Can Senior Executives of Company with Designations Like President, Vice-President, etc. be Termed as *De-facto* Whole-time Directors?

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Directors are designated in different styles in different corporations. What impact the designation has on a corporate enterprise is examined here.

"MANAGING director means a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him, and includes a director occupying the position of a managing director, by whatever name called."

A managing director or wholetime director may be appointed in any of the following five ways, namely :

(i) by virtue of an agreement with the company; **(ii)** by virtue of a resolution of General Meeting; **(iii)** by virtue of a resolution of Board Meeting; **(iv)** by virtue of the Memorandum of Association; and (v) by virtue of an Article of Association.

If, for instance, a managing director is appointed by a resolution of the Board of directors, there is no need for the existence of any provision in the articles of association for such appointment.

Further, there is no need to use the designation "managing director" in respect of a person appointed as such, so long as he occupies the position of a managing director by being entrusted with substantial powers of management. There need be, therefore, no "appointment of managing director" as such.

It is presumably for the above reasons that there is no specific provision in the Companies Act for the appointment of managing director. When section 269 speaks of the appointment of a person as a managing director, it contemplates such appointment in any one of the five methods specified above. There is, therefore, no need for a provision in the Act or in the Articles of association for the appointment of managing director as such (Extracts from File No. 4(101) CL 1/67.

DIRECTOR-IN-CHARGE

A director-in-charge, unlike in the case of managing director is statutorily invested with powers of management [vide definition in section 2 (26)] and his powers depend upon the extent of powers delegated to him by the Board. There is no presumption that a director-in-charge has any powers of management, except when functioning as a Board along with the other directors. One consequence of this is that third parties dealing with the company cannot presume, without further enquiry, that a director-in-charge has any powers of management at all.

EXECUTIVE, ASSISTANT OR SPECIAL DIRECTORS

In *Palmer's Company Law*, a new kind of managerial personnel is referred to under the above heading and described as follows:

"Some companies include in their articles of association an article empowering the directors to appoint a person a 'special', [divisional] 'executive', or assistant director' and so limiting the rights and liabilities of the person appointed that he is not deemed to be a director within the meaning of section 455(1) [section 741(1) of 1985 Act] [corresponding to section 2(13) of our Act]. The article empowering directors to make such appointments will authorise the directors to define and limit the powers, authorities and discretion of the person appointed, provided that an executive director shall not be deemed to be a member of the Board or any committee thereof, that he shall not attend Board meetings except at the invitation of the Board and, when present at a Board meeting by invitation, he shall not be entitled to vote.

"The purpose of such appointment is to enhance the status of the person appointed in his relationships with other members of the company's staff and customers so that in these relationships he can call himself a director, e.g., sales director. Furthermore, the executive director becomes, in effect, a trainee director for eventual recruitment to full directorial status.

If executive assistant or 'special directors' are not directors within the meaning of section 455(1), the requirements of the Act in regard to register of directors "register of directors' interests" etc., do not apply to these appointments. Care must be taken to ensure that a person appointed under such an article does not hold himself out to be director within the meaning of the Act in his dealings with third parties."

According to the Department also, such designations are not desirable as they give a wrong impression to the public that

they are full-fledged directors under the Companies Act. [Circular No. 2/82 dated 20.1.1983]. The Department's view has been again re-emphasised by a further Circular No. 11 of 1990, dated 29.5.1990: (1990) 68 Comp. Cas. (St.).

This kind of practice, whatever be its merits under the British law, will if allowed in this country, only lead to evasion of sections 198, 268, 269, 309, 310 and other provisions requiring approval of Central Government and put a premium on fraudulent management of companies, to the detriment of shareholders and the public interest. To describe persons who are not directors as 'executive directors' or 'special directors' is nothing but an attempt to mislead shareholders, creditors and the public and to exempt them from the provisions relating to directors and to put a premium on irresponsible management. Such directors will be in a very enviable position enjoying all the privileges of directors without their responsibilities, or liabilities and without subjecting their appointment or remuneration to Central Government's approval.

In the view of *Gower* also the practice of describing executives as "associate directors" or "special directors" is a 'potentially misleading' practice, (*Modern Company Law*, 4th Edition (1979) page 143).

NON-EXECUTIVE DIRECTORS

The practice of appointing non-executive directors also known as part-time, outside or independent directors, is growing, particularly in public limited companies. If a non-executive director qualifies as a director within the meaning of section 741(1), [S.2(13) Indian Act] he has, in principle, the same obligations and is subject to the same liability as any other director. This applies, in particular to his fiduciary duty to the company and to the possibility of disqualification under the statutory provisions or the articles. A non-executive director has the duty to keep himself informed about the business activities and financial status of his company, to attend Board meetings with fair regularity and to check on the activities of the full-time directors and leading executives. If he fulfils these duties conscientiously, the court may be inclined to adopt towards his obligation to exercise skill, care and diligence as a director a different standard from that which it would apply to a full-time director. In applying the standards of duties no distinction is to be drawn between executive and non-executive directors. On the facts, the two non-executive directors were found to be negligent in failing to carry out their duties as directors and in signing blank cheques which allowed the executive director to act as he pleased in completing those cheques. The three defendants were held liable to compensate the company for its loss and an inquiry was ordered as to damages. [*Jorchester Finance Co. Ltd.* v. *Stebbing*, 1989 BCLC/498 Ch D, see, *EJ Jacobs, Non-executive Directors*, 1987 JBL 269 and Palmer's Company Law, 907, 908 (24th Edn., 1987)].

