinction between the MD and manager and the focus is on the functions performed by them. Section 2(94) defines a **whole-time director** to be a full-time employee who is appointed to the Board. A **company secretary** is defined under section 2(24) and there is no direct definition. Rather, the term alludes to the definition in the Company Secretaries Act, 1980 and refers to one who is appointed by a company to perform the functions of a company secretary. Section 2(19) describes a **CFO** to be one who is appointed in that role by the company.

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<sup>1</sup> The process of appointment of a MD, whole-time director and manager is covered under section 196 of CA 2013

Most of these designations existed under the preceding law as well, but they were not classified as a KMP. By classifying these roles in a specified new designation the intent appears to bring a higher degree of responsibility to these positions. It seems that the intent and the spirit is to have three different positions (as bulleted above) covered by different individuals who will be in full-time employment of the company.

### Appointment Pointers

Section 203 of CA 2013 is the substantive provision for the appointment of a KMP. This provision has to be read in conjunction with Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014. And, these provide that every listed company, and other public company with a paid-up share capital of INR 100 million (about USD 1.5 million) must necessarily appoint a KMP. Further, pursuant to Rule 8A of the aforesaid rules, any company (private or public) with a paid-up share capital of INR 50 million (about USD 750,000) or more has to appoint a whole-time company secretary. Thus, the real trigger to appoint a KMP starts at the fiscal threshold of INR 50 million. A KMP has to be appointed by the Board and the resolution must necessarily contain the terms and conditions of the appointment including the remuneration. In the event of a vacancy, the Board will have to fill it at its meeting within of 6 months from the date of such vacancy.

The Act provides that a single person cannot assume the dual designations of Chairman and Managing Director or Chairman and CEO. There are certain exceptions to this general principle i.e., (i) the articles of a company permit appointment of the same person, or (ii) the company carries only a single business, or (iii) the company is engaged in multiple businesses and has appointed one or more CEOs for each business as may be notified by the Central Government. The Act also provides that a whole-time KMP cannot hold any office in more than one company at the same time. A carve-out exists in the following three cases:

- for a subsidiary;
- as director in another company but with the permission of the Board;
- as MD, if he is the managing director or manager of one company. In this case, the appointment or employment is with the Board approval and affirmative consent of all the directors present at the meeting (such resolution cannot be passed by circulation). It is also essential that specific notice of such meeting and the resolution(s) to be passed thereon should be given to all the directors then in India.

In view of section 196 of CA 2013, the age of a person appointed as a MD, manager or whole-time director, should be below 70 years. Where it is necessary to appoint someone above that age, the shareholders of the company have to approve such appointment by means of a *special* resolution, justifying the rationale and necessity for appointment of such person. A whole-time KMP holding simultaneous positions in more than one company had six months from April 1, 2014 to choose one company where he wished to continue to hold the office and resign from the others.

The penalty for non-compliance in the process of appointment of KMPs has consequences for the company, for each defaulting director and the KMP too. The company's liability ranges from INR 100,000 to 500,000 (about USD 1,500 -7,500)<sup>2</sup> and for directors and KMP, it is INR 50,000 or USD 750 and daily fine of INR 1,000 or USD 15 where the contravention is a continuous one.

### Governance Watchdogs

While this newsletter does not cover all the statutory provisions relevant to the obligations of KMPs, it is essential to highlight that there are multiple sections which contain other material provisions for KMPs, both substantive as well as procedural. For instance, details regarding appointment, changes and remuneration have to be disclosed in the company's annual return.<sup>3</sup> A company is required to maintain a register of KMPs at its registered office containing various particulars, including details of securities held by each of them (if any) in the company or its group companies – be it a holding, subsidiary, or associate companies. Another important provision relates to contracts or other arrangements with related parties, and is discussed below. All such contracts have to be disclosed in the report of the Board. In short, the law provides ample checks and balances to ensure transparency in the way KMPs are appointed and the way they function.

