Disqualification under Section 164 (2): retrospective or prospective?

CS Vinita Nair

vinita@vinodkothari.com

Richa Saraf

legal@vinodkothari.com

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Certain provisions of Companies Act, 2013 (Act) seems to have been written with a broken pencil- it's pointless! Provisions which are tainting provisions, crucial for determining the tenure of a director in a Company, have been drafted so loosely that companies are struggling with the interpretation. Additionally, a statutory auditor is also mandated under Section 143 (3) (g) of Act, 2013 [corresponding to Section 227 (3) (f) of Act, 1956] to report whether any director is disqualified from being appointed as a director under Section 164 (2) in the Auditor's report. Similarly, a secretarial auditor in their report provided under Section 204 in form MR-3 is required to comment on the composition of the Board. This article intends to discuss the applicability of one such provision as specified under Section 164 (2) of the Act read with Section 167.

SECTION 164 (2) OF COMPANIES ACT, 2013 (ACT, 2013):

"*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."

There are two situations when the disqualification arises:

1. Non filing of financial statements and annual return for any continuous period of 3 (Three) years;

2. failure to repay interest on deposit/ debentures or repayment of deposit/debentures **and** such failure continues for a period of 1 (One) year or more.

If any of the two situations arises, all the directors of such company get tainted with such disqualification. Consequence of the disqualification, as per Section 164 (2), is that such director neither can be re-appointed in that company not appointed as a director in any other company. This will be the case till 5 years from when the company fails to do so. So, in a way Section 164 (2) not only cites the situation in which the disqualification gets attracted but also specifies the

tenure of disqualification. What is the consequence if Section 164 (2) is not complied? Since there is no specific penalty provided under the said section, by virtue of Section 172 the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

POSITION UNDER COMPANIES ACT, 1956:

Section 274 (1) (g) was the corresponding provision to Section 164 (2) with the difference that Section 274 (1) (g) was not applicable to private companies. The offending company was required to be a public company and since the offending company did not include a private company there was no reason to include private companies within the ambit of affected companies as well. Further, Section 274 (1) (g) was inserted vide Companies (Amendment) Act, 2000 w.e.f December 13, 2000. In view of the same, the disqualification was attracted in case of failure of company to file annual returns, or failure to repay deposits, or pay interest on deposits for three consecutive financial years commencing on or after April 1, 1999. Thus, if there was a default in filing the documents for three consecutive financial years, i.e., financial years ending 31st March of 2000, 2001 and 2002, the disqualification under clause (g)(a) was attracted. The disqualification commenced on the expiry of the due date for filing of the documents. Additionally, the disqualification under Section 274 (1) (g) did not result in vacation of office under Section 283 of Companies Act, 1956.

POSITION UNDER ACT, 2013:

I. Impact of Section 167:

Section 167 corresponds to Section 283 of Companies Act, 1956 pertaining to vacation of office of a director. Section 167 (1) provides the premises when office of a director shall become vacant and Section 167 (2) specifies the consequence if a director continues to hold the office despite attracting any of the premises under Section 167 (1).

"(1) The office of a director shall become vacant in case-

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

*** (2) If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified in sub- section (1), he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both."*

Section 167 (3) provides the remedy in case the entire Board of the company vacates office under Section 167 (1). Section 167 (4) empowers a private company to provide for

additional grounds for vacation of office. Looking at the provisions it seems that the vacation of office has to happen immediately. However, Section 283 of Companies Act, 1956 did not formerly include the disqualifications under Section 274. In the present case, Section 167 (1) stipulates vacation of office if the director attains any of the disqualification under Section 164.

