IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 02/12/2019

C O R A M

THE HON'BLE MR.A.P.SAHI, CHIEF JUSTICE

a n d

THE HONOURABLE MR.JUSTICE SUBRAMONIUM PRASAD

Writ Petition No.32763 of 2019
and
WMP.No.33188 of 2019

G.Vasudevan ... Petitioner

Vs

1. Union of India,
   Rep. by its Secretary,
   Ministry of Corporate Affairs,
   Shastri Bhavan,
   Dr.Rajendra Prasad Road,
   New Delhi 110 001.

5. Union of India,
   Rep. by its Secretary,
   Ministry of Law and Justice,
   Shastri Bhavan,
   Dr.Rajendra Prasad Road,
   New Delhi 110 001. ... Respondents

Prayer : Petition filed under Article 226 of the Constitution of India praying for the issuance of a writ of Declaration, to declare the "Proviso" in Section 167(1)(a) of the Companies Act 2013, as inserted vide the Companies (Amendment) Act 2017 as ultra vires the Articles 14, 19(1)(g) of the Constitution of India and declare illegal and null and void.

For petitioner ... Mr.R.Rajesh

For respondent ...

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O R D E R

Subramonium Prasad,J.

The challenge in the instant writ petition is to the vires of the proviso to Section 167(1)(a) of the Companies Act, as inserted by the Companies (Amendment) Act 2017. The same is extracted hereunder:-

"(i) in clause (a), the following proviso shall be inserted, namely:— "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.";

2. The petitioner is a Company Secretary. The petitioner herein had previously challenged the impugned proviso before this Court through WP.No.22813 of 2018. However, the same was withdrawn on 19.11.2019 with the permission of the Court as the same was filed in the nature of a Public Interest Litigation. The petitioner has subsequently filed the instant writ petition. It is to be noted that the petitioner was not granted any liberty to institute a fresh petition for the same relief upon the earlier writ petition being withdrawn. The permission to withdraw the Public Interest Litigation was granted by this Court, without prejudice to the rights of any person aggrieved or otherwise entitled to file such a petition relating to the vires of the proviso, which has been questioned herein. Even though the present petition is not labelled as Public Interest Litigation, it in fact is a Public Interest Litigation. The petitioner's rights have not been in any manner affected by the insertion of the proviso in as much as the petitioner is not a Director in any company and has not had to vacate his office by virtue of the proviso inserted in Section 167(1)(a) of the Companies Act by the Companies (Amendment) Act 2017. The petitioner therefore has no locus to institute the present writ petition. The conduct of the petitioner in repeatedly approaching the Court by filing petitions for same relief is not appreciated. The writ petition

deserves to be dismissed on this score alone.

3. Learned counsel for the petitioner however contends that in order to challenge the vires of a provision as being unconstitutional, the locus test cannot be applied to non-suit the petitioner. We propose to relieve the petitioner of this burden by proceeding to deal with the mater as we find it more imperative to settle the legal position rather than limit the contours of locus more so when the issued raised can be conveniently answered by devoting more time to the substance of challenge rather than its form.

4. Chapter XI of the Companies Act 2013 deals with appointment and qualification of the Directors. Section 164 prescribes the disqualifications for appointment of Directors and Section 167 enumerates the instances which lead to vacation of the office of Director. Section 164 and Section 167 of the Companies Act 2013 read as under:-

"***164. Disqualifications for appointment of director.***—

(1) A person shall not be eligible for appointment as a director of a company, if —

(a) he is of unsound mind and stands so declared by a competent court;

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been 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 and a period of five years has not elapsed from the date of expiry of the sentence:

***Provided** that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;*

(e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

(f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;

(g) he has been convicted of the offence dealing with related

*party transactions under section 188 at any time during the last preceding five years; or**

*(h) he has not complied with sub-section (3) of section 152' or***

[(i) he has not complied with the provisions of sub-section (1) of section 165.]

(2) 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.*

(3) A private company may by its articles provide for any disqualifications for appointment as a director in addition to

those specified in sub-sections (1) and (2):

Provided *that the disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification.*

167. Vacation of office of director.—

(1) 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 disposal 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;

(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.

(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 subsection (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.

(3) Where 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.

(4) A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified in sub-section (1)."

5. Section 164(2) provides that if a company does not file financial statements for annual returns for any continuous period of three financial years, or fails 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 continuous for one year or more then, a Director of such company is not eligible to be

reappointed as a Director of that company or appointed in any other company for a period of five years from the date on which the said company fails to fulfil its commitments as prescribed in Clause b of sub-section 2 of Section 164.

6. Section 167 of the Companies Act as stated earlier gives instances where the office of a Director shall become vacant. Section 167(1)(a) states that if a Director incurs any disqualification specified in Section 164, then he vacates his seat as a Director. The proviso which is under challenge in the instant writ petition states that, when a company commits a default as stipulated in sub-section 2 of Section 164, then a Director of such defaulting company does not vacate the post in the company in which the default is committed but a Director of such a company has to vacate his seat as a Director in all other companies in which he is Director.

7. The petitioner contends that proviso to Section 167(1)(a) of the Companies Act, leads to unequal treatment being met out to Directors of a company defaulting company based on whether they are Directors in other companies or not. The petitioner claims that since this proviso states that

such Directors of a defaulting company would only have to vacate Directorship in other companies while retaining the same in the defaulting company, this leads to unfair treatment to those Directors who hold such posts in multiple companies. The petitioner further claims that this differential classification is not based on an intelligible differentia and that there is no justification provided for mandating the vacation of Directorship in other companies, thus leading to this provision being arbitrary and violative of Article 14 of the Constitution of India. It is also contended that the impugned provision irrationally has a detrimental effect on other, non-defaulting companies and punishes individual Directors for the defaults of a company even when fault cannot be directly attributed to them. The petitioner also claims that the impugned proviso also violates the principles of natural justice.

8. Prior to the Companies Act 2013, the corresponding provision to Section 164 in the 1956 Act was Section 274 and the provision corresponding to Section 164(2) was Section 274(1)(g) which was included to the Act through an amendment on 13.12.2000. Section 274 as it stood prior to the Companies Act 2013 reads as under:-

"274. DISQUALIFICATIONS OF DIRECTORS. (1) A person shall not be capable of being appointed director of a company, if - (a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force ; (b) he is an undischarged insolvent ; (c) he has applied to be adjudicated as an insolvent and his application is pending ; (d) 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 ; (e) he has not paid any call in respect of shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call; (f) an order disqualifying him for appointment as director has been passed by a Court in pursuance of section 203 and is in force, unless the leave of the Court has been obtained for his appointment in pursuance of that section ; or 1 [(g) 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 ; or (B) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more : Provided that 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 file annual accounts and annual returns under sub-clause (A) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend

referred to in clause (B).] (2) The Central Government may, by notification in the Official Gazette, remove - (a) the disqualification incurred by any person in virtue of clause (d) of sub-section (1), either generally or in relation to any company or companies specified in the notification ; or (b) the disqualification incurred by any person in virtue of clause (e) of sub-section (1). (3) A private company which is not a subsidiary of a public company may, by its articles, provide that a person shall be disqualified for appointment as a director on any grounds in addition to those specified in sub-section (1). "

9. Similarly, prior to the Companies Act 2013, the provision corresponding to Section 167 in the 1956 Act is Section 283. Section 283 as it stood prior to the Companies Act 2013 reads as under:-

"283. VACATION OF OFFICE BY DIRECTORS.

