

Producer Company - Need to Introduce a Separate Law?

The honorable Prime Minister has set a goal of doubling farmers' income and recently the Government also announced a Scheme with a total budgetary provision of ₹ 6,865 crores. Therefore, the formation of a producer company is a national priority. The professionals who will or who are handholding with such companies must understand the interplay between provisions of Chapter XXIA and other provisions of the Companies Act, 2013, then only such professionals will be able to give proper advice to Producer Companies.



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INTRODUCTION

The Government of India has launched various schemes and one of the schemes specifically announced to promote the Farmer Producer Organization is "Formation and Promotion of 10,000 Farmer Producer Organizations (FPOs)" with a total budgetary provision of ₹ 6,865 crores. Since the scheme was announced, a total no. of 2,315 FPOs¹ have been registered in India.

INTERPLAY BETWEEN CHAPTER XXIA AND OTHER PROVISIONS OF COMPANIES ACT, 2013

Companies Act, 2013 (hereinafter referred to as Act) was enacted at the end of August 2013, but for long, provisions relating to Producer Companies were retained in the Companies Act, 1956. Finally, through the Companies (Amendment) Act, 2020, chapter XXIA which deals with producer Companies was inserted w.e.f. 11th February 2021. It contains a total of 47 sections. (i.e. Section 378A to section 378ZU)

The Producer Company is treated as a Private Company² however, there is no restriction on the number of its members. All the provisions, limitations, and restrictions of the Act which apply to private companies, so far as those provisions are not in conflict with the provisions of Chapter XXIA apply to Producer Companies³. And which provisions of other chapters of Act will apply to producer company and up to what extent is the biggest area of ambiguity!

Many times, producer companies are treated the same way as any other company and many ill advice can happen due to this treatment. In this article, we will deliberate the nuances of Producer Companies and the need for special attention

towards Producer Companies from all stakeholders. All the more, the majority of provisions applicable to Producer Companies are now under the adjudication power of the Registrar of Companies (hereinafter referred as Registrar), and that also creates concern that interpretation of these provisions is going to be decentralized!

SHARE CAPITAL, ALLOTMENT, AND RETURNING OF CAPITAL

Member is defined under clause (e) of section 378A, which states as follows – "Member means a person or a Producer Institution (whether incorporated or not) admitted as a member of Producer Company and who retain the qualifications necessary for continuance as such." This indicates that there can be some eligibility for becoming a member of any producer Company.

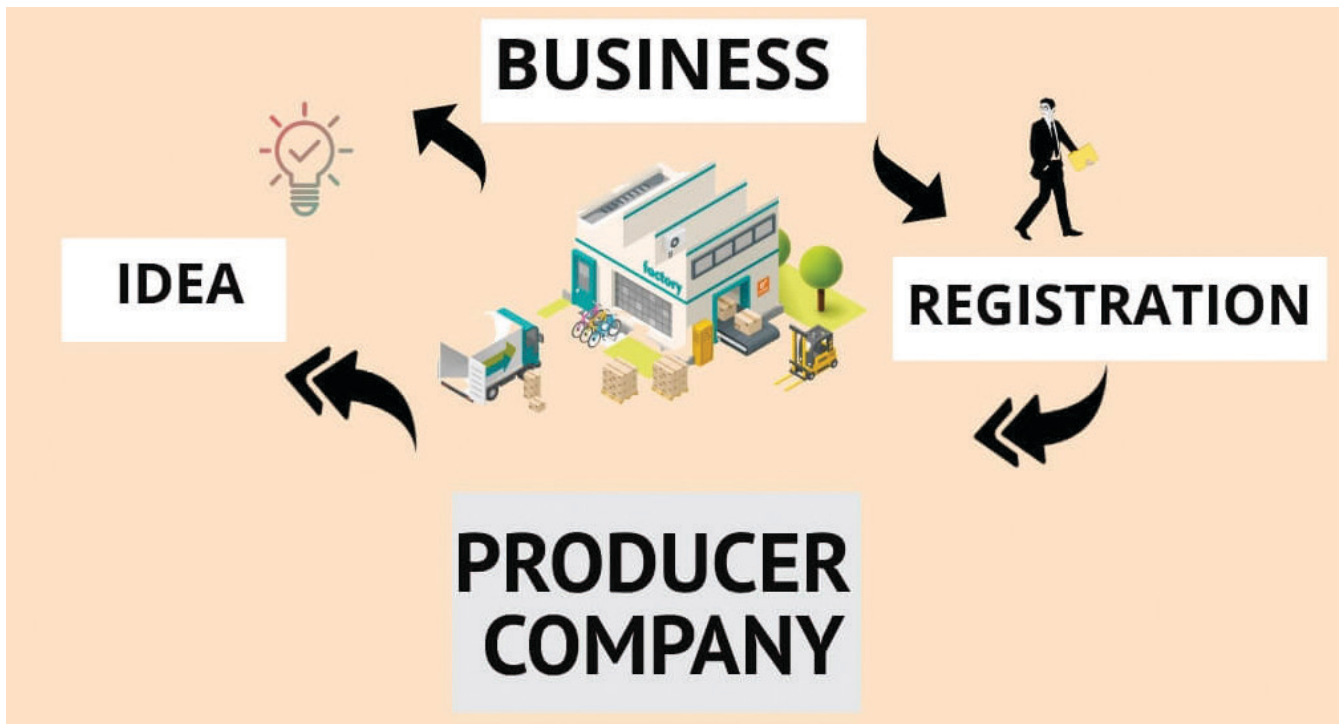
Further sub-section (2) of Section 378G states that – 'The Articles of Association (hereinafter referred as articles) shall contain mutual assistance principle enlisted in sub-section (2) of Section 378G, one of the principles is that the membership shall be voluntary and available to all eligible persons who can participate or avail of the facility or service of the Producer Company and are willing to accept the duties of membership.'

