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KERALA HIGH COURT ON DISQUALIFICATION OF DIRECTORS

A. Introduction.

High Court of Kerala (**HC**) in *Zacharia Maramkandathil Mohan and Ors. v. Union of India*,¹ upheld the constitutional validity of Sections 164(2)(a) and 167(1)(a) of the Companies Act, 2013 (**Act**) but held that the Director Identification Number (**DIN**) of a director cannot be deactivated solely on the basis of his/her disqualification of under Section 164(2) of the Act.

B. Brief Facts.

1. Over 200 petitions were filed challenging the constitutional validity of the above sections and the disqualification thrust upon the petitioners acting as directors of companies under Sections 164² and 167.³
2. Petitioners were disqualified under Section 164(2) for failure to file financial statements/annual returns by their respective companies.
3. Section 164 made the disqualification, on failure to file financial statements/annual returns, applicable to directors of all companies including private limited companies.
4. Section 164(2) proviso and Section 167(1)(a) provisos were inserted by the Companies (Amendment) Act, 2017 effective from 7th May 2018.

C. Contention of Petitioners.

Petitioners contended that:

- a. The incidents leading to disqualifications such as unsoundness of mind, conviction in criminal cases under Section 164(1) are personal to the directors. But incidents resulting in disqualification under 164(2) on account of the following are not directly attributable to the directors:
 - i. File annual returns or financial statements for continuous period of three years;
 - ii. Repay deposits accepted or interest payable;
 - iii. Redeem debentures on due dates;
 - iv. Pay dividends etc.
- b. Disqualifying them from serving as directors in any company for five years is excessive and arbitrary and should be hit by Article 14 of the Constitution (*Equality before law*).⁴
- c. Failure to file financial statements/annual returns can be due to reasons beyond the control of directors and they must be given an opportunity of hearing.
- d. The Act only has prospective operation and hence Section 164(2) cannot be retrospectively applied. Only the financial years (**FYs**) post 1st April 2014 can be considered to decide whether consecutive three years' failure in filing accounts and returns. Thus, there cannot be any disqualification of directors under the section until 2017 and retrospective implementation is *ultra vires*.
- e. Irrespective of the impact of the above sections on the petitioners, there is no justification for deactivating the DIN and cancelling Digital Signature Certificate (**DSC**) of the disqualified directors. They are not legally compellable to give up their DINs for the sole reason that they are temporarily disqualified for being appointed or reappointed as directors.

¹ Order in WP (C) 21628/2020 available at https://hckinfo.kerala.gov.in/digicourt/orders/2020/215700216282020_2.pdf.

² Sec. 164 on 'Disqualifications for appointment of director'.

³ Sec. 167 on 'Vacation of office of director'.

D. HC Judgment.

HC held as follows in a 546-page judgment:

1. The constitutional validity of the two sections were upheld.⁵
2. Directors are not entitled to an opportunity of hearing.⁶
3. Directors of private companies cannot be disqualified for appointment/ reappointment under Section 164(2) if any three consecutive defaults in filing annual returns/financial statements occurred before FY 2014-15.⁷
- a. DINs of the petitioners allotted under Rule 10 of the Companies (Appointments and Qualifications of Directors) Rules, 2014 (**Rules**), cannot be deactivated or cancelled solely because they stand disqualified for appointment/ reappointment by operation of Section 164(2).⁸

E. Reasoning.

1. The two sections are not violative of Article 14 of the Constitution as the directors are duty bound to ensure that financial statements and annual returns are filed promptly. Further, disqualification is entailed only when a company fails to file financial statements or annual returns for three consecutive years. Therefore, the Sections are not arbitrary as they make adequate provision for addressing inadvertent or unintended failure.⁹
2. Relying on the judgments of the Delhi and Allahabad High Courts respectively in *Mukul Pathak*¹⁰ and *Jai Shankar Agrahari*¹¹ cases the HC held that there is no provision in Section 164 to deactivate the DIN.
3. Rule 11 of the Rules does not empower any authority to cancel or deactivate DIN upon disqualification under Section 164(2).
4. HC observed that: “*It has to be kept in mind that DIN is an Identification Number and disqualification under Section 164(2) is of temporary nature. It is also submitted at the Bar that the DIN number is common to persons who are at the same time Directors of Companies and partners of Limited Liability Partnerships. In such circumstances, there is no justification for cancelling or deactivating DINs of Directors consequent on their disqualification resulting from Section 164(2).*”

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⁵ Paragraph 43 of the Judgment.

⁶ Paragraph 49 of the Judgment.

⁷ Paragraph 55 of the Judgment.

⁸ Paragraph 71 of the Judgment.

⁹ Paragraph 39 and 40 of the Judgement.

¹⁰ *Mukul Pathak and others v. Union of India*, (2020) 222 Comp Cas 383 (Delhi).

¹¹ *Jai Shankar Agrahari v. Union of India*, WP (C) 12498/2019.