As mentioned above, a noteworthy provision is regarding related party transactions, referenced in the foregoing paragraph. The ambit of contracts that qualify as related party<sup>4</sup> transactions is now enlarged when compared with the erstwhile law. Earlier, they were confined between certain Indian parties only and foreign companies were excluded. The enlarged definition is covered in section 2(76) of CA 2013 and sub-section (vi) of this provides that with reference to an Indian company, a body corporate whose board of directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager of an Indian company shall be considered as a related party with respect to such company. Thus, the new act now includes an “associate company” within the realm of related party. An associate company is other than a subsidiary and one over which a company has “significant influence”, i.e., controls at least 20% of the share capital or business decisions under an agreement, and it specifically includes a joint venture company. As a result, inter-company contracts between an Indian and a foreign company may qualify as a related party transaction in terms of section 188(1)(d), which require prior Board consent. Additionally, a prior shareholders' resolution is required if the transaction crosses certain thresholds<sup>5</sup> and is otherwise than in the ordinary course of business on a non-arm's length basis. In such case, other conditions have to be fulfilled under different sections.<sup>6</sup> Incidentally, the expression “ordinary course of business” has not been defined in CA 2013 and will have to be determined on a case-to-case basis. An interested director cannot be present at the company's board meeting when a related party transaction is under discussion and vote. Further, CA 2013 specifically prohibits forward contracts and put or call options between the KMPs or directors and the company or its holding, subsidiary or associate company. Therefore, it is clear from the

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<sup>2</sup> USD 1 = INR 67 and then rounded off

<sup>3</sup> Section 92(1)(g) of CA 2013 covers this requirement

<sup>4</sup> These have been described in section 188 of CA 2013

<sup>5</sup> The thresholds are above 10% of a company's turnover or INR 500 million, whichever is lower

<sup>6</sup> These are 184, 188 and 189 of CA 2013 read with rule 15 of the Companies (Meetings of Board and its Powers Rules, 2014)

foregoing that every KMP needs to exercise due caution, apply his/her mind fully and be cognizant of the consequences in the event of violations.

A KMP is included within the meaning of “officer-in-default” under CA 2013, which is a rather wide and an inclusive definition. Briefly, the onus is on any person to whom the Board gives responsibility and who is **aware**, actively participates, permits or fails to take active steps to prevent any default. The expectation is that apart from KMPs, even directors are expected to be the watch dogs. A key change in CA 2013 is to incriminate every director, who is "aware" of any contravention. This has raised the bar quite high. Interestingly, it is not essential to participate in Board meetings but the liability stems from the fact that the information about a contravention is contained in documents of the Board proceedings transmitted to the directors and, therefore, a deemed knowledge arises. Under section 2(60) of CA 2013 which defines an officer-in-default, there is an attribution of criminality to such person and, depending on the nature of offense, the consequences can be fiscal penalty or imprisonment. In fact, jail terms can go up to 10 years for KMPs and in cases of fraud, if proven guilty, the liability of key company officials will be three times the amount of the contravention involved. The definition of fraud is very wide and includes an act, omission, concealment of any fact or abuse of position **with intent** to deceive and gain undue advantage or to injure the interest of company, its shareholders or other stakeholders. It is important that actual wrongful gain<sup>7</sup> or wrongful loss<sup>8</sup> is not necessary at all.

## Conclusion

Given the severity of the consequences, the position of a KMP cannot and is not to be taken lightly. The law has become more intimidating, penalties have increased manifold, and it seems that the enforcement machinery is finally starting to wake up. The determined focus of the present political regime appears to be to send a strong message to recalcitrant corporations, habitual offenders and the world at large about its seriousness to enforce. Armed with new, technology driven techniques tracking processes will, in times to come, be swifter. Coupled with the obligations imposed on auditors to check, evaluate and report on internal systems to manage and mitigate risk, the task of top officers of a company is by, no means, an enviable one.

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<sup>7</sup>This means the gain by unlawful means of property to which the person gaining is not legally entitled

<sup>8</sup>This refers to the loss by unlawful means of property to which the person losing is legally entitled