(1) The office of a director shall become vacant if -

(a) he fails to obtain within the time specified in sub-section (1) of section 270, or at any time thereafter ceases to hold, the share qualification, if any, required of him by the articles of the company ;

(b) he is found to be of unsound mind by a Court of competent jurisdiction ;

(c) he applies to be adjudicated an insolvent ;

(d) he is adjudged an insolvent ;

(e) he is convicted by a Court of any offence involving moral turpitude and sentence in respect thereof to imprisonment for

not less than six months ;

(f) he fails to pay any call in respect of shares of the company held by him, whether alone or jointly with others, within six months from the last date fixed for the payment of the call unless the Central Government has, by notification in the Official Gazette, removed the disqualification incurred by such failure ;

(g) he absents himself from three consecutive meetings of the Board of directors, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board ;

(h) he (whether by himself or by any person for his benefit or on his account), or any firm in which he is a partner or any private company of which he is a director, accepts a loan, or any guarantee or security for a loan, from the company in contravention of section 295 ;

(i) he acts in contravention of section 299 ;

(j) he becomes disqualified by an order of Court under section 203 ;

(k) he is removed in pursuance of section 284 ; or

(l) having been appointed a director by virtue of his holding any office or other employment in the company, 1 [***] he ceases to hold such office or other employment in the company 2 [***].

(2) Notwithstanding anything in clauses (d), (e) and (j) of sub-section (1), the disqualification referred to in those clauses shall not take effect -

(a) for thirty days from the date of the adjudication, sentence or order ;

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

(c) where within the seven days aforesaid, any further appeal or petition is preferred in respect of the adjudication, sentence, conviction, or order, and the appeal or petition, if allowed, would result in the removal of the disqualification, until such further appeal or petition is disposed of.

(2A) Subject to the provisions of sub-sections (1) and (2), if a person functions as a director when he knows that the office of director held by him has become vacant on account of any of the disqualifications, specified in the several clauses of sub-section (1), he shall be punishable with fine which may extend to 3 [five thousand] rupees for each day on which he so functions as a director.

(3) A private company which is not a subsidiary of a public company may, by its articles, provide that the office of director shall be vacated on any grounds in addition to those specified in sub-section (1)."

10. Though the corresponding provisions in the Companies Act 1956 and the Companies Act 2013 deal with similar subject matter, there are important distinctions between the same. As per Section 167(1)(a) of the 2013 Act, the office of the Director is to become vacant if a Director incurs any disqualification as provided for under Section 164. However, no

such all-encompassing provision existed in the 1956 Act with each of the grounds for vacation being listed individually. It is important to note that liability under Section 274(1)(g) was not a ground for a Director to vacate his post in any company.

11. Before the impugned proviso was inserted in the Companies Act 2013, Directors of a company who had defaulted under Section 164(2) would have to vacate their post as Director of the defaulting company only. This was leading to a situation where any person who became a Director of a company which had defaulted under Section 164(2) automatically attracted Section 167(1). Thus, no person could be appointed as a Director in those companies which had defaulted under Section 164(2). This was noted in the judgment dated 14.11.2019, passed by the Hon'ble Delhi High Court in ***Mukut Pathak & Ors Vs. Union of India***, WP.No.9088 of 2018 which while placing reliance on the decision dated 09.07.2019 of the Hon'ble Bombay High Court in ***Kaynet Finance Ltd. Vs. Verona Capital Ltd.***, Appeal Lodging No.318 of 2019 in Arbitration Petition No.716 of 2019 wherein, the Delhi High Court observed as under:-

"...78. It was contended by the petitioners that Clause (a) of Section 167(1) as it stood prior to introduction of the proviso could apply only individuals who incurred the disqualification as specified in Section 164(1) of the Act not to those who incurred the disqualification under Section 164(2) of the Act. It was contended that introduction of the proviso brought about a material change in the import of clause(a) of Section 167(1) of the Act and therefore the same would be applicable only prospectively. The learned counsel appearing for the petitioners relied upon the decision of the Bombay High Court in Kaynet Finance Limited vs. Verona Capital Limited: Appeal Lodging No. 318 of 2019 in Arbitration Petition No. 716 of 2019 and Notice of Motion Lodging No. 662 of 2019, decided on 09.07.2019 in support of their contention. In that case, the Division Bench of the Bombay High Court had read down the provisions of Section 167)(1)(a) of the Act to be applicable only in cases where a director had incurred disqualification under Section 164(1) of the Act. The said clause was held wholly inapplicable in cases where a director had incurred disqualification under Section 164(2) of the Act. The Court had reasoned that directors of company that had defaulted in filing returns and financial statements for a period of three consecutive years would be disqualified from being appointed in that company by virtue of Clause (a) of Section 164(2) of the Act. If Section 167(1)(a) was read to apply to such directors, it would lead to an absurd situation where no person could possibly act as a director of a defaulting company. This would be so because a director would demit his office as soon as he was appointed. The Court observed that "it could not have been

the intention of law to create an absurdity."

...97. Although, the challenge to the constitutional vires to the provisions of section 164(2) and 167(1) of the Act have not been raised in any of these petitions, however, it is apposite to observe that reading down the provisions of Section 167(1)(a), as has been done by the Bombay High Court in Kaynet Finance Limited (supra), would also obviate the challenge to the provisions of Section 167(1)(a) of the Act as being arbitrary and unreasonable.

...113. As discussed above, the Scheme of Section 164(2) and Section 167(1)(a) of the Act was materially amended by the Companies Amendment Act, 2018 by introduction of the provisos to Section 164(2) and Section 167(1)(a) of the Act with effect from 07.05.2018. All directors who incur disqualification under Section 164(2) of the Act after the said date, would also cease to be directors in other companies (other than the defaulting company) on incurring such disqualification. However, the operation of the provisos to Section 164(2) and Section 167(1)(a) of the Act cannot be read to operate retrospectively. The proviso to Section 167(1) of the Act imposes a punitive measure on directors of defaulting companies. Such being the nature of the amendment, the same cannot be applied retrospectively. It is well settled that the Statute that impairs an existing right, creates new disabilities or obligations-otherwise than in regard

to matters of procedure-cannot be applied retrospectively unless the construction of the Statute expressly so provides or is required to be so construed by necessary implication. Therefore, the office of a director shall become vacant by virtue of Section 167(1)(a) of the Act on such director incurring the disqualifications specified under Section 164(1) of the Act. It shall also become vacant on the directors incurring the disqualification under Section 164(2) of the Act after 07.05.2018. However, the office of the director shall not become vacant in the company which is in default under sub-section 164(2) of the Act."

