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**Limitation on directors:
Maximum number of
concurrent directorships**

INTRODUCTION

A company's directors are given a great deal of power regarding the affairs of the business. However, it is essential to note that this power is not unlimited. The Companies Act, 1956, ("Act") includes several limitations on director power which help to harness the influence and control any particular director may have on the company. For example, voting quorums are mandated when the board makes a decision. Also, if a director is found to be violating his fiduciary duties to the company, he may be removed from office. Additionally, the Act includes a provision limiting the number of concurrent directorships that can be held by any one individual.¹ This final limitation on director power is the focus of this month's newsletter.

This newsletter focuses on section 275 of the Act, the provision setting out the maximum number of concurrent directorships that may be held by any one director. Further, it will discuss the accompanying sections – 276-279, which set out the logistics and penalty associated with section 275. It will go on to highlight the potential for directors to use the Act's limitation for personal benefit, for instance, to prematurely leave a current directorship without having to resign of their own volition, thereby avoiding the public reprimand which can be associated with quitting mid-term. Finally, this newsletter will highlight the Act's limitation on freedom to contract by limiting an individual's choice with regard to the maximum number of companies for which he will work as a director at any point in time.

1. Section 1 – The Law

Section 275 of the Act limits the number of companies in which an individual may concurrently serve in the role of a director. Since its passage, the Act has been amended numerous times, and section 275 is one of the provisions that has been altered through the Act's various amendments. The Act's provision limits the number of directorships an individual may hold in public companies or, alternatively, private companies which are subsidiaries of public companies. The 2000 amendment further restricted directors by lowering the maximum number of directorships from twenty to fifteen.

Exceptions:

Whenever a quantitative restriction is in place, it is essential to understand which items/positions "count" for purposes of the calculation. Section 278 of the Act provides a list of companies which are not to be included when evaluating whether a director is exceeding the fifteen company directorship maximum. Companies which are not counted in the calculation include:

- (a) a private company which is neither a subsidiary nor a holding company of a public company;
- (b) a company in which directors have unlimited liability;
- (c) an association not carrying on business for profit or which prohibits the payment of a dividend – Section 25;
- (d) a company in which such person is only an alternate director, that is to say, a director who is

¹ Companies Act, 1956, section 275.

only qualified to act as such during the absence or incapacity of some other director.

It is imperative to note that once a company falling into categories (a), (b) or (c) changes its status in such a way that it no longer qualifies as an (a), (b) or (c) company, it will be excluded from the maximum directorship count for only three more months. Once these three months have passed, the director's position with that company will be counted towards his fifteen directorship maximum, and if he has exceeded the maximum, the conflict must be addressed.

Foreign companies in which the director may participate also are not included in the count. These companies are excluded because they do not fall within the definition of "company" under the Act.² Additionally, an individual may be a manager in a company without having to include that position in the fifteen directorship total. By accepting appointments to managerial positions, an individual may continue to increase his sphere of influence within an industry without running afoul of the Act's provision.

Section 278 of the Act, by providing that the companies listed above are not to be counted when calculating a director's fifteen directorship maximum, essentially allows a director to carry directorships in more than fifteen companies. By following the Act's guidelines carefully, a director is able to evade the maximum number of directorships set forth in section 275.

2. Section 2 – When a conflict is present

When a director has been appointed to a directorship beyond the limit of fifteen, sections 276 and 277 guide him on how to correct the problem. Section 276 provides guidance for those directors who hold directorships in excess of the fifteen *at the time of* the Act's passage, while section 277 applies in those situations where a director is appointed in

² Companies Act, Taxmann's, 4th edition, 2007, section 3(1)(i). Section 3(1)(i) states that "company" means a company formed and registered under this Act or an existing company as defined in clause (ii). Clause (ii) defines "existing company" as a company formed and registered under any of the listed previous company laws of India or the applicable section of the Portuguese Commercial Code.

excess of fifteen directorships *after* the commencement of the Act.

Maximum exceeded at the time of the Act:

Section 276 provides directors with directorships in more than fifteen qualifying companies with a two month window in which to reduce the number of their directorships. Under this section, the director is to (1) choose fifteen or fewer companies in which to continue serving as a director, (2) resign from all other companies in which he is serving as a director, and (3) notify each of the companies he is leaving, the Registrar, and the Central Government of the steps he has taken.

