

Note

Original Power of NRC to appoint SMPs



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Note

Senior Managerial Personnel (SMP) is defined in the explanation to Section 178 of the Companies Act, 2013 ('Act') as:

The expression "senior management" means personnel of the company who are members of its core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads.

Similar definition has been given under the Listing Agreement.

With regard to appointment of SMPs, Section 178 (2) of the Act provides that:

*The Nomination and Remuneration Committee **shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down**, recommend to the Board their appointment and removal and shall carry out evaluation of every director's performance.*

Similar to this, Clause 49 (IV) (B) (4) of the Listing Agreement provides:

Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

Section 179 (3) read with Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014 ('MBP Rules') requires the Board to take note of the appointments and removals of persons one level below the KMP, which in all practicality would include SMPs as well.

Topic for discussion in this Article

Now the matter that we would discuss here is whether this power of the NRC can be exercised by Managing Director / Head of Human Resources subject to noting by the NRC. Also can such powers be delegated to the MD / HR by the NRC? This because of the fact that a company may have several functions and a head for each such function in which case each of these heads will be considered as an SMP. Also is the fact that the composition of NRC is NEDs and IDs who do not identify themselves in the day to day workings of the company.



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Now ponder over a situation where every time a SMP leaves the organisation, the position being of high importance, cannot be left vacant for long. In this case can one presume that the NRC, consisting of NEDs and IDs, will have to meet merely to appoint an SMP? If such appointments are to be made only by the NRC, then what is the role of the HR department? This is a practical problem companies are facing and finding a way out is the only solution.

Precedents in other countries

United States

Section 303A.04 of the New York Listed Company Manual lays down the role of the Nominating Committee which includes the following:

- (i) *the committee's purpose and responsibilities - which, at minimum, must be to: **identify individuals qualified to become board members, consistent with criteria approved by the board**, and to select, or to recommend that the board select, the director nominees for the next annual meeting of shareholders*

The Compensation Committee is, however, required to make recommendations to the board with respect to non-CEO executive officer compensation.

United Kingdom

Section B.2 of the UK Corporate Governance Code applicable to listed companies, lay down the role of the Nomination Committee which provides it should lead the process for board appointments and make recommendations to the board.

A separate remuneration committee (Section D.2.2) is required to approve and recommend to the Board, the remuneration payable to directors and senior management (should be determined by the board but should normally include the first layer of management below board level).



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Analysis of the above

As can be seen from the above, international practice is that companies are required to form 2 separate committees - (i) Nomination / Corporate Governance Committee and (ii) Remuneration / Compensation Committee. Indian Law, on the other hand, requires companies to form a single Nomination and Remuneration Committee which is entrusted with the dual duties of the both these committees.

Upon a perusal of the US and the UK listing rules the Nomination / Corporate Governance Committee under both the laws is not required to identify persons to the senior management. The NYSE listed company manual is similar to our NRC terms of reference. The major difference is that the Indian Law NRC terms of reference include, in addition to directors, the identification of persons who may be appointed in senior management in accordance to criteria laid down in that regard. The intension was to expand the scope of corporate governance to SMPs as well, who are responsible for the day-to-day management of the company.

Now, if we read the text of Section 178 (2) of the Act, it requires the Committee to:

- (i) Identity persons qualified to become directors
- (ii) Identity persons who may be **appointed** in senior management.

Both have to be done in accordance to a criteria laid down in that regard. The section further goes on to say that the persons identified has to be recommended to the Board for its approval.

Upon a perusal of Rule 8 of the MBP Rules, it provides that the Board is merely required to take note of the appointment of SMPs, excluding KMPs. Hence the phrase '*and recommend to the Board their appointment and removal*' used in Section 178 (2) pertains only to the directors who have been identified. Thus, the NRC has to identify persons who may be appointed in the senior management. The law uses the word 'appoint' for SMPs.

In light of the above and a reading of the provisions of the Act and the Listing Agreement, we are of the opinion that the NRC has the following functions:

- (i) Lay down the criteria for the identification of directors and SMPs;
- (ii) Identify and recommend to the Board the appointment of persons qualified to become directors; and
- (iii) Identify and appoint persons to senior management.**



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Thus, in our view, the contention that the company only needs to lay down the criteria for identification of SMPs and thereafter their appointment can be delegated to the MD / HR department is not correct. The NRC itself needs to identify persons who may be appointed to the senior management and appoint them. The appointment, of course, has to be done in accordance to the criteria laid down in that regard.

Our interpretation and solution

In India, a general perception is that Board of Directors of a company performs only a supervisory role and not an executive one, considering that the composition includes both executive and non-executive directors. Similarly the composition of NRC is mostly NEDs who cannot be burdened with the executive management of the company. The NRC cannot take the place of a MD / CEO who is involved for the executive management of a company. Hence, barring appointment of directors and KMPs who assume the 'officers in default' responsibility, appointment of SMPs can surely be considered to be an executive function. An organization hierarchy may demand that the company has various functions which may lead to appointment of SMPs for each such function. Burdening the NRC to meet every time there is a vacation in the position of an SMP is certainly a cumbersome task considering that a NRC consists of NEDs.

Having said this, the following are our observations:

- (i) The **powers of the NRC**, as vested by Section 178 of the Act and the Listing Agreement **are original powers and not delegated powers**. General principle of law is that delegated powers cannot be sub-delegated.
- (ii) Considering that the power to identify and appoint SMPs is an original power, the same may be delegated by the NRC. Also given the fact that the SMPs are an integral part of the management, the delegation must be to a higher authority, such as the MD / CEO.
- (iii) Since the ultimate power to appoint an SMP is with the NRC, the appointment must be subsequently ratified by the NRC.



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- (iv) Once the appointment comes up for ratification by the NRC, the NRC may, at its discretion, accept or reject the appointment. In case the appointment is not ratified, the same may remand back to the MD / the appointing authority with its reasons for not accepting the appointment. Based on the review of the NRC, the MD / appointing authority shall identify other eligible candidates for the position.

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