Article

Managerial Remuneration: A five decades old control cedes

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18/09/2018

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With the enforcement of the amendments to section 197 of the Companies Act, 2013 with effect from 12th September, 2018 vide MCA commencement notification[1], the system of administrative control on managerial remuneration, dating back at least to 1969, gives way, to system of shareholder-control. With this, companies will have the liberty to decide the remuneration of their managerial personnel, and in case the company has been a defaulter to banks, secured lenders or debenture holders, the payment of managerial remuneration will also be subject to the approval of the respective financial creditors.

History of control over managerial remuneration

The initiation of the regulatory approach to managerial remuneration of companies was in the year 1936. However, since inception, the topic of managerial remuneration was prone to great complexity and lack of clarity. Some restrictions were introduced in the year 1936 into the Indian Companies Act, 1913 ("1913 Act").

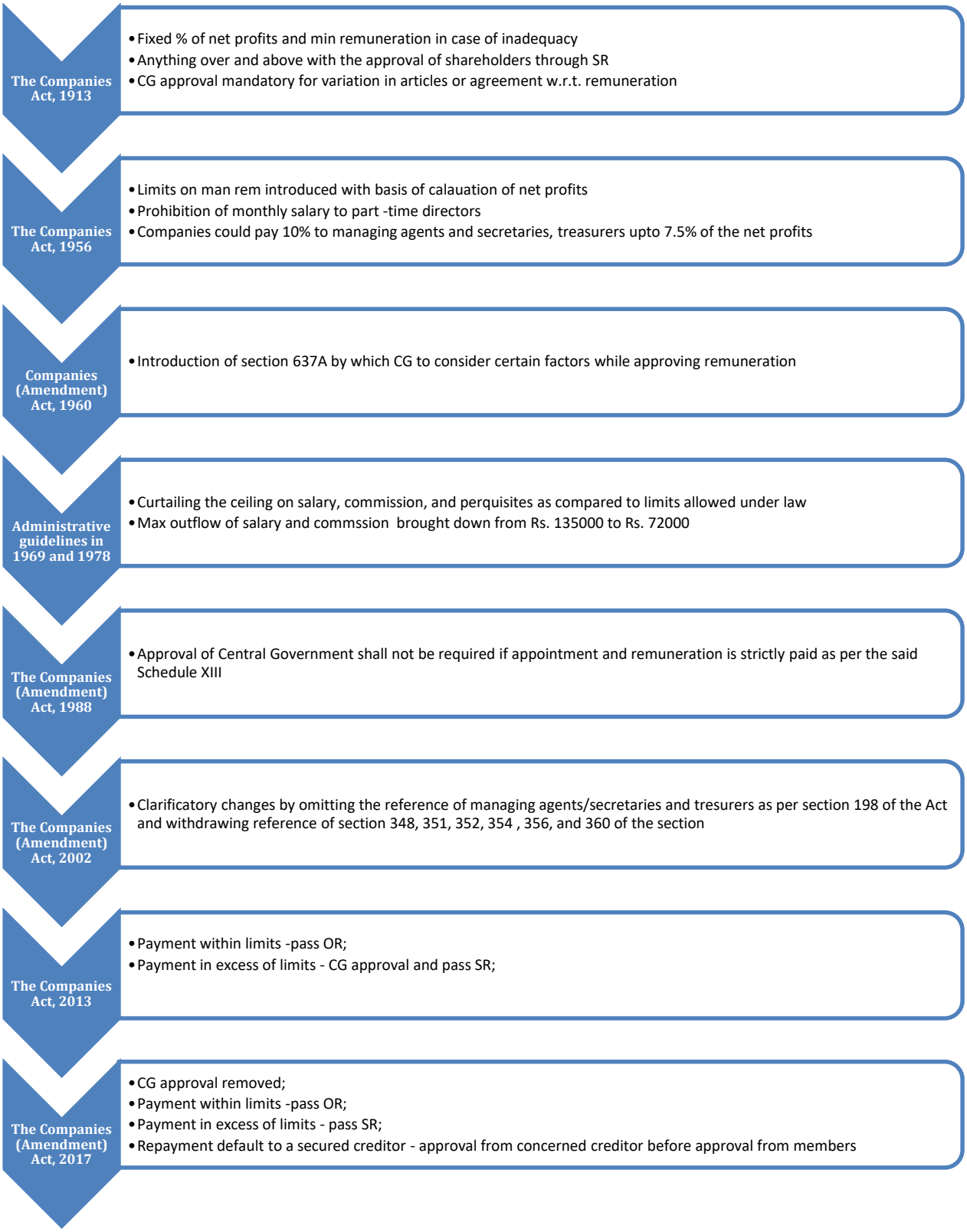
Moving over to the Companies Act, 1956 ("1956 Act"), which replaced the 1913 Act, the Company Law Committee, on whose recommendations the law was written, extensively discussed the topic of managerial remuneration. However, it was not in favour of any absolute limits on managerial remuneration. The Committee mentioned:

> *"Having regard, however, to be desirability of keeping the position flexible, we do not recommend any rigid scale of payment, for director or indeed any rigid method of remuneration. We would leave it to the company to decide how its directors should be remunerated, but, would suggest that if any commission on profit is to be paid to the ordinary director, the aggregate amount of the profit thus distributed to them should not exceed one percent of the net profit in the case of companies management by managing agents and 3 per cent in other cases.*"

As may be seen, the Bhabha Committee had suggested the limits of remuneration to non-executive directors which have since then continued in slightly modified form - 1% in case of companies which have executive directors (in place of managing agents, as originally recommended), and 3% in other cases.

The philosophy and executive control over managerial remuneration have evolved since 1936. The following are some watershed phases in the evolution:

[1] http://www.mca.gov.in/Ministry/pdf/commencementnoti_13092018.pdf



Watershed Phases in the evolution of control over managerial remuneration

- **The Companies Act, 1913**

The first control on remuneration to managerial personnel/managing agents was in 1936, when the 1913 Act was amended by introduction of Section 87C. The section provided:

> *"(1) Where any company appoints a managing agent after the commencement of the Indian Companies (Amendment) Act, 1936, the remuneration of the managing agent shall be a sum based on a fixed percentage of the net annual profits of the company, with provision for a minimum payment in the case of absence of or inadequacy of profits, together with an office allowance to be defined in the agreement of management.*
> *(2) Any stipulation for remuneration additional to or in any other form than the remuneration specified in sub-section (1) s**hall not be binding on the company unless sanctioned by a special resolution of the company.**"*

For those who are not familiar with the history of corporate governance in India, do note that till 1969, India had a system of managing agency/treasurers and secretaries, where companies could appoint other companies as managing agents, treasurers or secretaries, and pay managing agency commission to these companies. The managing agent was typically a company controlled by the promoters, and thus the promoters would continue to divert profits of the operating companies, where investors had interest, to self-owned managing agency companies. The system was abolished in 1969. Thus, for managing agents holding the reins of management, we now would have the managerial personnel – the managing director or manager controlling the affairs of companies.

- **The Companies Act, 1956**

The 1956 Act came up with statutory limits, based on a percentage of profits. The limits were laid as overall limits for all managerial personnel, and limits for each position of managing/whole time director, and NEDs. The hierarchy of limits, which has stayed the same ever since, is as follows:

1. In case the Company has adequate profits
   a) Individual limit for managers- 5% of the net profit
   b) Limit for all managerial personnel- 11% of the net profits.

2. In case of inadequate profits, the limit on managerial remuneration was based on scale of effective capital.

Also, in order to provide the so-called minimum remuneration, which would be applicable to pay a particular scale irrespective of profits, there was a provision for prior approval of the Central Govt. Further, by virtue of the introduction of section 309, 310 and 311, additional restrictions were placed on the powers of the company to remunerate their managerial personnel.

- **Introduction of administrative guidelines in 1969**

In November 1969, the Central Govt came with administrative guidelines. Two important changes were introduced by the Companies (Amendment) Act, 1969. The institutions of managing agents and secretaries and treasurers were abolished with effect from April 3, 1970. Secondly, contributions by companies to any political party or for any political purpose were prohibited.

The Government of India in the year 1961 fixed the ceiling for managing directors/whole time directors at Rs. 1,0000 per month in addition to the perquisites. Further, the limits were revised by the administrative guidelines issued in the month of November, 1969 [2]which provided a ceiling limit of:

a) Rs. 90,000 p.a. on salary
b) Rs. 45,000 on commission
c) Rs. 30,000 on perquisites

A committee under the chairmanship of Justice Rajinder Sacher was appointed by the Government of India for suggesting changes in the current regime of managerial and executive remuneration. ***The Committee did not recommend any specific changes however, highlighted the fact that remuneration of managerial personnel should be left to the companies to determine with approval of the shareholders by way of a special resolution.*** Further, the committee also recommended that the amended provisions of the Act should divide the Company categories based on their effective capital. Here, the approval of Central Government was mandated if the limits exceeded.

