

Notification and Circular dated July 05, 2017

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Implications of Notifications dated July 5, 2017, issued by Ministry of Corporate Affairs(MCA) regarding an amendment to Schedule IV of the Act and requirements relating to appointment of Independent directors in certain categories of companies
MCA has come out with two notifications dated July 5, 2017, which make certain amendments respectively to Schedule IV of the Act concerning the code of Independent directors and to the companies (Appointment and Qualification) of Directors Rules,2014.

The implications of the amendments are analyzed as follows:

1. Amendments to Schedule IV of the Act relating to code of independent directors (IDs)

In Paragraph III in Sub-para(12), the words "acting within his authority" will be substituted by the words "act within their authority".•

Paragraph III in the Schedule speaks about the duties of independent directors. Sub-para (12) as existing is drafted defectively to refer to the individual duty of the ID. The change is to only establish the collective duties of the IDs.

As per existing paragraph VI (2), if there is resignation or removal of an ID, he shall be replaced within 182 days. This period is being reduced to three months. Hence an ID will have to be replaced within three months. •

The above amendment is also intended to remove the existing contradiction between Schedule IV and Rule 4 (second Proviso) to the Companies (Appointment and qualification of Directors)Rules, 2014 which provides for replacement of an ID either at the next Board Meeting or three months whichever is later.

In paragraph VII in sub-para (1) for the words "in a year" the words " in a financial year "will be substituted. Paragraph VII provides that at least one Meeting of the Independent directors shall be held in a the amendment clarifies that the Meeting should be held at least once in a financial year. •

• Exemption from the applicability of Schedule IV for Government Companies

The following provisions of Schedule IV shall not apply to a Govt. Company if the requirements given below are specified by the concerned Ministries or Departments of the Central Govt or the state Government as the case may be and such requirements are complied with by the concerned Govt company.

a) Provisions relating to evaluation of the performance of the Board and Management

b) Determination of levels of remuneration for executive directors, KMPs and members of Senior Management

c) Manner of appointment and re-appointment of IDs (paragraphs IV and V)

d) Holding meetings for reviewing the performance of non-independent directors (sub-para(3) of Paragraph VII)

e) Evaluation Mechanism for independent directors (Paragraph VIII).

2. Amendments to Companies (Appointment and Qualification of Directors) Rules,2014 made by the Companies (Appointment and Qualification of directors) Amendment Rules, 2017.

The above amendments are effective from their date of notification (July 5, 2017)•

Rule 4 of the companies (Appointment and qualification of Directors) Rules, 2014 is being re-numbered as sub-Rule(1) and after such renumbering, a new sub-rule shall be inserted which has the following implications:•

a) Following classes of unlisted public companies shall not be required to appoint Independent directors:

- a) A Joint venture
- b) A wholly owned subsidiary and
- c) a dormant company as defined under Section 455 of the Act.

The implications of the above amendments are as follows:

- a) The unlisted public company which seeks to enjoy the benefit of the amendment has to be a wholly owned Subsidiary. Hence the requirement of appointing IDs will continue to apply to a partially owned subsidiary which satisfies the prescribed thresholds for appointing IDs as per the existing Rules.
- b) There is no definition under the Act for a “Joint Venture ”. Only the Companies (Amendment)Bill 2016 contains a definition. The absence of the definition will cause confusion as to whether the benefit can be availed of by a JV.
- c) Despite the amendment, an unlisted public company which has set up an Audit committee under Section 177 since it satisfies the criteria laid down in Rule 6 of the Companies (Meetings of Board and its powers)Rules, 2014 will continue to be governed by the requirement under Section 177 that the committee shall consist of majority of independent directors .This is due to the fact that Section 177 (2) is not being amended through the above amendment Rules
- d) Similarly companies covered under Rule 6 of the Companies (Meetings of Board and its powers) Rules, 2014 which have set up the Nomination and Remuneration Committee of which half of the members have to be IDs will have to still comply with the provisions of Section 178(1) as no a consequential amendment is being made to Section 178(1).
- e) In case of a Listed company which has a wholly owned Material Subsidiary the requirement of nominating at least one ID from the Board of the Holding company on the Board of the Subsidiary will continue as the listed Company will be bound by the requirements of the SEBI(LODR)Regulations,2015.
- f) Section 135 provides for the requirement of appointing at least one ID on the CSR Committee. As per Rule 5 of the CSR Rules, 2014, only an unlisted public company or private company which is not required to appoint ID is not required to have an ID in the CSR Committee. As the above amendment in the Rules does not cover the provisions of Section 135, the requirement of appointing an ID in the CSR Committee will continue.

Conclusion

The benefit of the above Amendment Rules will not be available to most companies unless complementary amendments relating to the appointment of IDs are made to Sections 135,177 and 178 of the Act. The impact of the above changes will therefore, be limited.