12. It was in order to rectify such situations the proviso to Section 167(1)(a) was inserted by the 2017 Amendment Act. It is worthwhile to mention that the Company Law Committee had also made its recommendations to this effect. The relevant portion of the 2016 Company Law Committee report reads as under:-

"11.13 Section 167(1)(a) dealing with vacation of office by a director triggers an automatic vacation of office of the director if he incurs any of the disqualifications stipulated under Section 164. Section 164(1) provides for disqualifications

which are incurred by a director in his personal capacity such as being an undischarged bankrupt, of unsound mind, convicted of an offence etc., and Section 164(2) lists out disqualifications related to the company such as non-compliance of annual filing requirements, etc. ***The Committee acknowledged that this Section created a paradoxical situation, as the office of all the directors in a Board would become vacant where they are disqualified under Section 164(2), and a new person could not be appointed as a director as they would also attract such a disqualification****. In this regard, the Committee recommended that the vacancy of an office should be triggered only where a disqualification is incurred in a personal capacity and therefore, the scope of Section 167(1)(a) should be limited to only disqualifications under Section 164(1).*

11.14 The Committee also recommended that a disqualification under Section 164(2) be only applicable to a person who was a director at the time of the noncompliance, and in case of a continuing non-compliance, there should be a period of six months' time allowed for a new Director to make the company compliant. 11.15 ***The Committee felt that the proviso to Section 164 (appearing under sub-section (3) of the section) creates an inconsistent situation when read with the proviso to Section 167(1)(f), as these provide for a person to be appointed as a Director if he has been convicted/disqualified by a Court but has an appeal preferred in a Court whereas for a sitting Director, it does not allow such consideration and he has to vacate office on conviction, even if an appeal had been preferred against such conviction and sentence****. The Committee, therefore,*

recommended that such inconsistency be corrected and in case of requirement for vacation of office of a Director, it should not take effect until the appeals are disposed off, while in case of disqualification, it is not required to provide for period of pendency of appeal."

(emphasis supplied)

13. A perusal of the above quoted report brings out the justification for the suggested proviso to Section 167(1)(a). The purpose of the amendment was that if the post of Directorship is vacated under the provision (as it was) then, this post would remain vacant as these provisions would automatically apply to any individual subsequently appointed. There were two solutions proposed to rectify this, firstly, it was recommended that vacancy of the office should only be acknowledged when the conditions under Section 164(1) are satisfied and not when there is liability under Section 164(2). The second solution suggested that disqualification under Section 167(1)(a) read with Section 164(2) should be applicable only to the individual who was Director at the time of the default.

14. The primary issue in this case relates to whether or not the

proviso to Section 167(1)(a) was without justification irrationally mandating the vacating of Directorship in other companies while not providing for the same in the defaulting company. It is the contention of the petitioner that the impugned proviso provides for vacating of the post of Directorship in all other companies without any justification being provided for the same. The petitioners have contended that the reasoning behind inclusion of this proviso finds scarce reference in the Statement of Objects and Reasons of the 2017 Amendment Act and that this Act merely states that the justification can be found in the 2016 Company Law Committee report.

15. As stated above, Section 164(2) is nearly identical to, and has borrowed from, Section 274(1)(g) of the Companies Act 1956, the object and purpose of these two Sections can be accepted as being the same. It is thus vital to analyse the justification behind Section 274(1)(g) of the erstwhile Companies Act. In this regard, reference can be made to two judgments one of the Gujarat High Court in ***Saurashtra Cement Ltd. & another Vs. Union of India***, (2006) SCC Online Guj 258 and the other of the Bombay High Court in ***Snowcem India Ltd & Ors Vs. Union of India***, (2004) SCC Online Bombay 1085. In both these cases, the vires of Section

274(1)(g) was challenged as being violative of the fundamental rights enshrined in the Constitution of India. In the former judgment the Section was challenged claiming violation of Article 14 of the Constitution of India and in the later, it was also challenged as being violative of Articles 14,19, 21 as well as the principles of natural justice. The statement of object and reasons behind Section 274(1)(g) of the Companies Act 1956 has been referred to in paragraph 15 ,16 and 17 of the former judgment are as follows:-

> *"...**15**. The Statement of Objects and Reasons for enactment of section 274(1)(g) reads a under:*
>
> *"The Government introduced a comprehensive Companies Bill, 1997 in Rajya Sabha on August 14, 1997, and the same was referred to standing committee of Parliament for examination and report thereon. The process of examination, however, is not yet over and is till to take some more time. The passing of this Bill is thus likely to be delayed further. It is however considered desirable by the Government that some more important changes in the Companies Act, 1956, are brought out in order to provide immediately certain measures for good corporate governance and for protection of investors. These measures are as follows…*
>
> *(xiv) to provide that in case of a public company which does not file annual accounts and annual returns continuously for the last three years, the directors of such companies will be debarred from becoming the director of other public companies for five*

years. Similarly, in the case of any public company which fails to repay its depositors on maturity of deposit amount/debentures, dividend and interest on deposits/debentures on due dates. The whole-time directors of defaulting companies as on such date will be debarred from becoming a director of any other public company for a period of five years."

16**. According to newly amended Act, a person shall not be capable of being appointed "director" of a company, if such person is already a director of a public company which has not filed annual accounts and annual returns for any continuous three financial years commencing on and after the first date of April 1998, or has failed to repay its deposits or interest thereon or redeem its debentures on due date or pay dividend and such failure continue for one year or more and 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 sub-clause (a) or has failed to repay its deposits or interest or redeem its debentures on due date or pay dividend referred to in clause (b). **The purpose of the amendment is to disqualify certain person from directorship in public companies. The intention and the purpose of the above amendment is to disqualify errant directors, protect the investors from mismanagement, ensure compliance in filing of annual accounts and annual returns. The purpose of the said provision is as such not to punish those who are disqualified but to save the community from the consequences of mismanagement and also to

prescribe some standards of corporate managership. It appears that the primary purpose of the disqualification is not to punish the individual but to protect the public against future conduct by person whose past record as directors shows a great danger to creditors and others. Failure is often a sign of incompetence from which the community should be protected. *Thus, considering the Statement of Objects and Reasons, what emerges is that the above amendment will ensure proper governance of companies, transparency in working of companies and also ensure more effective enforcement. The said provision has been enacted with the intention and purpose of:*

(i) disqualifying errant directors;

(ii) protecting the investors from mismanagement;

(iii) ensuring compliance and filing of annual accounts and annual returns which are the means of disclosure to all stakeholders;

(iv) increasing compliance rate of filing statutory documents; and

(v) infusing good corporate governance in the regulations of corporate affairs and to protect the interest of the investors.

