

Disqualifications of Directors (Section 274)

Question 1

Mr. A is a director of ABC Limited failed to repay matured deposits from 1st April, 2001 onwards and the default continues. But ABC Limited is regular in filing annual accounts and annual returns. Mr. A is also a director of PQR Limited and XYZ Limited.

Answer the following questions with reference to the relevant provisions of the Companies Act, 1956:

- (i) Whether Mr. A is disqualified under Section 274(1)(g) of the Companies Act, 1956 and if so, whether he is required to vacate his office of director in PQR Limited and XYZ Limited.*
- (ii) Is it possible for Board of Directors of DEF Limited to appoint Mr. A as an Additional Director at the board meeting to be held on 15th May, 2002? Would your answer be different if Mr. A ceased to be a Director of ABC Limited by resignation on 1st March, 2002?*

State also the auditor's responsibility with regard to reporting of disqualification under Section 274(1)(g). (May, 2002)

Answer

- (1) A person who is already a director of a public company becomes disqualified for being appointed as a director, if the concerned company has committed default on either of the two counts mentioned in sub-clauses (A) and (B) of section 274 (1) (g) of the Companies Act, 1956. In this case ABC Ltd., is regular in filing annual accounts and annual returns. But ABC Ltd failed to repay matured deposits from 1st April 2001 onwards and such failure continues for more than one year. Hence ABC Ltd committed default under section 274(1)(g)(B) and Mr. A, being a director of ABC Ltd is disqualified under Section 274(1)(g).

This disqualification would come into operation only at the time of appointment or reappointment of Mr. A as a director in any other public company after the default has become effective. Hence Mr. A. need not vacate the office of director in PQR Ltd and XYZ Ltd as there is no such requirement either in section 274 or in section 283 which provides for vacation of office.

- (2) According to proviso to section 274(1)(g), Mr. A is disqualified to act as director of any other public company for a period of 5 years from the date on which ABC Ltd. in which

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he is a director makes default under section 274(1)(g)(A) or 274(1)(g)(B). Hence, the Board of Directors of DEF Ltd cannot appoint Mr. A as additional director at the board meeting to be held on 15th May 2002.

The words 'such a person is already a director of public company' in section 274(1)(g) indicates that this disqualification would attach only if the two conditions are satisfied (i) either of the two defaults have taken place while the person was a director of the concerned public company and (ii) he holds that directorship at the time of his appointment/re-appointment in public company. The essential condition, therefore, is that a person should be a director of a public company at the relevant time when the default under sub-clause (B) takes place. The failure under sub-clause (B) takes place only when such failure continues for one year or more. If Mr. A ceased to be a director of ABC Ltd. by resignation on 1st March 2002, he would not attract disqualification for a period of 5 years from being eligible to be appointed as a director of any other public company. Hence Mr. A can be appointed as a director in DEF Ltd.

The auditor is required to state in his report whether any of the directors of the company, whether public or private are disqualified from being appointed as a director in terms of section 274(1)(g). [Section 227(3)(f)]. Section 274(1)(g) is applicable to appointment of directors both in public and private companies but the reporting will be limited to this directors of a company who are also directors of any public company.

Question 2

Mr. Ram is a Director of ABC Limited, XYZ Limited and PQR Limited. ABC Limited was regular in filing annual returns, but did not file annual accounts for the year ended 31st March, 2002. Further ABC Limited failed to pay interest on loans taken from a public financial institution from 1st January, 2002 onwards and also failed to repay the matured deposits on due date from 1st April, 2002 onwards.

Mr. Ram is proposed to be appointed as additional director of MN Limited on 1st June, 2003. MN Limited has sought a declaration from Mr. Ram to the effect that the disqualification specification Section 274(1) (g) of the Companies Act, 1956 is not applicable in his case. Mr. Ram seeks your advice on the following:

- (i) Whether it is in order for him to give the declaration sought by MN Limited in view of the defaults committed by ABC Limited.*
- (ii) Whether he can continue as a Director in XYZ Limited and PQR Limited and also seek reappointment when he retires by rotation at the annual general meetings of respective companies to be held in September, 2003.*

Advise explaining the relevant provisions of the Companies Act, 1956. Would your answer be different, if Mr. Ram resigned his office of director in ABC Limited on 31st December, 2002?

(May 2003)

Answer

According to Section 274 (1)(g) of the Companies Act, 1956, a person who is already a director of a public company becomes disqualified for being appointed as director; if the concerned company has committed default on either of the two counts mentioned below:-

- (i) The concerned public company has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after 1st April, 1999 or
- (ii) The concerned public company has failed to repay its deposit or interest on due date or redeem its debentures on due date or pay dividends and such failure continues for one year or more.

Such a person is disqualified to act as a director of any other public company for a period of five years from the date on which the public company (in which he is a director) makes default as specified in the (A) or (B) above.

Here Mr. Ram is a director of ABC Ltd. ABC Ltd was regular in filing annual returns but did not file annual accounts (i.e. Balance sheet and profit and loss accounts) for only one year i.e financial year ended 31st March 2002. The disqualification specified in 274(i)(g) (A) will not apply unless the company has committed defaults in respect of both the matters i.e annual returns and annual accounts for three consecutive financial years. Hence Section 274(i)(g)(s) is not attracted in this case.

