

Case: Zacharia Maramkandathil Mohan and Ors. vs. Union of India

Facts:

Several petitions were filed by Petitioners with Kerala High Court for deactivation of their DIN solely on the basis of disqualification due to non-filing of Financial Statement/Annual Returns by the Companies.

Provisions under Companies Act, 2013:

Section 164(2)- Disqualifications for Appointment of Director

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.

Provided that where a person is appointed as a director of a company which is in default of clause (a) or clause (b), he shall not incur the disqualification for a period of six months from the date of his appointment.

Section 167(1)- Vacation of Office of Director

The office of a director shall become vacant in case—

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

Provided that where he incurs disqualification under sub-section (2) of section 164, the office of the director shall become vacant in all the companies, other than the company which is in default under that sub-section.

(b) he absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board;

(c) he acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;

(d) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184;

(e) he becomes disqualified by an order of a court or the Tribunal;

(f) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months:

Provided that the office shall not be vacated by the director in case of orders referred to in clauses (e) and (f)-

(i) for thirty days from the date of conviction or order of disqualification;

(ii) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of; or

(iii) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed of.

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(g) he is removed in pursuance of the provisions of this Act;

(h) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

Rule 11 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 Cancellation or Surrender or Deactivation of DIN

(1) The Central Government or Regional Director (Northern Region), Noida or any officer authorised by the Regional Director may, upon being satisfied on verification of particulars or documentary proof attached with the application received alongwith fee as specified in Companies (Registration Offices and Fees) Rules, 2014 from any person, cancel or deactivate the Director Identification Numbers (DIN) in case -

(a) the DIN is found to be duplicated in respect of the same person provided the data related to both the DIN shall be merged with the validly retained number;

(b) the DIN was obtained in a wrongful manner or by fraudulent means;

(c) of the death of the concerned individual;

(d) the concerned individual has been declared as a person of unsound mind by a competent Court;

(e) if the concerned individual has been adjudicated an insolvent:

Provided that before cancellation or deactivation of DIN pursuant to clause (b), an opportunity of being heard shall be given to the concerned individual;

(f) on an application made in Form DIR-5 by the DIN holder to surrender his or her DIN along with declaration that he has never been appointed as director in any company and the said DIN has never been used for filing of any document with any authority, the Central Government may deactivate such DIN:

Provided that before deactivation of any DIN in such case, the Central Government shall verify e-records.

Questions raised:

- Whether Sections 164(2)(a) and 167(1)(a) of the Companies Act, 2013 are ultra vires the Constitution of India, being violative of Article 14 or 19?
- Whether the principles of natural justice should be read into Section 164(2) in view of the nature and severity of consequences arising from its operation?
- Whether Section 164(2) is retrospective in its operation?
- Constitutionality and consequences of the first proviso to Section 164(2) and the proviso to Section 167(1)(a), inserted by the Companies (Amendment) Act, 2017 with effect from May 07, 2018.
- Whether the action of the respondents in deactivating the DINs of the petitioners, is justified?

Petitioners argued that-

The failure to file Annual Returns / Financial Statements can be due to reasons beyond the control of Directors and an opportunity of being heard shall be given to him before disqualifying them.

The notice under Section 455(4) shall be a mandate and without issuing the same, a disqualification cannot be given effect.

Before disqualification, principles of natural justice shall be considered.

Section 164 cannot have retrospective effect, hence no disqualification can take place until 2017.

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The disqualification is against Article 14 & Article 19 of Constitution of India. The Section 164(2) bars only appointment of director. A director can be re-appointed in other companies.

Learned Counsel for petitioners stated:

The temporary disqualification is not a ground for deactivation of DIN and it can be done only as per Rule 11.

Cases referred:

Meethelaveetil Kaitheri Muralidharan and others v. Union of India and others [(2020) 7 MLJ 641]
State Bank of Patiala and others v. S.K.Sharma [(1996) 3 SCC 364]
S.L.Kapoor v. Jagmohan and others [(1980) 4 SCC 379]
The State of Jharkhand and others v. Brahmaputra Metalics Ltd and others [2021 (1) SCJ 131]
Narmada Bachao Andolan and others v. State of Madhya Pradesh and others [(2011) 7 SCC 639]

Respondents argued that:

The petitioners stand disqualified as per law and Section 164(2) has to be read in line with Section 167(1).

The disqualification does not have any adjudicatory process or hearing to be provided to the errant Companies or Directors in default.

The law does not have any provision for giving notice to director before disqualification.

Learned Counsel for respondents referred following case laws:

The non-filing of annual return is a serious offence and disqualification should be extended to other companies also.

The disqualification is temporary, limited to five years, the consequence of Section 164(2) cannot be termed as excessive or disproportionate.

The petitioners do not have a fundamental right to be Directors of any company incorporated. The right to be a Director of an incorporated Company is not an absolute statutory right.

Grounds of passing judgement:

Filing of Financial Statements and Annual Returns by incorporated entities at regular and stipulated intervals is crucial to ensure transparency. Section 166 makes it a duty of Directors to act in good faith in order to promote the objects of the Company.

Any eventualities cannot last for three years, but disqualification will only arise at end of three years.

The purpose of disqualification of defaulting Directors in other Companies is to make the Directors answerable to the corporate sector. The purpose is to save the corporate community from the consequences of mismanagement.

The ineligibility arises by operation of law. Therefore the requirement of hearing does not arise.

As held by the Hon'ble Karnataka High Court in Yashodhara Shroff (supra), the ineligibility of Directors under Section 164 is in the nature of suspension and is temporary, for a period of five years, and not perpetual.

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Directors of private Companies cannot be disqualified for appointment / re-appointment as mandated under Section 164(2) if any of such three consecutive defaults in filing Annual Returns/Financial Statements, is before the financial year 2014-'15.

The DIN of the petitioners allotted under Rule 10 of the Companies (Appointments and Qualifications of Directors) Rules, 2014 ,are not liable to be deactivated or cancelled solely for the reason that the petitioners stand disqualified for appointment / reappointment as Directors of Companies by operation of Section 164(2).

Where disqualification of petitioners is based on any period of default prior to 01.04.2014, such disqualifications are bad in law and are hence set aside.

Cases referred:

Official Liquidator v. P.A.Tendolkar
Yashodhara Shroff v. Union of India
Union of India v. W.N Chadha

Decision : Petition allowed

Judgement:

Kerala High Court ruled that aforesaid Sections are not ultravires to Constitution of India Article 14 or Article 19(1)(g).

Also Section 164(2) does not have retrospective effect. It is only applicable to the defaults made by the Companies on or after Financial Year 2014-15.

It was held that DIN cannot be deactivated solely on the basis that petitioners are disqualified under Section 164(2).

The Court directs the Respondents to reactivate the DIN but they can anytime deactivate it as per Rule 11 of the Companies (Appointment and Qualifications of Directors) Rules, 2014,