In this regard the Bhoothalingam Committee also made various recommendations which are mentioned below:

a) Maximum salary of managerial personnel should be Rs. 60,000 per month;
b) Total value of perquisites should be maximum 20% of basic salary;
c) Payment of commission to managerial personnel should be done away with;
d) For Government companies a National Pay Commission should be appointed for determination of the managerial remuneration of Government companies.

Accordingly, the administrative guidelines were revised in November, 1978 to further reduce the ceiling limits.

As per the Table III of the said guidelines, segregation was made amongst the ceiling limits of private sector, banks, Central Government and Public Sector.
Thereafter came a spate of litigation challenging the administrative guidelines and inclusion of section 637AA which was inserted by the Companies (Amendment) Act, 1974. The said section

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2 http://14.139.60.114:8080/jspui/bitstream/123456789/1071/1/019_Regulation%20and%20Cantrol%20Managerial.pdf

provided that the Central Government may grant approval for paying managerial remuneration over and above the limits specified in the Act, however, certain factors to be considered in this regard were:

a) The financial position of the Company;
b) Total commission drawn by individual in other capacity in the Company;
c) Remuneration drawn by the managerial personnel in other companies;
d) Professional qualifications and experience of the individual concerned;
e) Public policy relating to the removal of disparities in income

In the matter of *Company Law Board vs Upper Doab Sugar Mills Ltd.*[3]; 1977 AIR 831, 1977 SCR (2) 503; while the Apex Court had reversed the decision of the Delhi Court in this appeal by stating that CLB had acted well within its powers for fixing the remuneration of managing directors, the Delhi Court had a diverse view on the same. Delhi HC was of the clear view that fixing of remuneration which is far below the ceiling limits mentioned in law is illegal.

Further, in the case of *Cibatul Ltd. And Ors. vs Union Of India*[4]*;* (1980) 1 GLR 825, the Gujarat High Court stated :

> *"Though the Government of India constituted the Sachar Committee and Bhoothalingam Committee, it had not formulated a statutory policy relating to the removal of disparities in income and, therefore, the guidelines issued in 1969 were indisputably administrative instructions of a genera1 nature as no statutory public policy referred to by section 637AA(e), had yet been formulated by the Central Government."*

Further, the said case also stated that while disposing applications under Section 269 the Central Government shall take full account of the objective facts, such as, qualitative attributes of the person, interest of the company, fairness of the terms, etc. Further, the approval issued by the Government should set out reasons in support of its conclusion because it is the reasoned judgement which rules out the element of arbitrariness in a decision.

Accordingly, while the High Courts had the view that the guidelines were arbitrary and ultra-vires the Companies Act, 1956 in view of the absence of a public policy relating to removal of disparities in income, the Supreme Court had a different view altogether.

- **Replacement of administrative guidelines by Schedule XIII**[5]

The Companies (Amendment) Act, 1988 saw the replacement of the administrative guidelines by Schedule XIII. The Schedule laid certain scales. Companies could pay within the scales without any Central Government approval. However, any payment above the scale would require the approval of Central Govt. The limits specified were again based on scale of effective capital of the company.

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[3] https://indiankanoon.org/doc/1511361/
[4] https://indiankanoon.org/doc/681279/
[5] https://www.casemine.com/act/in/5a979da44a93263ca60b71ad#5a979da44a93263ca60b71ad

This section requires previous approval of the Central Government for payment of minimum remuneration in the event the Company has not earned profits or profits are inadequate. However, no approval of the Government was required if the said remuneration was within the limits specified in Schedule XIII (i.e. Schedule V of CA, 2013) of the Act 1956.

- **The Companies (Amendment) Act, 1988**

The Amendment Act made changes in the provisions of section 198(4) of the Companies Act, 1956 which provided payment of minimum remuneration in cases of loss or inadequacy of profits of the Company subject to approval of the Central Government. The provisions of section 269 of the 1956 Act which required prior approval of the Central Government of appointment of managerial personnel was dispensed with if the same is as per Schedule XIII(i.e. Schedule V of the CA, 2013) . Accordingly, the Amendment Act made necessary changes in the provisions of section 198(4) i.e. approval of Central Government shall not be required if appointment and remuneration is strictly paid as per the said Schedule.