ABC Ltd. failed to pay interest on term loan taken from a public financial institution from 1.1.2002 onwards and also failed to repay matured deposits from 1.4.2002 onwards. The disqualification specified in sub-clause (B) will not apply unless the company has committed default in respect of loans from public financial institution is not covered under section 276(i) (g)(B). But as ABC Ltd has failed to repay its deposits on due date and the failure continues for more than one year, Mr. Ram is disqualified under section 274(1)(g)(B) and he cannot give the declaration sought by MN Ltd. In view of his disqualification u/s 274(i)(g)(B), Mr. Ram is not eligible to be appointed as additional director in MN Ltd. from 1st June 2003 onwards.

The disqualification would come into operation only at the time of appointment or reappointment of Mr. Ram as director on any public company after the default has become effective. Till such time, Mr. Ram can continue to hold the office of director in all public companies in which he is a director. He need not vacate the office of director in XYZ Ltd and PQR Ltd. as there is no such requirement either in section 274(1)(g) or section 283 (Section 283 stipulates the circumstances under which the office of a director shall become vacant). But Mr. Ram cannot seek reappointment on XYZ Ltd and PQR Ltd when he returns by rotation at the AGMs to be held in September, 2003.

If Mr. Ram resigned his office of director in ABC Ltd. on 31st December 2002, he is not a director when the default u/s 274(i)(g)(B) becomes effective i.e. 31st March, 2003. Hence he can give the declaration sought by MN Ltd. He can also seek re-appointment as a director in XYZ Ltd. and PQR Ltd. when he retires by rotation.

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Question 3

State with reference to the relevant provisions of the Companies Act, 1956 whether the following persons can be appointed as a Director of a Public company:

- (i) *Mr. A, who has huge personal liabilities far in excess of his Assets and Properties, has applied to the court for adjudicating him as an insolvent and such application is pending.*
- (ii) *Mr. B, who was caught red-handed in a shop lifting case two years ago, was convicted by a court and sentenced to imprisonment for a period of eight weeks.*
- (iii) *Mr. C, a Former Bank Executive, was convicted by a court eight years ago for embezzlement of funds and sentenced to imprisonment for a period of one year.*
- (iv) *Mr. D is a Director of DLT Limited, which has not filed its Annual Returns pertaining to the Annual General Meetings held in the calendar years 2001, 2002 and 2003.*

(May, 2004)

Answer

All the cases stated in the question are based on the provisions of Section 274(1) of the Companies Act, 1956 dealing with disqualifications of directors. Based on the provisions of the said section, each case can be discussed as follows:

- (a) Section 274(1)(c) states that a person shall not be capable of being appointed as a director of a company if he has applied to be adjudicated as an insolvent and his application is pending in the present case, Mr. A has applied to be adjudicated as an insolvent and his application is pending with the Court. Hence, he cannot be appointed as a Director of a Company – whether public or private.
- (b) Section 274(1)(c) states that a person shall not be capable of being appointed as a director of a company if 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. In the present case, although the sentence was only two years ago, but the period of sentence was only eight weeks, i.e., less than six months. Hence, Mr. B does not come under the prescribed disqualification and can be appointed as a director of a company.
- (c) This case also falls within the provisions of section 274(1)(c). In this case the imprisonment was for a period of one year, i.e., for more than six months, but since more than five years have elapsed from the expiry of the sentence, Mr. C has come out of the prescribed disqualification and can be appointed as a director of a company.
- (d) Section 274(1)(g) states that a person who is already a director of a public company which has not filed the annual accounts and annual returns for any continuous three years, then such a person shall not be eligible to be appointed as a director of another public company. In the present case, DLT Limited has failed to file only annual returns

and not annual accounts. Hence, the disqualification for Mr. D is not attracted and he can be appointed as a director.

Question 4

Clever, a Director of ABC Ltd. Made default in filing of Annual Accounts and Annual Returns with the Registrar of Companies for a continuous period of three financial years ending 31st March, 2005. Referring to the provisions of the Companies Act, 1956 examine the validity of the following:

- (i) *Whether X can continue to be a Director of ABC Ltd. And also EF Ltd., where he is a Director. Also state whether he can be reappointed as a Director in ABC Ltd. as well as EF Ltd.*
 - (ii) *Would your answer be still the same in case X is a nominee Director of a Public Financial Institution?*
 - (iii) *What would be your answer in case the defaulting company (i.e. ABC Ltd.) is a Private Company?*
- (May 2006)**

Answer

In accordance with the provisions of Section 274(1)(g) a person shall not be capable of being appointed as director of a company if such person is already a director of a public company, which –

- (A) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999;

Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of 5 years from the date on which such public company, in which he is a director failed to file annual accounts and annual returns under this clause.