17*. The vires of section 274(1)(g) of the Companies Act came to be considered by the Division Bench of Bombay High Court in the case of Snowcem India Ltd. v. Union of India, [2005] 124 Comp Cas 161 : [2005] 60 SCL 50, and the Division Bench of the High Court has upheld the vires of section 274(1)(g) of the Companies Act by holding that:*

"(1) The Statement of Objects and Reasons for enactment of section 274(1)(g) is for better corporate governance and protection of investment of the depositors. Such amendment would ensure transparency in the functioning of the company and would lead to the protection of investment and investors for better corporate governance. According to the wisdom of the Legislature, this can be achieved by enhancing penalty/punishment for contribution so as to ensure better compliance with the provision of the Act;

(2) Article 21 of the Constitution is not at all attracted;

(3) Section 274(1)(g) of the Act does not violate the directors' fundamental rights guaranteed under article 19(1)(g) of the Constitution of India. The amendment does not debar the petitioners from carrying on any business, trade or occupation, only that the person have been rendered incapable of becoming directors in other companies and the said amendment became imperative in view of a large number of companies becoming defaulters;

(4) The said amendment does not violate the rules of natural justice;

(5) Section 274(1)(g) does not penalize the company. It is only the directors who are rendered incapable of functioning as directors for certain period. The amendment has been carried out primarily to ensure that directors of the company discharge their obligation properly. They should be more vigilant and careful and ensure that investors do not lose their life time savings;

(6) Once a person becomes a director, it is his primary duty to ensure that there is proper governance and investors' money is protected;

(7) The amendment is not violative of article 14;

(8) Amendment to section 274(1)(g) has been made primarily in larger public interest to protect large number of investors, particularly small and poor investors who had invested their life time savings with these companies and in majority of the case neither principal amount nor interest is paid."

(emphasis supplied)

16. A perusal of the above mentioned paragraphs would show that Section 273(1)(g) was brought into the Companies Act only for the purpose of good governance by regulating defaulting directors and saving companies from mismanagement. The legislature intended to ensure that companies adhere to the mandate under the Companies Act by ensuring compliance and filing of annual accounts and annual returns which was the only method by which the public could know the financial health of the company. The object was to ensure transparency in the conduct of the business of the company intended to protect investors from mismanagement of companies. The Bombay High Court in ***Snowcem India Ltd & Ors Vs. Union of India***, (2004) SCC Online Bombay 1085, while

upholding the constitutionality of Section 274(1)(g) which was introduced in 2000, further observed as under:-

> *"...**13**. We have heard learned counsel for the parties at some length regarding validity and legality of the said amendment. In view of the Statement of Objects and Reasons of enactment of section 274(1)(g) of the Act, it is abundantly clear that this amendment has been incorporated for better corporate governance and protection of the investment of the depositors. In the instant case, the company has collected huge deposits from small and poor investors, who had deposited their lifetime savings with this company, in the hope of getting reasonable interest on their deposits. It is expected that such amendment would ensure transparency in the functioning of the company and would lead to the protection of the investment of investors and better corporate governance. According to the wisdom of the Legislature, this can be achieved by enhancing penalty/punishment for contravention so as to ensure better compliance with the provisions of the Companies Act, 1956.*
>
> ***14**. We fail to appreciate how article 21 of the Constitution is attracted, which refers to right to live. The challenge seems to be totally without any merit. We would appreciate if the submission is made on behalf of the small investors, who had deposited their lifetime savings with the petitioners and similar other companies where these small investors do not receive either the principal or interest and*

consequently, their children may not be provided education and/or medical treatment affecting their families' fundamental rights guaranteed under article 21 of the Constitution. Therefore, if at all there is violation of article 21, it is the violation of fundamental right under article 21 of the children and their parents.

***15**. Similarly, we are unable to comprehend how the amendment of section 274(1)(g) violates the petitioners' fundamental rights guaranteed under article 19(1)(g) of the Constitution. This amendment does not debar the petitioners from carrying on any business, trade or occupation, only that the persons have been rendered incapable of becoming directors in other companies. Perhaps, this amendment became imperative in view of a large number of companies becoming defaulters. It is a matter of common knowledge that millions of small investors, who had deposited their lifetime savings with these companies, in order to get reasonable returns, have been totally ruined. In most cases, they neither receive the principal amount nor any interest. A number of such petitions are pending in various courts of the country. We find no merit in the submission of the petitioners that this amendment, in any manner, violates the petitioners' fundamental rights guaranteed under article 19(1)(g) of the Constitution.*

***16**. We do not see any merit in the petitioners' submission that this amendment, in any manner, violates the*

rules of natural justice. Once the company failed to repay the interest or the principal amount, there is nothing required, but surely, when this fact is not disputed by the company, the challenge that this amendment being violative of rules of natural justice becomes hollow and without any merit.

***17**. The petitioners' submission is that no distinction is made between its failure and failure beyond the means of the directors of the company. It is pertinent to note that section 274(1)(g) does not penalise the company; it is only the directors that are rendered incapable of functioning as directors for certain period. The amendment has been carried out primarily to ensure that directors of the company should discharge their obligation properly. They should be more vigilant and careful and ensure that investors do not lose their lifetime savings.*

*...**19**. We see no force in the submission of the petitioners that the section does not make any discrimination between director and non-director or executive and non-executive director. Once any person becomes a director, it is his primary duty to ensure that there is proper governance and investors' money is protected.*

***20**. We find no merit in the submission of the petitioners that this amendment is violative of article 14 of the Constitution. The provision of section 274(1)(g) does not make distinction between the Government-nominated directors and other directors. The Government of India,*

Ministry of Law, Justice and Company Affairs, letter dated March 22, 2003, has interpreted the composite effect of the non obstante clause in the statute of public financial institutions like Industrial Development Bank of India, Life Insurance Corporation of India, Unit Trust of India, etc., and gave an opinion that the directors appointed by these institutions cannot be disqualified as appointment as directors is by virtue of section 274(1)(g) and also directors appointed on the boards of assisted companies, etc. "

17. A perusal of the above extract reveals that the Bombay High Court in ***Snowcem India Ltd & Ors Vs. Union of India,*** has held that Section 274(1)(g) of the Companies Act 1956, would not violate Article 19 or 14 of the Constitution of India as it does not restrict an individual's freedom to carry on his business, trade or occupation, does not create any unreasonable classification and merely acts as a penal measure in cases where a Director has failed to carry out his duties. Additionally it held that Section 274(1)(g) of the Companies Act 1956, was a necessary provision as it was in the interest of ensuring good corporate governance and transparency.