- **The Companies (Amendment) Act, 2002**

The Companies (Amendment) Act, 2002 brought some clarificatory changes by omitting the reference of managing agents/secretaries and treasurers as per section 198 of the Act and withdrawing reference of section 348, 351, 352, 354 , 356, and 360 of the section.

- **The Companies Act, 2013**

As per CA, 2013 the approval for payment of managerial remuneration was conditionally two-fold and was lying with dual controlling authorities mainly the shareholders and the Central Government. Approval of the shareholders by way of an ordinary / special resolution was required in all cases, however, approval of Central Government was required in case of payment of remuneration was more than the threshold limits given under the section and Schedule V except for professional directors.

- **The Companies (Amendment) Act, 2017**

The Companies (Amendment) Act, 2017 introduced by the Government on 12th September, 2018 provided withdrawing the requirement of obtaining approval of Central Government altogether by replacing it with special resolution and the approval of the secured creditors of the Company where a company has defaulted in its payments.

The Amendment Act, 2017 effectively spells out that if a company has defaulted in repayment to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, remunerating its managerial personnel without the prior consent of the concerned creditor will not be possible. Further, the requirement of Central Government approval has been done away with and now the Company has to obtain the approval of the shareholders by way of ordinary resolution (in case of payment within the limits) or special resolution (in case of payment in excess of the limits).

Global overview of remuneration control

While controls on managerial remuneration are common, as a part of corporate governance provisions, in many countries, however, the process of administrative control of approving such managerial remuneration differs from country to country. Below we have given a comparative overview on managerial remuneration in selected countries:

Name of the Country	Approvals required	Analysis
United Kingdom[6]	The Financial Reporting Council's UK Corporate Governance Code requires quoted companies to report annually on the ratio of Managerial Personnel pay to the average pay of their UK workforce, along with a narrative explaining changes to that ratio from year to year and setting the ratio in the context of pay and conditions across the wider workforce, and to provide a clearer explanation in remuneration policies of a range of potential outcomes from complex, share-based incentive schemes. The Governance report widely provides that: a) Companies to setup a remuneration committee for overseeing remuneration and workforce policies and practices follow formal and transparent terms of reference for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. Directors of listed companies should not be involved in deciding their own remuneration. b) Institutional Investors in UK specifically requires Investment Association (IA)to provide guidance to companies through principles of remuneration which focuses mainly	The United Kingdom, famous for its good corporate governance practice has not extended the control of its management to the Government but the in hands of the remuneration committee and the BoD. This is also within the approval blanket of the shareholders by way of their remuneration policy.

6 https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf

	on manner of determination of executive directors remuneration c) Subject to the company's articles, the remuneration of directors is set by the board. d) Remuneration of private company directors is decided by the board unless there is a shareholders' or investment agreement in place with other requirements. e) As per the Companies Act, 2006 shareholders of quoted companies shall provide an advisory vote on the directors' remuneration report. This means that director's remuneration is not conditional on shareholders' approval. f) Shareholders have to approve the directors' remuneration policy every three years. **Disclosure:** The annual accounts of all companies (other than small companies) required to include details of directors' remuneration and benefits. Quoted companies are required, under the Listing Rules and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, to provide shareholders annually with a detailed remuneration report.	
Australia[7]	**a) Private and Unlisted Companies:** Remuneration is determined by the shareholders. **b) Listed Companies:** i) Directors determine remuneration to be paid to executive directors	Here we see that remuneration of non-executive directors require prior approval of the shareholders; however, payment of remuneration to executive directors of the

[7] https://iclg.com/practice-areas/corporate-governance-laws-and-regulations/australia

	ii) Australian Securities Exchange (ASX) Corporate Governance Council's Principles and Recommendations recommend the establishment of a remuneration committee to review and make recommendations on senior executive remuneration packages and incentive schemes. iii) A remuneration report (as part of the directors' report) is approved by the shareholders at each annual general meeting (AGM), which discloses prescribed information (including the amount of remuneration paid to key personnel, such as directors).	company requires disclosure under remuneration report.
China[8]	Approval of shareholders is required for paying remuneration to directors.	The governance of China does not discriminate payment of remuneration to a non-executive director or a executive director. They follow a thumb rule that any payment to remuneration to directors should be routed through the shareholders.
Hong Kong	**Private & Unlisted Companies :** Recommendation of the Board and approval by the shareholders; **Listed Companies:** The Listing Rules contain provisions that require listed companies to establish a remuneration	There is no statutory corporate governance code in Hong Kong. However, companies listed on the Stock Exchange of Hong Kong Limited (SEHK) are subject to the Corporate