II. Conflicting provisions under Section 164 (2) and Section 167[1]

In case a director was to incur disqualification under section 164(2), then he shall not be eligible to be re-appointed as a director of that company or be appointed in other company for a further period of 5 years from the date on which the company fails to do so. While the disqualification is immediate but the director is allowed to serve his present tenure in that company and in other companies in which he is a director. In view of the provisions one can infer that disqualification under Section 164(2) does not envisage immediate vacation. A company can possibly not function without a board and it is keeping this in mind that Section 164(2) provides a carve-out to the boards of companies which have defaulted under this section. Further, one may note that similar provision existed under Section 274(1)(g) of Companies Act, 1956. However, that section was not applicable to private companies and neither did it attract the provisions of Section 283 of Companies Act, 1956 which pertained to disqualification.

Act, 2013 has thus linked Section 164 to Section 167 leading to an impression that disqualification under Section 164 leads to automatic vacation. This may seem logical if one were to be disqualified under Section 164(1) i.e. become an undischarged insolvent or is declared as being of unsound mind by a Court. Most certainly such a person cannot continue as a director. However, Section 164(2) is on a different footing than Section 164(1). The failure to file financial statements or inability to redeem debentures may be due to circumstances beyond the control of the Company. Section 164 (1) specifies disqualification due to personal default while Section 164 (2) specifies about disqualification arising due to corporate default. It is under such circumstances that the board of the defaulting company will have to take steps to make good the failure. If the board is required to immediately vacate the office, question of being disqualified at the time of re-appointment does not arise at all. As evident from the aforesaid discussion there seems to be a mismatch of language, both provisions seems to be talking at each other rather than stipulating provision in line with another.

1 As discussed in the article - The dichotomy between the provisions of sections 164(2) and 167 of Companies Act, 2013 springs an unsuspected surprise! written by CS Nivedita Shankar.

In such a case, one has to harmoniously interpret the provisions of Section 164(2) and Section 167 of Act, 2013. The intent of law cannot be to incorporate such a provision which will render some other provision completely useless. If one were to conclude that Sections 164(2) and 167 were to be read together, then Section 164(2) will be rendered completely useless. Thus, Section 164(2) does not lead to ipso facto vacation. It envisages vacation only at the end of the present tenure which is logical also. To conclude, a plain reading of Sections 164 and 167(1)(a) may give an impression that both are co-linked. However, given the intent behind Section 164(2), it can be considered that section 167 pertains to vacation in case of disqualifications under Section 164(1) only. The intent is to allow time to the Board to make good the default and not worsen the problem.

On a separate note, if we look into the provisions of Section 164 (1) (d), (e) and (g) read with proviso to Section 164 (3) it has been clearly specified when the disqualification shall not take effect. Thus, one has to harmoniously interpret when the office of such director will be vacated under Section 167 (1) after taking note of the carve outs provided under proviso to Section 164 (3). In terms of Section 167 (3), one may argue that if all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting. This provision was not provided under Section 283 of Companies Act, 1956. If we try to ascertain the intent on a parallel reading of Section 164 (2) read with Section 167 (1) and (3), the objective of Central Government to ensure discipline cannot be by vacating the Board instantaneous. Further, in case of private companies, the directors are also the shareholders of the Company as these are closely held companies. The defaulting directors, as shareholders will elect new directors to make good the default in filing on their behalf – seems unrealistic.

III. Date from when a director will be regarded as disqualified:

If any public company had defaulted in terms of Section 274 (1) (g), will the office of directors get vacated as on April 1, 2014 by virtue of Section 167 (1)? If any private company had not filed the financial statements and annual returns for 4 years immediately preceding April 1, 2014, will the directors be said to have vacated their office under Section 167 (1)? Or will the disqualification arise only in case of defaults made for FY – 2013-14 onwards (as the filing for FY 2013-14 was required to be done post April 1, 2014?

IV. Law to be made applicable prospectively:

Article 20 of the Constitution of India stipulates that a penal law cannot be retrospective at all. The relevant extract is reproduced as herein below-

"**20. Protection in respect of conviction for offences-**
(1) No person shall be convicted of any offence except for violation of the law in force at the time of the commission of the act charged as an offence, nor be subjected to a penalty greater than that which might have been inflicted under the law in force at the time of the commission of the offence."