From this section, it appears that if any person is eligible to become a member as per the criteria set out in the articles, he has a right to become a member of the Producer Company. Further admitting such a person as a member and allotting him shares cannot be left to the decision of shareholders. Therefore, the process laid down in Section 42 (private placement) and Section 62 (preferential allotment) will not be applicable in the case of a producer company, unlike other companies. Rather allotting shares to eligible members is not a discretion but an obligation on the board of directors.

As per sub-section (2) of Section 378R admission of members is within the powers of the board of directors of Producer Companies.

This indicates that allotment of shares under the producer company will not need to follow processes of section 42 or section 62. However, if the Producer Company wants to raise capital by way of the rights issue, surely it has to comply with section 62(1)(a).

This can be a matter of interpretation and some professionals certifying MGT-7 OR MGT-8 or local Registrar adjudicating certain matters may take a different view. And therefore, there is a need for simplification of process or guidance to make farmers' and Producer Companies' life easy.



CANCELLATION OF MEMBERSHIP

As far as the cancellation of issued/paid up shares is concerned, it requires either compliance of buyback under section 68 or reduction of capital under section 66 of Act. The only exception generally is forfeiture of partly paid shares, if articles of the company provide so. However, sub-section (5) of section 378D states that “a member, who acquires any business interest which is in conflict with the business of the Producer Company, shall cease to be a member of that company and be removed as a member in accordance with articles.” Here the word ‘shall’ is important and it mandates that a member shall cease to be a member and only process would be as provided in the articles of the Producer Company. If articles remain silent, it can cause a lot of trouble and litigation. Sub-section (5) of section 378D gives power to the Board of Directors of the Producer company to direct the surrender of shares by members to the Producer Company in certain circumstances like if the member is no longer a producer etc.

Further Sub-section (4) and (5) of Section 378ZD, are also exceptions to Section 66 or Section 68. Such provisions make it clear that the applicability of section 66 or section 68 will not trigger in certain circumstances and it is within the power of the Board to mandate certain members to surrender their shares and pay them back without going to shareholders or without permission of National Company Law Tribunal.

These provisions are very sensitive and require a very high level of corporate governance standards. Therefore, an appropriate process needs to be laid down in Chapter XXIA.

We need to note that sub-section (5) of Section 378D or sub-section (4)/(5) of Section 378ZD are exceptions and compliance of Section 66 or Section 68 will be required in all other cases.

APPOINTMENT OF DIRECTORS

Sub-Section (2) of Section 152 sets one thumb rule with respect to the appointment of a director. It says unless expressly mentioned somewhere else, directors will have to be appointed by members. Section 161 generally sets out exceptions to this rule. However, in Producer Companies section 378P is charging section w.r.t appointment of Directors. Section 378P states that except for the first directors, all Directors shall be appointed by the members in **Annual General Meeting!** Since the law is very specific, directors cannot be appointed even in extraordinary general meetings. It is surprising to have such restrictions! It seems probably a drafting error or unnecessary hindrance!