[8] https://www.oecd.org/corporate/ca/corporategovernanceprinciples/48444985.pdf

	committee chaired by an independent non-executive director for the purposes of, among other things, determining the remuneration packages of all executive directors and senior management, or making recommendations to the board on such remuneration packages.	Governance Code (CG Code), which was first introduced by the SEHK in 2005 and has since been amended from time to time.
United States[9]	The BoD of the Company determines the remuneration of directors. However, listed companies have to have an independent compensation committee for determining the remuneration of directors which has to forward its recommendation to BoD for their approval. Here, please note that shareholders have an advisory role at AGM where the report on remuneration of directors shall be placed.	On similar grounds as United Kingdom and Australia, the governance of United States also does not bestow any obligation on the shareholders for approving the remuneration of directors except mere approval of annual remuneration report.
United Arab Emirates[10]	Recommendation of remuneration should be provided by the Nomination and Remuneration committee of the Company and thereby shall be approved by the BoD. However, the maximum remuneration to directors is capped at 10% of net profits after deduction of consumption, reserves and profit distribution to shareholders of at least (5%).	Does not prescribe approval of shareholders or ratification of remuneration by the shareholders.
Luxembourg[11]	**Private & Unlisted Companies:** The remuneration of the directors is determined by the general meeting of shareholders. **Listed Companies:** The LuxSE Principles state that the company must secure the services of qualified directors and executive managers by means of a fair remuneration policy that is compatible with the long-term interests of the company. However, approval of shareholders shall be still needed.	The governance policy of Luxembourg requires approval of shareholders for payment of managerial remuneration.

[9] https://iclg.com/practice-areas/corporate-governance-laws-and-regulations/usa

[10] https://www.adjd.gov.ae/sites/Authoring/AR/ELibrary%20Books/E-Library/PDFs/Corporate%20Governance%20in%20UAE%20Legislation.pdf

[11] https://thelawreviews.co.uk/edition/the-corporate-governance-review-edition-8/1168932/luxembourg

Indonesia[12]	The remuneration of directors is determined by the shareholders at a general meeting. However, the same may be delegated to the board of commissioners	Similar to the governance of Luxembourg, governance of Indonesia also allows shareholders to exercise control over managerial remuneration of directors.
Japan[13]	The matters of nomination and remuneration of the senior management and directors, are forwarded to committee like NRC to seek appropriate involvement and advice from independent directors in the examination of such important matters as nominations and remuneration. In practice, the supervisory committee determines distribution of the remuneration amongst its members and the board determines distribution amongst other directors.	The governance of Japan does not provides for specific approval of the shareholders.

Earlier regime of control in India

Just before the Companies (Amendment) Act, 2017 came the approval for managerial remuneration was lying partly with the shareholders and partly with the Central Government and in some cases with the approval of concerned secured creditors (where the company has defaulted).

Basically the limits were as follows:

- Overall 11% of the net profits;
- 5% of the net profits per managerial personnel;
- 10% of the net profits for all managerial personnel taken together;
- 3% of the net profits to NEDs where there is no managerial personnel; and
- 1% of the net profits to the NEDs where there is a managerial personnel.

Further, in case of inadequacy of profits, the minimum managerial remuneration was based on scales of effective capital and the same could be doubled with special resolution. In case of payment in excess of the double limits, the approval of Central Govt was mandatory except for in case of professional directors.

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12 https://www.ifc.org/wps/wcm/connect/64185f0042cc3ab0b145fd384c61d9f7/Indonesia_CG_Manual_Feb2014.pdf?MOD=AJPERES