18. Further, Gujarat High Court in ***Saurashtra Cement Ltd. &***

another Vs. Union of India, (2006) SCC Online Guj 258, at paragraph 24 and 27 held as under:-

> *"...**24**. It is also the submission on behalf of the petitioners that section 274(1)(g) is ultra vires the statement of objects and reasons and/or the above provision has no nexus to the objects sought to be achieved, namely good corporate governance and protection of the investors. Section 274(1)(g), is reproduced hereinabove and the statement of objects and reason is also reproduced hereinabove. The primary object of enactment of section 274(1)(g) is better corporate governance as well as protection of investment of the depositors. The intention and purpose of the above amendment is to disqualify the errant directors and to protect the investors from mismanagement. The amendment becomes absolutely imperative to protect large number of investors, particularly small and poor investors who had invested their life time savings with such companies and in majority of the cases neither the principal amount nor the interest is paid back. It is an admitted position that so far as petitioner No. 1 company is concerned, the said company is unable to redeem the debentures which fell due on September 30, 2003. Thus, it cannot be said that section 274(1)(g) has no nexus to the objects sought to be achieved, namely good corporate governance and protection of investors.*
>
> *...**27**. So far as the submission on behalf of the petitioners that a person may be a director in many companies*

and some companies may be profit making company and some company may be loss making company and therefore to disqualify a director to be a director of other profit making companies or becoming a director of a company which is unable to repay the deposits or redeem the debentures, has no nexus with the statement of objects and reasons, i.e., to protect the interest of investors and/or it will not be in the interest of a loss making company and such directors either will be disqualified and/or prior thereto they will resign and therefore the management of the loss making company will be in the hands of those persons who know nothing about the business, operation and management of the company. It is required to be noted that on the aforesaid ground a provision of a statute cannot be declared "ultra vires". One has to consider the very provision of the statute and the purpose for the said provision. The purpose is to see that under the threat of the aforesaid provision, the whole board of directors may act vigilantly and may see to it that the company is revived and the affairs of the company are managed in such a manner that ultimately deposits are repaid and/or debentures are redeemed. Otherwise, no company would try to improve their affairs and ultimately try to protect the interest of the investors. The purpose of the provision is not to punish those who are so disqualified only but to save the community from the consequences of mismanagement and to protect the public against future conduct of persons whose past records as directors shows them to be a danger to creditors and others. The hon'ble Supreme Court in R.K. Garg v. Union of India, (1981) 4 SCC 675, 690 : [1982] 133 ITR 239, has held as under (page 255):

"… laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It has been said by no less a person than Holmes J., that the Legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrinaire or strait-jacket formula and this is particularly true in the case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the Legislature. The court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human rights are involved…

The court must always remember that legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry; that exact wisdom and nice adaption of remedy are not always possible and that judgment is largely a prophecy based on meagre and uninterpreted experience. Every legislation particularly in economic matters is essentially empiric and it is based on experimentation or what one may call trial and error method and therefore it cannot provide for all possible situations or anticipate all possible abuses. There may be crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid. The courts, cannot, as pointed out by the United States Supreme Court in Secretary of

Agriculture v. Central Reig Refining Co., [1950] 94 L. Ed. 381, be converted into tribunals for relief from such crudities and inequities If any crudities, inequities or possibilities of abuse come to light, the Legislature can always step in and enact suitable amendatory legislation. That is the essence of pragmatic approach which must guide and inspire the Legislature in dealing with complex economic issues."

19. A perusal of the above extract makes it clear that Section 274(1)(g) of the Companies Act 1956 was made to protect investors rights and to ensure that Directors of companies act vigilantly in preventing any misfeasance or discrepancy which may affect investors and the public. It is thus held that the underlying object of Section 274(1)(g) is facilitating good corporate governance and it cannot be declared unconstitutional without considering the purpose that the provision serves.

20. In our opinion, the legislative intent behind the inclusion of the proviso to Section 167(1)(a) is also to ensure good governance and inculcate a sense of security in investors through transparent disclosures and control over erring Directors. The Hon'ble Supreme Court in ***N.Narayanan Vs. Adjudicating Officer, Security and Exchange Board of India***, (2013) 12 SCC 152, in paragraphs 35 and 36 state as under:-

*"**35**. Gower and Davies in Principles of Modern Company Law, 9th Edn. (2012) at p. 751, reiterated their views on the scope and rationale of annual reporting required under the Companies Acts, as follows:*

"On the basis that 'forewarned is forearmed' the fundamental principle underlying the Companies Act has been that of disclosure. If the public and the members were enabled to find out all relevant information about the company, this, thought the founding fathers of our company law, would be a sure shield. The shield may not have proved quite so strong as they had expected and in more recent times, it has been supported by offensive weapons."

***36**. The Companies Act casts an obligation on the company registered under the Companies Act to keep the books of accounts to achieve transparency. Previously, it was thought that the production of the annual accounts and their preparation is that of the accounting professional engaged by the company where two groups who were vitally interested were the shareholders and the creditors. But the scenario has drastically changed, especially with regard to the company whose securities are traded in public market. Disclosure of information about the company is, therefore, crucial for the accurate pricing of the company's securities and for market integrity. Records maintained by the company should show and explain the company's transactions, it should disclose with reasonable accuracy the financial position, at any time, and to enable the Directors to ensure that the balance sheet and profit and loss accounts will comply with the statutory expectations that accounts give a true and fair view. The*

Companies (Amendment) Act, 2000 has added clause (iii) to Section 209-A(1) of the Companies Act, 1956 under which SEBI has also been given the power of inspection of listed companies or companies intending to get listed through such officers, as may be authorised by it. "

21. An analysis of the above mentioned extract reveals that filing of returns and disclosures regarding the finances of the company are vital to ensure greater transparency and accountability to the public which is the need of the hour in today's corporate set up. These measures are extremely necessary in the interest of fair trade and ensuring justice. Additionally, a great deal of responsibility is borne by the Directors of a company to ensure that the company acts in accordance with laws and upholds the principles of transparency and probity. It would be apt to rely on the judgment of the Hon'ble Supreme Court in ***Official Liquidator, Supreme Bank Ltd., Vs. P.A.Tendolkar,*** (1973) 1 SCC 602, that holds that the Directors of a company must be responsible for actions and affairs of the company which are visible to the public even superficially. A Director must not derelict his duties as a Director and must exercise all due diligence necessarily to ensure that the company abides by laws and regulations. The relevant paragraphs are extracted hereunder:-

*"**45**. It is certainly a question of fact, to be determined upon the evidence in each case, whether a Director, alleged to be liable for misfeasance, had acted reasonably as well as honestly and with due diligence, so that he could not be held liable for conniving at fraud and misappropriation which takes place. A Director may be shown to be so placed and to have been so closely and so long associated personally with the management of the Company that he will be deemed to be not merely cognizant of but liable for fraud in the conduct of the business of a Company even though no specific act of dishonesty is proved against him personally. He cannot shut his eyes to what must be obvious to everyone who examines the affairs of the Company even superficially. If he does so he could be held liable for dereliction of duties undertaken by him and compelled to make good the losses incurred by the Company due to his neglect even if he is not shown to be guilty of participating in the commission of fraud. It is enough if his negligence is of such a character as to enable frauds to be committed and losses thereby incurred by the Company."*

The above mentioned extract has also been reaffirmed in the case of ***N.Narayanan Vs. Adjudicating Officer, Security and Exchange Board of India***(supra).