Further, board of directors has the power to co-opt one or more additional expert director(s)⁴ on the Board which shall not exceed one-fifth of the total number of Directors. However, the tenure of such a director can be decided by the Board and need not go to shareholders in the immediately succeeding Annual General meeting like an additional director appointed as per Section 161. In short, an additional expert director can hold office for a tenure of more than 1 year without going to shareholders. This is a very wide power that can be misused.

There are a lot of powers with respect to the appointment of directors, which has to derive from Articles. Since members are exclusively producers (predominantly farmers) it is the responsibility of professionals to make promoters and members of Producer Company aware of these options and it requires very conscious calls from members. Some of the provisions which the law expects Articles to prescribe are as follows⁵:-

1. Directors need to be appointed by members for a minimum period of 1 year and the maximum period needs to be

specified by articles, such period cannot be more than 5 years.

2. Maximum tenure for which additional expert directors can be appointed, such period cannot be more than 5 years.
3. Manner of election and appointment of directors and retirement by rotation and condition for the same.
4. Qualification for being elected or continuance.
5. Filling up vacancies on the board.

Interestingly, if articles are silent about the maximum tenure of such additional directors, the board almost gets a free hand! Whether this is in the best interest of farmers/members of the producer company is doubtful.

EXERCISE OF POWERS BY BOARD OF DIRECTORS

Under Section 179 of the Act, the board of directors shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorized to exercise and do but subject to restriction by law, articles and/or the resolution of shareholders. In the case of a producer company, section 378R governs the powers and functions of the board. Section 378R simply states that subject to provisions of this act and articles, the Board of Directors of the Producer Company shall exercise such powers and do all such acts and things as the Company is authorized to do. This means members cannot put any additional restrictions on the Board! Not sure if this is the intention or otherwise?

Sub-section (3) of section 378R mandates that all powers shall be exercised by the Board by means of a resolution passed at its meeting on behalf of the Producer Company. And more so, explanation in sub-section (3) says 'for the removal of doubts it is hereby declared that a director or a group of directors, who do not constitute the Board, shall not exercise any of the powers exercisable by Board'.

Sub-section (3) of Section 378R can be equated with Section 179(1) and Sub-section (1) of Section 179 does not have words that all powers are to be exercised at Board meetings only. Of Course, there are exceptions like Sub-section (3) of Section 179, Sub-section (5) of Section 186, etc. Whereas sub-section (3) of Section 378R puts overall restrictions and hence, it seems from the language of sub-section (3) of Section 378R that directors cannot take any decision by passing a circular resolution.

APPOINTMENT OF CHIEF EXECUTIVE

Section 378W mandates every Producer Company to have a full-time Chief Executive who should not be a member. Chief Executive is going to be an ex-officio Director who is not liable to retire by rotation. Being ex-officio, he can act as director till he holds a position as Chief Executive in the company.

Appointment of Chief Executive does not require approval of shareholders at all! This is very surprising. And unless articles provide otherwise, qualification, experience, and terms and conditions of service of Chief Executive shall be such as may be determined by the Board. This means even the remuneration of the Chief Executive will be decided

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by the Board. Further, there is no separate provision w.r.t removal of the Chief Executive also. Further being ex-officio, Chief Executive will act as director till he holds such position and therefore Chief Executive cannot be removed as director, therefore Section 169 which deals with removal of director won't apply here.

In the Producer Company, there is a concept of one member one vote and it is a purely democratic approach. However, the Act gives authority to the board to appoint the Chief Executive without going to members! Whether this works in the interest of producers who are farmers is doubtful.

APPLICABILITY OF SECTION 196 TO CHIEF EXECUTIVE

As discussed earlier, section 378W states that Chief Executive shall be an ex-officio director and shall not be liable to retire by rotation. Further, sub-section (4) of section 378W also states that the "Chief Executive" shall be entrusted with substantial power of management as the Board may determine." Sub-section (1) of section 378W states that every producer company shall have a full-time Chief Executive Officer by whatever name called.

Further, if we refer to the definition of Managing Director given under clause (54) of section 2 of Act, any director entrusted with substantial power of management of the affairs of the Company shall be treated as Managing Director. Sub-section (2) of section 196 which applies even to private companies states that "no company shall appoint any person as its managing director for a term exceeding 5 years at a time. Sub-section (3) of section 196 also stipulates certain conditions a managing director must meet to become eligible to be appointed as managing director or to continue as Managing Director. Since there is no conflicting provision to Section 196 under Chapter XXIA. It appears that Section 196 may become applicable to producer companies. Professional certifying e-forms related to producer companies and ROC adjudicating e-forms may take different views due to complexities. And for ease of operation, a clarification would be necessary from the Ministry of Corporate Affairs ((hereinafter referred as MCA).