Further, it was discussed in the Supreme Court Judgment in case of **Maharaja Chintamani Saran Nath ... vs State Of Bihar And Ors on October 7, 1999** that the true principle is that Lex prospicit non respicit (law looks forward not back). As Willes, J. said,

"*retrospective legislation is contrary to the general principle that legislation by which the conduct of mankind is to be regulated ought, when introduced for the first time, to deal with future acts, and ought not to change the character of past transactions carried on upon the faith of the then existing law. A law that affects substantive rights of parties can only be prospective."*

Similarly, the Supreme Court of India in **Hitendra Vishnu Thakur and Others v. State of Maharashtra and Others**[2], has culled out the principles with regard to the ambit and scope of an amending Act and its retrospective operation as follows:

(i) *A statute which affects substantive rights is presumed to be prospective in operation unless made retrospective, either expressly or by necessary intendment, whereas a statute which merely affects procedure, unless such a construction is textually impossible, is presumed to be retrospective in its application, should not be given an extended meaning and should be strictly confined to its clearly defined limits.*

(ii) *Law relating to forum and limitation is procedural in nature, whereas law relating to right of action and right of appeal even though remedial is substantive in nature.*

(iii) *Every litigant has a vested right in substantive law but no such right exists in procedural law.*

(iv) *A procedural statute should not generally speaking be applied retrospectively where the result would be to create new disabilities or obligations or to impose new duties in respect of transactions already accomplished.*

2 [1994] 4 SCC 602

(v) *A statute which not only changes the procedure but also creates new rights and liabilities shall be construed to be prospective in operation, unless otherwise provided, either expressly or by necessary implication.*

Recently, in the case of **Raj Shekhar Agarwal v. Pragati 47 Development Ltd**[3] a petition was filed the Company Law Board, Kolkata Bench contending that all erstwhile directors of Respondent Company vacated their offices in terms of section 167(1) read with section 164(2) due to default committed by erstwhile directors in filing financial statements of Respondent Company for years 2010-11, 2011-12 and 2012-13. However, it was held that action under section 167 (3) would accrue on non-filing of financial statements for three years commencing from 1-4-2014 and, hence, erstwhile Directors continued to be validly and legally appointed directors. The relevant extract of the judgment is reproduced below-

"since the relevant provision was notified on April 1, 2014, the period of disqualification as envisaged under Section 164(2) of the Act of 2013 would count, at the earliest, from April 1, 2014 and the default for any previous period cannot be reckoned for the purpose of the disqualification."

Thus, the disqualifications under Section 164 (2) cannot become applicable as on April 1, 2014 for any annual filings not done in any of the previous financial years by a private company. Similarly, it cannot lead to immediate vacation of office under Section 167 (1).

In the case of ***Vikram Ahuja v. Greenstone Investments Pvt. Ltd***.[4], one of the point for discussion and decision before the Hon'ble NCLT, Mumbai Bench was whether the disqualification set forth in Section 164(2)(a) r/w 167(1) (a) of the Act 2013 has retrospective effect or not. The Hon'ble Tribunal, after considering various case laws made the following observations:

a. The statute providing posterior disqualification on past conduct does not become a retrospective one because a part of a requisition for its action is drawn from a time antecedent to its passing.

b. The provisions of Section 164 (2)(a) shall be applicable where the non-filing has started in the past and continuing while this enactment has come to existence and also to the

3 http://indiankanoon.org/doc/31665409/

4 CA 47/2016 in CP 68/2010 decided on 22.11.2016

future non-filing. Mere applicability of such provision on continuous default till date shall not give rise to the question of retrospective or prospective effect.

c. The default in filing will be taken from where the non-filing has started.

Section 164(2) should not applied retrospectively and should not be applicable to the defaults made under the Companies Act, 1956. However, MCA had issued ROC wise list of directors at MCA website who were disqualified u/s 164(2) even though three years deadline under the new Act was yet to be completed.

