

## **Section 164 When a director is considered as disqualified**

### **DETAIL NOTE ON SECTION 164 OF THE COMPANIES ACT 2013 VACATION OF OFFICE OF DIRECTOR**

**This article is a detailed research under section 164 and section 167 of the Companies Act 2013 and to decide when and at which date the any person would be considered as disqualified.**

**Illustration :** Mr. A was appointed as the additional director in ABC Limited (Independent Category) at its Board Meeting held in January 2012 and was regularized at the AGM held in August 2012 till the conclusion of AGM to be held in August 2017.

ABC Limited, vide a special resolution, reappointed Mr. A as Independent Director for a further term of five years commencing from the date of AGM held in August 2017. The term of office of Mr. A as Independent Director is due to expire in July 2021 and is not liable to retirement by rotation pursuant to Section 152(6) of the Companies Act, 2013.

Apart from ABC Limited Mr. A was an Independent Director in XYZ Limited.

On October 18, 2017, XYZ Limited has first defaulted in payment of interest on debentures issued by it. After the date of first default Mr. A has resigned from the board of XYZ Limited with effect from October 20, 2017. The matter of resignation was disclosed by Mr. A to X Limited on September 24, 2017.

Thereafter XYZ Limited had continuously defaulted in payment of interest and repayment of principal amount of debentures to various debenture holders.

**The Questions which arise are :-**

1. Is Mr. A disqualified under clause (b) of sub section 2 of section 164
2. Whether he need to vacate the office from all other companies except defaulting companies under section 167
3. Which shall be date of disqualification / the date when one has to vacate the office under section 164

**Quote :**

Sub section 2 of section 164 of Companies Act 2013, states the conditions for Disqualification for appointment of Director :

- 2) No person who is or has been a director of a company which—
  - (a) has not filed financial statements or annual returns for any continuous period of three financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

Provided that where a person is appointed as a director of a company which is in default of clause (a) or clause (b), he shall not incur the disqualification for a period of six months from the date of his appointment.

(3) A private company may by its articles provide for any disqualifications for appointment as a director in addition to those specified in sub-sections (1) and (2):

Provided that the disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification.

Further, sub section 1 of section 167 of the Companies Act 2013, states the condition for Vacation of Office of Director :

1) The office of a director shall become vacant in case—

(a) he incurs any of the disqualifications specified in section 164;

Provided that where he incurs disqualification under sub-section (2) of section 164, the office of the director shall become vacant in all the companies, other than the company which is in default under that sub-section.

**One can interpret the given case in many ways, in the light of the intention of the law following are the 2 different interpretation**

**Interpretation 1 – When Mr. X shall not be considered disqualified under section 164 (2) (b)**

As per the above quoted conditions under clause (b) of sub section 2 of section 164, the person shall be disqualified, if the Company had failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, and the same person shall not be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

Further, if the person becomes disqualified to hold the office as a director under sub-section 2 of section 164, then such person shall vacate the office of the director in all the companies, other than the company which is in default under that sub-section.

It's clearly stated under section 164, that if any such defaults specified under the clause sub section 2 of Section 164 continues for more than 1 year, then the same person shall not be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so, and person who is already on Board of the defaulted Company, has to

vacant the office of the director in all the companies, other than the company which is in default under section 167.

In the given case, if XYZ Limited defaulted in payment of interest on 18th October 2017 and Mr. X resigned from the Board of XYZ Limited with the effect from 20th October 2017. i.e. Mr. X resigned within the couple of days from the date of default. Technically, Mr. X was not disqualified as per clause b of sub section 2 of section 164. For Mr. X to incur disqualification, he should have hold the office at Y Limited for more than 1 year from the date of first default i.e. 17th October 2018.

As Mr. X is not disqualified under section 164, hence no question of vacating office arise under section 167.

Furthermore to be precise, A non-executive/independent director should be held liable only in respect of any contravention of any provisions of the Act which had taken place with his knowledge (attributable through Board processes) and where he has not acted diligently, or with his consent or connivance. If the independent director does not initiate any action upon knowledge of any wrong, such director should be held liable. Mr. X cited the personal reason for the resignation in the letter and same was accepted by the Board w.e.f. 20th October 2017.

The first default which continued after his resignation, does not make him liable or disqualified.

**Answer to the Specific Question :**

**1. Is Mr. A disqualified under clause (b) of sub section 2 of section 164**

**Ans: NO. The day when Mr. X resigned from Y Limited, he was not disqualified**

**2. Whether he need to vacate the office from all other companies except defaulting companies under section 167**

**Ans: ANS: No. If he had been disqualified then only vacation of office shall arise under section 167.**

**3. Which shall be date of disqualification / the date when one has to vacate the office under section 164**

**Ans: This question shall not arise, as Mr. X is not disqualified**

**Interpretation 2 – When Mr. X shall be considered disqualified under section 164 (2) (b)**

If we understand what's intention of the law and new Act 2013, then 164 specifically focus on the words "Who is or has been". Which makes it clear that irrespective of the Director continues on the Board or was on the Board, he would get disqualified.

The time period of one year is given to the Company to make good (make payment) and not to the Directors to consider themselves as disqualified only after he continues on the Board for a period one year

In the given case, if all the directors resigned from the Board just couple of days before completion of one year and get free from all the disqualification then what. In such a case, then there shall be lifting of the Corporate Veil and all the directors would be considered as Disqualified.

### **Answer to the Specific Question :**

1. Is Mr. A disqualified under clause (b) of sub section 2 of section 164

Ans: Yes, Mr. A is considered disqualified by lifting the corporate veil.

2. Whether he need to vacate the office from all other companies except defaulting companies under section 167

Ans: ANS: YES. He is disqualified and needs to vacate the office.

3. Which shall be date of disqualification / the date when one has to vacate the office under section 164

Ans: The date shall be 17th October 2018. That's the date when disqualification occurred.

Disclaimer : The views presented are personal and has nothing to do with where I am employed. Views are in general form and not as legal advice.

Source courtesy : TaxGuru