EFFECT OF CONTRAVENTION OF SECTION 197

In R.S. Mathur v. *H.S. Mathur,* AIR 1968 All 241, it has been held that section 197 prohibits only the company, and the persons appointed or whose employment is continued in contravention of the section are not punishable under section 629-A. But the legal effect of such appointment is that it is not valid, as the provision is clearly mandatory.

TECHNICAL DIRECTOR

Where technical personnel are appointed to the Board, it is necessary to consider whether in addition to the technical duties, they are also vested with any powers of management. In such cases the approval of the Central Government is necessary under section 269 of their original appointment. In the absence of any data to indicate the dividing line between the remuneration payable to them for rendering technical services and that for managerial services, the entire remuneration payable to them would be deemed to fall within the purview of sections 309 and 310 of the Companies Act, 1956.

STATUS OF MANAGING DIRECTOR

A managing director cannot be equated with an ordinary director. Section 2(26) and section 2(13) show the intention of the legislature to treat the two as separate categories. Therefore, when the term of a managing director expires, he cannot continue as a managing director without being reappointed. [*Sishu Ranjan Dutta v. Bhola Nath Paper House Ltd.*, (1983) 53 Comp. Cas. 883, 898, (Cal.)] A person does not acquire the status of a manager or managing director only on being appointed as a director. [*Deen Dayalu T* v. *Sri Bezwada Papi Reddy,* (1984) 2 Comp. LJ 396 (AP)].

As per the new section 197-A, there cannot be both a manager and managing director at the same time in a company. The question whether a managing director, in as much as he is both a 'director' and 'employee' should in his capacity of employee be considered a 'servant' or agent of the company is unimportant for purposes of the Companies Act, though it may be relevant for determining whether his remuneration is salary or business income for purposes of the Income-Tax Act. For Income-Tax purposes, remuneration of managing director taxed as salary and not as income from business. Managing Director can exercise the powers of day to day management without reference to the Board. *[Boschoek Properietary Co. Ltd.* v. *Fuke,* (1906) 1 Ch 148].

It is not the name or description/designation alone but all the circumstances of the case are to be taken into account in deciding the true position of a person, whether he is having substantial powers of management or not. In case of person who is designated as 'President' or 'Vice-President' and had having management of the whole or substantially the whole of the management of the affairs of the company, he may come under the definition of 'Manager' under the Companies Act and so in view of section 197A, he could be treated as managerial personnel. By implication, if the head of finance, head of purchase, head of technical, head of legal functions, head of personnel, head of sales, etc., report to a person designated as President there is a strong presumption that he has the management of, if not the whole but substantially the whole of affairs of the company and hence under section 2(24) he would be a Manager under the Companies Act, 1956. In view of section 197A, a such a case a company can not have a Managing Director in the same company.

ADOPTION OF NEW NOMENCLATURE : NEED FOR CLOSE WATCH BY REGISTRARS

The Deptt. of Company Affairs has no objection to the adoption by companies of the American nomenclature of President and Vice-President for designating their managerial personnel provided that in their Articles of Association, it is made clear what these terms precisely mean in the context of company management by clearly defining their duties and powers.

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It is also essential that the company concerned should make it quite clear to the prospective investors if and when a Public Issue is contemplated by it, or its public announcements, what such nomenclature means in terms of the conventional nomenclature of managing director, whole-time director, executive directors etc. ordinarily used by companies.

Registrars of Companies are supposed to a keep a note of all companies adopting such nomenclature and ensure that all the statutory provisions relating to managing directors are compiled with by companies which designate their managerial personnel as President/Vice-President and that the provisions of section 197A of the Act are not infringed in any way. (*Source :* Letter No. 14/37/63-PR dated 23.9.1963 of Deptt. of Company Affairs).

PRESIDENT : WHETHER MANAGING DIRECTOR

A person appointed as 'President' of a company cannot strictly be construed as a whole-time director, requiring shareholders or Central Government approval for his appointment, nor can his appointment be taken into account for determining "inter-connection" within the meaning of MRTP Act.

So, it is advisable that all the Head of Deptts. should not report to a person designated as President. One or two Head of Deptts. can report to President or Vice President; that would not attract the provisions of Companies Act and that also should not involve substantially the whole affairs of the company. Also as a due precaution the nomenclature/powers of President and Vice-President and other senior executives is made clear in the context of company Management by way of definition in the Interpretation/Insertion of new clause in the Articles of Association of the company. ❑