V. MCA circulars create confusion:

MCA vide General Circular No. 34/2014 dated 12th August, 2014[5] was benevolent enough to introduce Company Law Settlement Scheme, 2014, in exercise of powers conferred under Section 403 and 460[6] of Act, 2013, in view of the stricter regime prescribed under Act, 2013 for defaulting companies thereby condoning the delay in filing the statutory documents, granting immunity for prosecution and charging a reduced additional fee. The Scheme was valid till 15th October, 2015, extended till 15th November, 2014[7] and thereafter extended till 31st December, 2014[8]. Additionally, MCA vide General Circular No. 41/2014[9] gave a strange clarification to the following effect:

"*The matter has been examined and it is hereby clarified that in case of companies who have filed their balance sheets and annual returns on or after 1st April, 2014 but prior to launch of CLSS-2014, disqualification under Section 164 (2) (a)* ***shall apply only for prospective defaults, if any, by such companies."***

This means that where a company has failed to file annual financial statements for periods prior to enforcement of Act, 2013 and could not file even under CLSS 2014, disqualifications are likely to get attracted. While the law does not expressly provide for retrospective operation of Section 164 (2), the said MCA circular expressly seems to provide that the defaulting status will get attracted even for non-filings for the period prior

5 http://www.mca.gov.in/Ministry/pdf/circular_34_13082014.pdf

6 403 pertains to fee filing and 460 pertains to condonation of delay in certain cases.

7 http://www.mca.gov.in/Ministry/pdf/General_Circular_40-2014.pdf

8 http://www.mca.gov.in/Ministry/pdf/General_Circular_44-2014.pdf

9 http://www.mca.gov.in/Ministry/pdf/General_Circular_41-2014.pdf

to April 1, 2014. MCA circular mandated all existing defaulting companies to either regularize the filings under CLSS-2014 or regard itself as inactive companies and make an application for being declared as 'dormant company'.

As per the said circular, the MCA has clarified that the disqualification will be applicable for the prospective defaults of such companies directors who have filed their Balance Sheets and Annual returns on or after 01.04.2014 but before CLSS-2014 i.e. before 15.08.2014. In other words, it can be said that the provisions of Section 164 (2) are not prospective in nature that is the three financial years will not be counted from 01.04.2014 (the day the section became effective) but even in case where the balance sheets or annual returns of previous years i.e. prior to 01.04.2014 have not been filed for consecutive period of three years and such default continues after 01.04.2014, the directors of such companies will be considered as disqualified. The prospective effect of disqualification will be applicable on such companies who have prior to 15.08.2014 have complied with filing of its past balance sheets or annual return as the case may be.

VI. When can a law be said to apply retrospectively?

There are laws which have been made applicable retrospectively, viz Securitisation Asset Reconstruction & Enforcement of Security Interests Act, 2002 (hereinafter referred to as SARFAESI). SARFAESI did not cast any new burden on the borrower, as a borrower was anyways liable to repay loan even prior to enactment of the same. SARFAESI intended to remedy a situation where recovery of loans of specified financial institutions were held up and intended to be speedily recovered, without reference to procedure of the Court, by a substituted procedure and forum. Provisions of SARFAESI did not create any new offence or any substantial right. It has been provided presumption against retrospectivity is not applicable to enactments which merely affect procedure or change forum or are declaratory.

As discussed above, if a law creates a new obligation or restrains a person of their rights, in such cases law cannot be regarded to apply retrospectively. It would be retrospective if the Act provided that anything done before the Act came into force or before the order was made should be void or voidable, or if a penalty were inflicted for having acted in this or any other capacity before the Act came into force or before the order was made. Had that been the case, all directors of such private companies with a default in annual filing for 3 or more continuous period will be required to vacate their offices on April 1, 2014. As expressly specified under Section 274 (1) (g) regarding the disqualification to arise for non –filings for a continuous period of 3 years from April 1, 1999, Section 164 (2) (a) is silent on the applicability. Section 164(2) of the Act was made effective from 1st April 2014. It is

settled principal of law that a statue will not apply retrospectively unless specifically stated. Thus, disqualification under Section 164(2)(a) read with Section 167(1)(a) cannot relate back to the defaults in the past. Silence cannot be said to mean retrospective applicability of the section. The Act simply enables a disqualification to be imposed for the future which in no way affects anything done in the past.