22. It has also been noted by the Hon'ble Supreme Court in ***Dale &***

Carrington Invt. Pvt. Ltd. v. P.K. Prathapan, (2005) 1 SCC 212 that the directors of a company owe an obligation to the shareholders of the company to make all disclosures and to act in the best interest of the company, exercising due diligence and good faith. The Hon'ble Supreme Court also stated that irrespective of whether directors are described as trustees, agents or representatives, they have a duty to act for the benefit of the company and must not derelict their duty towards the shareholders and investors in the company. The relevant portion reads as under:-

> "*(d) We may also test the alleged act of allotment of equity shares in favour of Ramanujam from a legal angle. Could it be said to be a bona fide act in the interest of the company on the part of Directors of the company? At this stage it may be appropriate to consider the legal position of Directors of companies registered under the Companies Act. A company is a juristic person and it acts through its Directors who are collectively referred to as the Board of Directors. An individual Director has no power to act on behalf of a company of which he is a Director unless by some resolution of the Board of Directors of the company specific power is given to him/her. Whatever decisions are taken regarding running the affairs of the company, they are taken by the Board of Directors. The Directors of companies have been variously described as agents, trustees or representatives, but one thing is certain that the Directors act on behalf of a company in a fiduciary capacity and their acts and deeds have to be exercised for the benefit of the*

company. They are agents of the company to the extent they have been authorised to perform certain acts on behalf of the company. In a limited sense they are also trustees for the shareholders of the company. To the extent the power of the Directors are delineated in the Memorandum and Articles of Association of the company, the Directors are bound to act accordingly. As agents of the company they must act within the scope of their authority and must disclose that they are acting on behalf of the company. The fiduciary capacity within which the Directors have to act enjoins upon them a duty to act on behalf of a company with utmost good faith, utmost care and skill and due diligence and in the interest of the company they represent. They have a duty to make full and honest disclosure to the shareholders regarding all important matters relating to the company. It follows that in the matter of issue of additional shares, the Directors owe a fiduciary duty to issue shares for a proper purpose. This duty is owed by them to the shareholders of the company. Therefore, even though Section 81 of the Companies Act, 1956 which contains certain requirements in the matter of issue of further share capital by a company does not apply to private limited companies, the Directors in a private limited company are expected to make a disclosure to the shareholders of such a company when further shares are being issued. This requirement flows from their duty to act in good faith and make full disclosure to the shareholders regarding affairs of a company. The acts of Directors in a private limited company are required to be tested on a much finer scale in order to rule out any misuse of power for personal gains or ulterior motives. Non-applicability of Section 81 of the

Companies Act in case of private limited companies casts a heavier burden on its Directors. Private limited companies are normally closely held i.e. the share capital is held within members of a family or within a close-knit group of friends. This brings in considerations akin to those applied in cases of partnership where the partners owe a duty to act with utmost good faith towards each other. Non-applicability of Section 81 of the Act to private companies does not mean that the Directors have absolute freedom in the matter of management of affairs of the company. In the present case Article 4(iii) of the Articles of Association prohibits any invitation to the public for subscription of shares or debentures of the company. The intention from this appears to be that the share capital of the company remains within a close-knit group. Therefore, if the Directors fail to act in the manner prescribed above they can in the sense indicated by us earlier be held liable for breach of trust for misapplying funds of the company and for misappropriating its assets."

23. A Director, irrespective of the nature of Directorship, by virtue of the fact that he holds the position of Directorship cannot claim immunity for the defaults of the company in the filing of returns or the business of the company, and therefore cannot be made to vacate his post in other companies. This Court can take judicial notice of the fact that people invest their hard earned money in companies in which there are persons of repute holding the position of a Director. The Director therefore

cannot absolve himself of the misdeeds of the company after holding a position in the company. Section 166 of the Companies Act 2013, which enumerates the duties of a Director mandates that the Director of a company shall act in good faith in order to promote the objects of the company for the benefit of the other members as a whole and in the best interest of the company, its employees, shareholders, the community and the protection of the environment. The object of inserting the proviso is to ensure that a person who is a Director in a Company that does not file its returns for a period of three years or does not return the money back to its investors or creditors does not continue as Director in other companies. This proviso will also act as a deterrent from incorporating shell companies to park illegally obtained money. There is thus a rational nexus between the amendment and the object for which the amendment was brought about in the Companies Act 2013. The contention of the petitioner that the proviso to Section 167(1)(a) is irrational, manifestly arbitrary and unreasonable, and thus must be declared as ultra vires Article 14 of the Constitution of India cannot be accepted.

24. It is well established by decisions of the Hon'ble Supreme Court such as ***Subramanian Swamy v. Director, Central Bureau of***

Investigation, (2014) 8 SCC 682, ***Indian Express Newspapers (Bombay) Private Ltd. v. Union of India***, (1985) 1 SCC 641 and ***Cellular Operators Association of India v. Telecom Regulatory Authority of India***, (2016) 7 SCC 703 that legislation can be struck down if the same is shown to be manifestly arbitrary and thus violative of Article 14 of the Constitution of India.

25. The test for examining whether or not a legislation is manifestly arbitrary has been examined in detail by the Hon'ble Supreme Court in ***Shayara Bano v. Union of India***, (2017) 9 SCC 1 where the Court, while placing reliance on ***Khoday Distilleries Ltd. v. State of Karnataka***, (1996) 10 SCC 304 and ***Sharma Transport v. State of A.P.***, (2002) 2 SCC 188 states as under:

> "***100***. *To complete the picture, it is important to note that subordinate legislation can be struck down on the ground that it is arbitrary and, therefore, violative of Article 14 of the Constitution. In Cellular Operators Assn. of India v. TRAI [Cellular Operators Assn. of India v. TRAI, (2016) 7 SCC 703] , this Court referred to earlier precedents, and held: (SCC pp. 736-37, paras 42-44)*
>
> *"Violation of fundamental rights*
>
> *42. We have already seen that one of the tests for challenging the constitutionality of subordinate legislation is that*

subordinate legislation should not be manifestly arbitrary. Also, it is settled law that subordinate legislation can be challenged on any of the grounds available for challenge against plenary legislation. [See Indian Express Newspapers (Bombay) (P) Ltd. v. Union of India [Indian Express Newspapers (Bombay) (P) Ltd. v. Union of India, (1985) 1 SCC 641 : 1985 SCC (Tax) 121] , SCC at p. 689, para 75.]

43. The test of "manifest arbitrariness" is well explained in two judgments of this Court. In Khoday Distilleries Ltd. v. State of Karnataka [Khoday Distilleries Ltd. v. State of Karnataka, (1996) 10 SCC 304] , this Court held: (SCC p. 314, para 13)

> *'13. It is next submitted before us that the amended Rules are arbitrary, unreasonable and cause undue hardship and, therefore, violate Article 14 of the Constitution. Although the protection of Article 19(1)(g) may not be available to the appellants, the Rules must, undoubtedly, satisfy the test of Article 14, which is a guarantee against arbitrary action. However, one must bear in mind that what is being challenged here under Article 14 is not executive action but delegated legislation. The tests of arbitrary action which apply to executive actions do not necessarily apply to delegated legislation. In order that delegated legislation can be struck down, such legislation must be manifestly arbitrary; a law which could not be reasonably expected to emanate from an authority delegated with the law-making power. In Indian Express Newspapers (Bombay) (P)*

Ltd. v. Union of India [Indian Express Newspapers (Bombay) (P) Ltd. v. Union of India, (1985) 1 SCC 641 : 1985 SCC (Tax) 121] , this Court said that a piece of subordinate legislation does not carry the same degree of immunity which is enjoyed by a statute passed by a competent legislature. A subordinate legislation may be questioned under Article 14 on the ground that it is unreasonable; "unreasonable not in the sense of not being reasonable, but in the sense that it is manifestly arbitrary". Drawing a comparison between the law in England and in India, the Court further observed that in England the Judges would say, "Parliament never intended the authority to make such rules; they are unreasonable and ultra vires". In India, arbitrariness is not a separate ground since it will come within the embargo of Article 14 of the Constitution. But subordinate legislation must be so arbitrary that it could not be said to be in conformity with the statute or that it offends Article 14 of the Constitution.'