Maximum exceeded after commencement of the Act:

Under section 277, an excessive appointment taking place after the commencement of the Act, "shall not take effect" unless the individual appointed as director effectively vacates one of his current directorships within fifteen days. This section provides for a fifteen day overlap during which a director may hold directorships in more than fifteen companies. However, at the end of the fifteen day grace period, the directorships to which the individual was appointed in excess of section 275's maximum will become void if the director has failed to effectively vacate his directorship in other companies.

3. Section 3 – Positive Implications

The limitation on an individual's number of directorships has positive implications such as (1) limiting effective directors from being "spread too thin" thus becoming ineffective, (2) ensuring that one individual is not influencing too many companies and thereby controlling the market system, and (3) providing guidance to those in power as to how many companies the government feels they should be involved in. Each of these results are to be praised, as they provide for a more efficient corporate system within India.

4. Section 4 – Possible Negative Implications

Despite the several positive implications, the provision may prove to be a source of conflict in some instances. One of the main goals of regulations

which temper the power of directors is to protect the company from harm. Section 275 does not *cause* harm itself, however it can be argued that the provision enables directors to harm the company by following “the letter of the law” rather than “the spirit of the law.”

For example, imagine a situation in which a director is offered a directorship in a new and promising company – one with great future earning potential. If this director has already met section 275’s maximum of fifteen directorships, the director may decide to drop one of his current directorships, perhaps one in a failing company. While it is true that directors have the ability to resign a directorship at any time, it is important to note that by citing section 275 as the reason for his departure, the director will effectively avoid the negative public opinion which can follow a decision to leave an appointment mid-term.

This point is crucial as the appointment of directors is often tied to their reputation as a “good” or “bad” business person. By using section 275 as an exit strategy, a director may essentially fool the market by continuing his reputation as a reliable and efficient director when this may not actually be the case. Using the Act’s provision in this way sets up a system in which future shareholders are ill-informed about the individuals they appoint as directors, leading to bad appointments and higher levels of monetary risk for the shareholders.

Freedom to contract:

Additionally, section 275 restricts the freedom to contract. In the above scenario, the director may feel capable of serving sixteen or seventeen public companies at one time, a decision formerly allowed by the Act; however since the Act’s 2000 amendment, he would not be allowed to do so. By forcing the director to pick only fifteen companies in which he will hold directorships, the Act may have the effect of hindering the market system in place for the director’s services. Where when left to its own devices the market would likely function as a supply and demand system, section 275 hinders the director’s ability to “market” his services beyond a certain point.

Similarly, a company’s right to contract for the director they desire is limited. The shareholders of a

company may be aware that the director they would like for their board is already serving in fifteen other companies. In fact, it may be exactly that record of efficient service that has attracted the shareholders to the director in the first place. Although they would like to appoint the individual to their company, they are unable to do so successfully unless they are relatively certain that the individual will resign one of his current directorships. Without this assurance, it is expected that the company’s appointment will fall through, since a director is unlikely to subject himself to penalty by exceeding the fifteen directorship maximum of section 275. In this regard, the Act may keep a company from being able to appoint the director it really wants.

5. Section 5 – Penalty

A key section of any legal provision is the possible penalty which may be given when a violation is found. Section 279 of the Act provides for penalty for those who act contrary to the limitation set forth in section 275. A fine of up to INR 50,000 may be levied against the director for each directorship accepted after the first fifteen. A shareholder of the company may file a complaint with the court personally, or he may alert the Registrar of Companies (“**ROC**”) of the violation. Once the ROC has been notified,³ he may choose to file a complaint with the court. After investigating the complaint, the court may decide, based on the facts of the case, to impose the fine listed in section 279. The way this provision is drafted – the penalty increases based on the number of infractions rather than a set fine for violation of section 275 – helps to curb the quantity of infractions by any one individual.

CONCLUSION

Indian law does not provide unchecked power to directors. By having limitations in place through the Act, the government is able to regulate how individuals will act in relation to their business endeavors. When questioning the appropriateness of a limitation on personal freedom, a balancing test may be used to evaluate the provision’s worth in spite of any potential problems. In the present case, section 275 limits personal freedom and it may be used by

³ Notice may come from a shareholder or another interested party such as a director.

directors with self-serving motivations; however there remain many reasons to limit the number of directorships an individual may accept at any one time. The positive effects associated with provisions such as section 275: the protection of shareholders from directors who would over-extend themselves, thereby providing less than adequate care to each

company, and the protection of the community from directors who would seek to single-handedly control an industry, continue to outweigh the negatives, thereby justifying the provision's continued existence in Indian law. (*April Gay*)

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