An offender who has been punished may be restrained in his acts and conduct by some legislation, which takes notes of his antecedents, but so long as the action taken against him is after the Act comes into force, the statute cannot be said to be applied retrospectively.

The most concrete cases wherein laws are made retrospective are those in which the date of commencement is earlier than enactment, or which validate some invalid law, otherwise, every statute affects rights which would have been in existence but for the statute and a statute does not become a retrospective one because a part of the requisition for its action is drawn from a time antecedent to its passing.

Hence, before 01.04.2014, non- filing of financial statements for three consecutive financial years was not a default. Also, directors continuing until before enactment were also not disqualified to continue as directors. Therefore, an act antecedent to the enactment cannot and shall not be construed void relating the enactment to the acts back to it unless and until it explicitly said as retrospective. Non- filing of financial statements before this enactment would not tantamount to disqualification and amounts to an offence only after 01.04.2014. If this disqualification is construed to be applicable to the past acts, it is obviously unfair to the people conducted the affairs of the company under the impression that non- filing of financial statements for three years is not a default and not an offence. Therefore, this provision has to be read as applicable to the situations where non- filing has started, at the most in the past and continuing while this enactment has come into existence and also to future non- filing but not to be considered as applicable to the past acts.

Here, the doctrine of attribution comes into picture. The tenure of the director should be considered before attributing the default to him. There might be a circumstance that a director was appointed only at the end of the third year and was not even a part of the company during the period of default. The default having occurred before the appointment of such director, should not be attributable to him/ her. The Companies (Amendment) Bill, 2017 has proposed certain amendments, which might be useful in providing such clarity in this regard. The same is discussed as hereunder.

COMPANIES (AMENDMENT) BILL, 2017

With regard to Section 164, the Bill stipulates that when a director is appointed in company which is in default of filing of financial statements or annual return or repayment of deposits or pay interest or redemption of debentures or payment of interest thereon or payment of dividend

then such director shall not incur the disqualification for a period of 6 (Six) months from the date of his appointment. Immunity has been provided to new directors for 6 (Six) months from incurring disqualification. In case the new director fails to do correct the filing defaults committed by the company, within the stipulated time period, he/ she shall not be eligible to be re- appointed as a director of that company or appointed in other company for a period of 5 (Five) years.

It is also clarified that disqualification arising due to conviction by court or order passed by court or tribunal or conviction related to section 188 (related party transactions), shall continue to exist even if appeal or petition has been filed against the order of conviction or disqualification.

Further, for the purposes of "Vacation of Office of a Director" (Section 167), it is proposed that in case a director incurs any of disqualifications under section 164(2) due to default of filing of financial statements or annual return or repayment of deposits or pay interest or redemption of debentures or payment of interest thereon or payment of dividend, then he shall vacate office in all the companies other than the company which is in default. In case of the company in default, the director shall not be eligible for re- appointment. It is also proposed that the director will not vacate office in certain cases where an appeal is preferred.

CONCLUSION

While Sections 164 and 167 came into force on April 1, 2014, the disqualifications under Section 164 (2) cannot become applicable as on April 1, 2014 for any annual filings not done in any of the previous financial years. Section 164 (2) curtails the right of directors of such companies to continue as directors, casts a new burden, imposes a new liability on such directors for having defaulted in filing financial statements for any 3 continuous financial years. In view of Section 164 (2), the disqualification will get attracted in case of non- filings made for years commencing from FY 2013-14 onwards**.** The remedies available to a director are to either regularize the filings or make an application for regarding such company as a dormant company under Section 455 of Act, 2013. However, it will be inappropriate to regard that this will lead to immediate vacation of office under Section 167 (1). This matter will invite lots of litigations and will get settled after a judgment by the Apex Court.