44. Also, in Sharma Transport v. State of A.P. [Sharma Transport v. State of A.P., (2002) 2 SCC 188] , this Court held: (SCC pp. 203-04, para 25)

'25. … The tests of arbitrary action applicable to executive action do not necessarily apply to delegated legislation. In order to strike down a delegated legislation as arbitrary it has to be established that there is manifest arbitrariness. In

order to be described as arbitrary, it must be shown that it was not reasonable and manifestly arbitrary. The expression "arbitrarily" means: in an unreasonable manner, as fixed or done capriciously or at pleasure, without adequate determining principle, not founded in the nature of things, non-rational, not done or acting according to reason or judgment, depending on the will alone.' "

***101**. It will be noticed that a Constitution Bench of this Court in Indian Express Newspapers (Bombay) (P) Ltd. v. Union of India [Indian Express Newspapers (Bombay) (P) Ltd. v. Union of India, (1985) 1 SCC 641 : 1985 SCC (Tax) 121] stated that it was settled law that subordinate legislation can be challenged on any of the grounds available for challenge against plenary legislation. This being the case, there is no rational distinction between the two types of legislation when it comes to this ground of challenge under Article 14. The test of manifest arbitrariness, therefore, as laid down in the aforesaid judgments would apply to invalidate legislation as well as subordinate legislation under Article 14. Manifest arbitrariness, therefore, must be something done by the legislature capriciously, irrationally and/or without adequate determining principle. Also, when something is done which is excessive and disproportionate, such legislation would be manifestly arbitrary. We are, therefore, of the view that arbitrariness in the sense of manifest arbitrariness as pointed out by us above would apply to negate legislation as well under Article 14. "*

26. A perusal of the principles as reaffirmed by the Hon'ble Supreme Court in ***Shayara Bano v. Union of India(supra)***, reveals that for a legislation to be manifestly arbitrary, it must be shown that such legislation has been made capriciously, irrationally, unreasonably and in such excessive and disproportionate terms that it would offend Article 14 of the Constitution of India. The intention and the purpose of the above amendment in question is to disqualify errant directors, protect the investors from mismanagement, ensure compliance in filing of annual accounts and annual returns. The purpose is to save the community from the consequences of mismanagement and also to prescribe strict standards of corporate managership. The purpose of the disqualification is not only to punish the Director but also to protect the public against future conduct by person whose past record as directors shows a great danger to creditors and others. The intention of the impugned amendment is to ensure proper governance of companies, transparency in working of companies and also to ensure more effective enforcement of the provisions of the Companies Act 2013. The petitioner placing a reliance upon paragraphs 15 and 18 of the decision of the Hon'ble Supreme Court in ***B.Manmad Reddy Vs. Chandraprakash Reddy***, (2010) 3 SCC 314,

contended that any classification must be done in a just manner, bearing a rational relation to the object that is sought to be achieved. He further placed reliance on paragraphs 31 to 36 of the decision of the Hon'ble Supreme Court in Lok Prahari Vs. State of Uttar Pradesh, (2018) 6 SCC 1, contending that any legislation that is irrational and manifestly arbitrary is violative of Article 14 of the Constitution of India. However, based on the above reasoning, the impugned proviso cannot be seen to be irrational that bears a direct nexus to the object that it seeks to achieve. It therefore cannot be said or contended that the impugned amendment to Section 167(1) by inserting the proviso is so manifestly arbitrary that it offends Article 14 of the Constitution of India.

27. The Hon'ble High Court of Karnataka in ***Yashodhara Shroff Vs. Union of India***, *(2019) SCC Online Kar 682* has upheld the validity of the proviso to sub-section 1 of Section 167. The learned Single Judge has observed as under:-

> ***181.****However, I do not find that the said provision is arbitrary inasmuch as a director who suffers disqualification as per Section 164(2) of the Act cannot be re-appointed as a director of the defaulting company as well as any other company for a period of five years. The said consequence stems*

immediately after the company in which a person is a director does not comply with Section 164(2) of the Act. When a director cannot be re-appointed in the defaulting company or in any other company for a period of five years from the date of disqualification, by the same logic, the director cannot be permitted to continue as a director in any other company. The short term effect of the non-compliance of Section 164(2) of the Act by a company is that the director of such a defaulting company would have to vacate his office as a director in all companies where he is a director. The whole object and purpose of such a provision is to ensure that a director of a defaulting company does not continue to hold the office of the director in any company, while at the same time, he is ineligible to be appointed as a director in the defaulting company or in any other company. In other words, when there is ineligibility for a director of a defaulting company to be re-appointed as a director of the defaulting company or appointed as a director of any other company, then by the same logic he cannot be permitted to be continued as a director in the defaulting company or in any other company. The disqualification on account of non-compliance under Section 164(2) of the Act implies that the director is a part of the Board of Directors of a company who has not complied with the requirements of Section 164(2) of the Act. Such a director cannot be permitted to hold the office of a director in any other company also. In other words, the object and purpose of vacating the office of a director of a defaulting company in the defaulting company and in all other companies in which he is a director is in the interest of transparency, probity and

protection of share-holders' rights. It is also in order to achieve greater accountability in corporate governance. For the same reason, it is held that Section 167(1)(a) of the Act is also not unreasonable as it has been made in public interest and is not in violation of Article 19(1)(g) of the Constitution as it is saved under Article 19(6) of the Constitution.

*...**195**.At the outset, it would be relevant to delineate on the scope and object of a proviso to the provision.*

(a) The normal function of a proviso is to except something out of the provision or to qualify something enacted therein which, but for the proviso, would be within the purview of the provision. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment and ordinarily, a proviso is not interpreted as stating a general rule. In other words, a proviso qualifies the generality of the main enactment by providing an exception and taking out as it were, from the main enactment, a portion which, but for the proviso would fall within the main enactment. Further, a proviso cannot be construed as nullifying the enactment or as taking away completely a right conferred by the enactment.

(b) In this regard, learned Author, Justice G.P. Singh has, in "Principles of Statutory Interpretation", enunciated certain rules collated from judicial precedents. Firstly, a proviso is not to be construed as excluding or adding something by implication i.e., when on a fair construction, the principal provision is clear, a proviso cannot expand or limit it. Secondly, a proviso has to be construed in relation to which it is

appended i.e., normally, a proviso does not travel beyond the provision to which it is a proviso. A proviso carves out an exception to the main provision to which it has been enacted as a proviso and to no other. However, if a proviso in a statute does not form part of a section but is itself enacted as a separate section, then it becomes necessary to determine as to which section the proviso is enacted as an exception or qualification. Sometimes, a proviso is used as a guide to construction of the main section. Thirdly, when there are two possible construction of words to be found in the section, the proviso could be looked into to interpret the main section. However, when the main provision is clear, it cannot be watered down by the proviso. Thus, where the main section is not clear, the proviso can he looked into to ascertain the meaning and scope of the main provision.