Applying the above provisions as contained in Section 274(1)(g), answers to the given questions are:

1. In the given case, Mr. Clever, the Director of ABC Ltd. is disqualified to be appointed as Director of other public companies for a period of 5 years from the date on which default has been committed.
2. In the second case, Mr. Clever, as a nominee of the Public Financial Institution, shall not be disqualified to be appointed as Director for the reason that the Public Financial Institutions and are exempted from the provisions of Section 274(1)(g) of the Companies Act, 1956.
3. A director of a private company is not disqualified even if that company is a defaulter in filing return.

Mr. Clever does not cease to be a director in ABC Ltd. and EF Ltd. immediately because Section 283 which provides for 'vacation of office' has not been amended. He

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can continue as a director till his term ends. But he can be reappointed in the defaulting company ABC Ltd., but not in EF Ltd. as the disqualification applies only to 'any other public company'.

Question 5

Mr. John is a director of MNC Ltd., which had accepted deposits from public. The Financial position of MNC Ltd. turned very bad and it failed to repay the deposits which fell due for payment on 10th April, 2007 and such repayment has not been made till 5th May, 2008. Another company JKL Ltd. wants to appoint the said Mr. John as its director at its annual general meeting to be held on 6th May, 2008. You are required to state with reference to the provisions of the Companies Act, 1956 whether Mr. John can be appointed as a director of JKL Ltd.
(May 2008)

Answer

Section 274(1) (g) of the Companies Act, 1956 states that where a person is a director of a public company which has failed to repay its deposit on due date and such failure continues for one year or more, then 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 repay its deposit. In the instant case, MNC Ltd., has failed to repay its deposit on due dates and the default continues for more than one year. Hence, Mr. John will not be eligible to be appointed as a director of JKL Ltd.

Question 6

Mr. Ramanathan is a Director of Fraudulent Ltd, Honest Ltd. and Regular Ltd. For the financial year ended on 31st March, 2008 two irregularities were discovered against Fraudulent Ltd. for the financial year ended on 31st March, 2008 two irregularities were discovered against Fraudulent Ltd. Fraudulent Ltd. did not file its annual accounts for the year ended 31.3.2008 and failed to pay interest on loans taken from a financial institution for the last three years.

On 1st June, 2009 Mr. Ramnathan is proposed to be appointed as additional director of Goodwill Ltd, which company has sought a declaration from Mr. Ramnathan and he also submitted the declaration stating that the disqualification specified in Section 274 of the Companies Act, 1956 is not attracted in his case. Decide under the provisions of the Companies Act:

- (i) *Whether the declaration submitted by Mr. Ramanathan to Goodwill Ltd. is in order?*
- (ii) *Whether Mr. Ramnathan can continue as a Director in Honest Ltd. and Regular Ltd.?*
(June 2009)

Answer

According to section 274 (1) (g) of the Companies Act, 1956, a person who is already a Director of a public company becomes disqualified for being appointed as Director, if the concerned company has committed default on either of the two counts mentioned below:-

- (a) The concerned public company has not filed the annual accounts and annual return for any continuous three years (financial) commencing on and after 1st April, 1999 or.
- (b) The concerned public company has failed to repay its deposits or interests on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

Such a person is disqualified to act as a Director of any other public company for a period of five years from the date on which the public Company make default as specified above.

Here Mr. Ramanathan is a Director of Fraudulent Limited. Fraudulent Limited was regular in filing Annual returns but did not file annual accounts for only one year i.e. financial year ended 31st March, 2008. The disqualification will not apply unless the company has committed defaults in respect of both the matters for three consecutive financial years. Hence the provision of section 274 is not attracted.

The disqualification specified in sub-clause (b) is not applicable in matter of loans from public financial institutions. In view of this Mr. Ramnathan is eligible to be appointed as additional Director in Goodwills Limited and declaration submitted by him is in order

The disqualification if any would come in to operation only at the time of appointment or reappointment Hence Mr. Ramnathan can continue as director of Honest Ltd and Regular Ltd.

Question 7

Mr. Ravindranathan is holding the post of Director in three companies out of which Goodluck Colours Limited is one. For the financial year ended on 31st March, 2009, Goodluck Colours Limited failed to pay interest on loans taken from a financial institution and also failed to repay the matured deposits. On 1st June, 2009 Mr. Ravindranathan accepting the post of Additional Director in Soma Footwear Limited, submitted a declaration that the disqualification specified in Section 274 of the Companies Act, 1956 is not applicable in his case. Decide whether the declaration submitted by Mr. Ravindranathan to Soma Footwear Limited is in order.

(CA Final, New Course, May 2010)

Answer

According to Section 274(1)(g) of the Companies Act, 1956 a person who is already a director of a public company becomes disqualified for being appointed as Director if the concerned public company has failed to repay its deposits or interest on due date or pay dividend and such failure continues for one year or more. The disqualification specified in Section 274(i) (g) of the Companies Act, 1956 is not applicable in matters of loan from public financial institutions. But Goodluck Colours Limited has failed to repay its deposits on due date and the said failure continues for more than one year, Mr. Ravindranathan is disqualified under the said section of the said Act. The declaration submitted by him is not in order and he is not eligible to the appointment as Additional Director in Soma Footwear Limited.