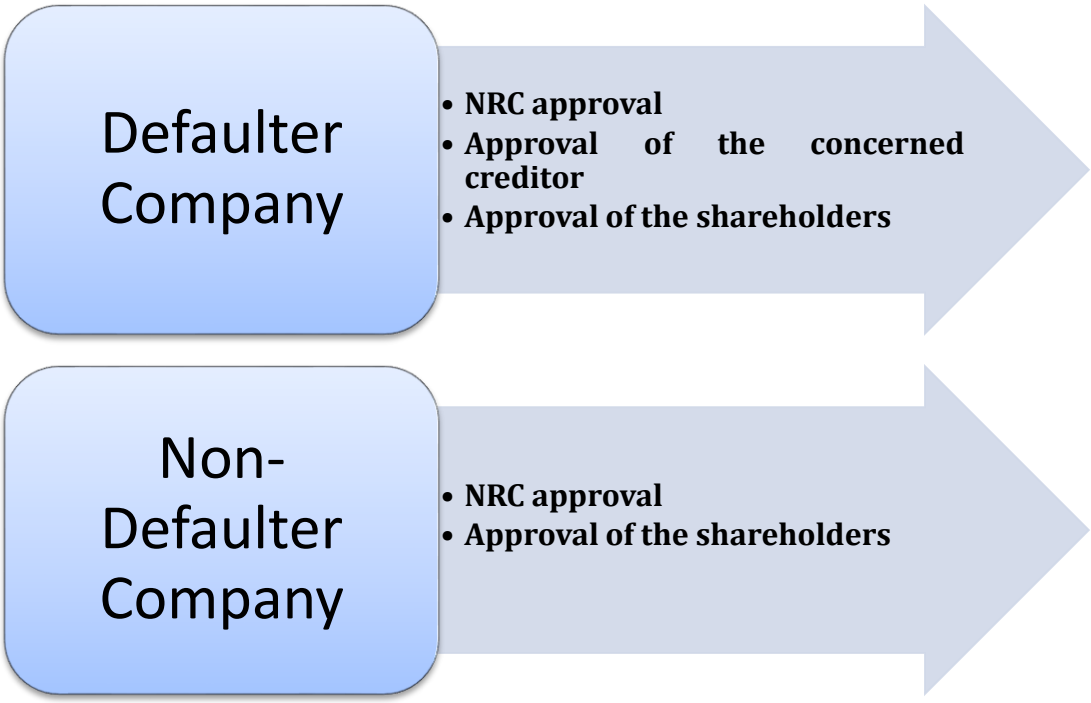
13 https://www.jpx.co.jp/english/news/1020/b5b4pj000000jvxr-att/20180602_en.pdf

Current regime in India

With time the fetters on limits of managerial remuneration were relaxed to quite an extent. Seeking of approval of Central Government for payment of minimum remuneration either prior or post facto (i.e. a waiver application) was tedious and time consuming process. The Companies (Amendment) Act, 2017 has completely done away with the requirement of Central Government approval w.r.t remuneration and has changed the control mechanism from Central Government to shareholders in case of non-defaulter companies and from Central Government to shareholders and creditors in case of defaulter companies. The amendments introduced in the Companies (Amendment) Act, 2017 are the following:

1. Approval of Central Government in all cases has been omitted except for the qualifying criteria defining the eligibility criteria for managerial personnel ;
2. Reference of approval of Central Government shall be omitted for payment of remuneration to managerial personnel as per Schedule V Part II
3. Prior approval of the creditors in case of defaulter companies i.e. any company who has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor shall be obtained by the company before obtaining the approval in the general meeting;
4. Shareholders approval by way of special resolution shall be required for payment of any amount of remuneration to managerial personnel which is over and above the limits as prescribed under Schedule V Section II Part A.
5. A new clause has been inserted in section 197 of the Act by virtue of which any director who draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without approval required under this section shall be required to refund the same to the company, within two years or such lesser period as may be allowed by the Company. Here, the Company shall be required to hold such finds in the name of the trust and shall not be allowed to use the same for personal benefits or earn any economic benefit out of it.
6. The auditor report of the Company shall also include statement as to whether the remuneration paid by the company to its directors is as per the provisions of section 197 of the Act.

Therefore the approval requirements under the new regime shall be as follows:



Conclusion

Another amendment proposed in section 197 of the Amendment Act is to cancel all pending applications with the Central Government and provide a one year timeline for transition from old provisions to new provisions. Considering the global view on the concept of managerial remuneration, it appears that India is now falling in line with the rest of the world. Further, as per the provisions of section 92(1)(g) of the Companies Act, 2013 every company is required to disclose details of remuneration paid to directors and key managerial personnel. On the other hand the provisions of law has been amended to include the requirement of obtaining shareholders resolution by ordinary or super-majority based on the scales of remuneration. Also, where the company is unable to meet its financial obligations, the need for creditors' approval seems reasonable. The piece which is still amiss is in case of professional directors, where the need for a special resolution seems superfluous. This is perhaps a product of drafting oversight.