(c) The proviso should not be so construed as to make it redundant. In certain cases, "the legislative device of the exclusion is adopted only to exclude a part from the whole, which, but for the exclusion, continues to be a part of it", and words of exclusion are presumed to have some meaning and are not readily recognized as mere surplusage. As a corollary, it is stated that a proviso must be so construed that the main enactment and the proviso should not become redundant or otiose. This is particularly so, where the object of a proviso sometimes is only by way of abundant caution, particularly when the operative words of the enactment are abundantly clear. In other words, the purpose of a proviso in such a case is to remove any doubt. There are also instances where a proviso is in the nature of an independent enactment and not merely,

an exception or qualifying what has been stated before In other words, if the substantive enactment is worded in the form of a proviso, it would be an independent legislative provision concerning different set of circumstances than what is worded before or what is stated before. Sometimes, a proviso is to make a distinction of special cases from the general enactment and to provide it specially.

(d) At this stage, the construction or interpretation of a proviso could be considered. InIshverlal Thakorelal Almaulav.Motibhai Nagjibhai[AIR 1966 SC 459], while dealing with the Bombay Tenancy and Agricultural Lands Act, 1948, the Hon'ble Supreme Court held, that a proper function of a proviso is to except or qualify something enacted in the substantive clause, which but for the proviso, would be within that clause. InKaviraj Pandit Durga Dutt Sharmav.Navaratna Pharmaceutical Laboratories[AIR 1965 SC 980], while considering proviso to Section 6 of Trade Marks Act, 1940, it was observed that it would not be a reasonable construction for any statute, if a proviso which in terms purports to create an exception and seeks to confer certain special rights on a particular class of cases included in it should be held to be otiose and to have achieved nothing. InKedarnath Jute Manufacturing Co. Ltd.v.The Commercial Tax Officer, [AIR 1966 SC 12], it was observed that "the effect of an excepting or qualifying proviso, according to the ordinary rules of construction, is to except out of the preceding portion of the enactment or to qualify something enacted therein, which, but for the proviso, would be within it". [See "Craies" on Statute Law - 6thEdition - P.217]. In this case, the Court was

considering Section 5(2)(a)(ii) of Bengal Finance Sales Tax Act, 1941 and Rule 27-A of Bengal Sales Tax Rules. InDattatraya Govind Mahajanv.The State of Maharashtra, [(1977) 2 SCC 548:AIR 1977 SC 915], a Constitution Bench of the Apex Court, while considering the amendment made to Maharashtra Agricultural Lands (Ceiling on Holdings) Act, 1961, in the context of Article 31B of the Constitution and the second proviso thereto, reiterated what was stated inIshverlals case, supra. InS. Sundaram Pillaiv.V.R. Pattabiraman, [(1985) 1 SCC 591:AIR 1985 SC 582], while dealing with the scope of a proviso and explanation to sub-section (2) of Section 10 of Tamil Nadu Buildings (Lease and Rent Control) Act, 1960, the Hon'ble Supreme Court held that a proviso may have three separate functions. Normally, a proviso is meant to be an exception to something within the main enactment or qualifying some thing enacted therein which, but for the proviso, would be within the purview of the enactment. In other words, a proviso cannot be torn apart from the main enactment, nor can it be used to nullify or set at naught the real object of the main enactment. Sometimes, a proviso may exceptionally have the effect of a substantive enactment.

(e) After referring to several legal treatises and judgments, the Apex Court held in the above judgment as under:—

"43. We need not multiply authorities after authorities on this point because the legal position seems to be clearly and manifestly well established. To sum up, a proviso may serve four different purposes:

(1) qualifying or excepting certain provisions from the main enactment;

(2) it may entirely change the very concept of the intendment of the enactment by insisting on certain mandatory conditions to be fulfilled in order to make the enactment workable;

(3) it may be so embedded in the Act itself as to become an integral part of the enactment and thus acquire the tenor and colour of the substantive enactment itself; and

(4) it may be used merely to act as an optional addenda to the enactment with the sole object of explaining the real intendment of the statutory provision."

(f) The approach to the construction and interpretation of a proviso are enunciated in the following cases. InM. Pentiahv.Muddala Veeramallappa, [AIR 1961 SC 1107], it was observed that while interpreting a section or a proviso, if the choice is between two interpretations, the narrower of which would fail to achieve the manifest purpose of the legislation, one should avoid a construction which would reduce the legislation to futility and should rather accept the bolder construction based on the view that Parliament would legislate only for the purpose of bringing about an effective result. In Superintendent & Remembrancer of Legal Affairs to Govt. of West Bengal v. Abani Maity, [(1979) 4 SCC 85:AIR 1979 SC 1029], the Apex Court observed that the statute is not to be interpreted merely from the lexicographer's angle. The Court must give effect to the will and inbuilt policy of the Legislature as discernible from the object and scheme of the

enactment and the language employed therein. The words in a statute often take their meaning in the context of a statute as a whole. They are, therefore, not to be construed in isolation."

28. A perusal of the above extract from the judgment of the Hon'ble Karnataka High Court in ***Yashodhara Shroff Vs. Union of India (supra)***, reveals that the Court has found that the proviso to Section 167(1)(a) must be interpreted in ordinary terms and would apply to the entirety of Section 164 including sub-section 2. The Court has further held that this proviso can be justified on two grounds. Firstly, it has been reiterated that the exclusion of Directors from vacating their posts in the defaulting company while doing so in all other companies where they hold Directorship has been done in order to prevent the anomalous situation wherein the post of Director in a company remains vacant in perpetuity owing to automatic application of Section 167(1)(a) to all newly appointed Directors. Secondly, the underlying object behind the proviso to Section 167(1)(a) is seen to be the same as that of Section 164(2) both of which exist in the interest of transparency and probity in governance. Owing to these justifications, the Court thus holds that the proviso to Section 167(1)(a) is neither manifestly arbitrary nor does it offend any of the

fundamental rights guaranteed under Part III of the Constitution of India.

29. We are pursuaded to agree with the views of the Hon'ble Single Judge of the Karnataka High Court that present an accurate interpretation of the impugned law. The impugned provisions are intravires for all the reasons hereinabove. The writ petition is accordingly dismissed. No Costs.

(A.P.S., CJ.) (S.P., J.)
02/12/2019

Index : Yes / No
Internet : Yes / No
Speaking/Non-speaking order
pkn.

To

1. The Secretary,
   Union of India,
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The Hon'ble Chief Justice

a n d

SUBRAMONIUM PRASAD, J

pkn.

Order made in
W.P.No.32763 of 2019

02/12/2019