CESSATION OF DIRECTOR

There is no express provision in the chapter governing Producer Company about resignation, removal, or disqualification of the director. Section 378G which deals

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with the contents of articles mentions that articles shall have provisions relating to the method of removal of directors and qualifications for continuance.

It appears that Section 168 and Section 169 will be applicable even to Producer Companies. However, there is some ambiguity about the applicability of sub-section (2) of Section 164 because clause (d) of sub-section (1) Section 378Q talks about non-filing of annual accounts and annual return for a continuous period of 3 years for any producer company or failed to repay its deposits or patronage bonus or interest for one year or more. After reading this, it appears that sub-section (2) of Section 164 will not be separately applicable to directors of Producer Companies. Further, Section 378Q mainly deals with the vacation of office of the director and does not expressly mention about disqualification, so whether sub-section (2) of Section 164 will be applicable or not to the producer company is also a matter where clarity from MCA will be needed.

COMMITTEES OF DIRECTOR

Section 378U is titled ‘Committee of Directors’. Sub-section (1) of section 378U, says ‘the Board may constitute such a number of committees as it may deem fit for the purpose of assisting the Board in the efficient discharge of its function.’ A proviso to sub-section (1) of section 378U states that – “Provided that the Board shall not delegate any of its powers or assign the powers of the Chief Executive, to any committee”. This means the Committee is only to assist and not to take any important decisions! The only exception is section 378W, which expects every producer company to have a full-time Chief Executive to be appointed by the Board. And as per section 378W, Chief Executive can be delegated with substantial power of management as determined by the board.

Unlike a normal company, the board of directors of a producer company can delegate certain powers to the Chief Executive but not to committees.

TREATMENT OF LOAN/ INVESTMENTS

Section 378ZK and Section 378ZL deal with loans to members and investments in other companies respectively. A careful reading of section 378ZK reflects that section 185 (1) may not be applicable to Producer Companies. However, the loan should be for the furtherance of the mutual assistance principle.

Section 378ZL deals with investments and sub-section (1) of this section indicate that Producer Companies can only invest in fixed deposits, units, and bonds issued by Government or Co-operative or Scheduled banks. Further Sub-section (2) to (4) of Section 378ZL deals with the acquisition of shares of another producer company or investment in other companies. From reading section 378ZL it appears that even section 186 won't be applicable to Producer Companies to the extent where companies can invest. However, there is no separate provision dealing w.r.t giving a guarantee or providing security in connection with a loan. However, Section 186 is not applicable if such a company is engaged in the business of providing infrastructural facilities as prescribed in Schedule VI of the Act which includes Agriculture also. Therefore

Producer Company may fall under the exemption criteria provided under sub-section (11) of Section 186.

RELATED PARTY TRANSACTIONS

If any company enters into a contract or arrangement of any one or more of the kinds specified in clause (a) to (g) of sub-section (1) of Section 188 with the related party as per the definition given in clause (76) of Section 2, then section 188 will become applicable.

Further 2nd Proviso to sub-section (1) of Section 188 states that, if any member is a related party to any contract or arrangement, such member shall not vote on a resolution to approve any such contract or arrangement which may be entered into by the company.

However, if we refer to sub-section (5) of Section 378D, it states that in case a member acquires any business interest which is in conflict with the business of the producer company such members cease to be a member and be removed as a member according to the articles.

Here it is important to understand “whether Conflict means competing business or even business transaction with producer Company”?

It seems that it is referring to competing business and not w.r.t any particular business transaction in which such member is interested. If we take a view that it is referring to all the transactions between members and company, it will be difficult to do a business for a producer company as the members of the producer company will be producers, and distributor and shall have day-to-day transactions with the producer company.

Therefore, to deal with such situations, there should be a different framework to regulate the RPT of producer companies. We cannot simply apply Section 188 as it is.

APPLICABILITY OF SECRETARIAL STANDARDS

SS-1(Secretarial Standards on Meetings of Board of Directors) and SS-2 (Secretarial Standards on General Meeting) both are applicable to all companies incorporated under the Act except One Person Company (OPC) and a company licensed under Section 8 of the Act. There is no express exclusion w.r.t Producer Companies. However, many provisions w.r.t board and general meeting are different for producer company like –

Section 378V which deals with meetings of board and quorum states that – “notice of every meeting of the board of directors shall be given in writing to every director for the time being in India and at his usual address in India to every other director”. For all other Companies notice in writing is required to be served to **every director** at his address registered with the company and shall be sent by hand delivery or by post or by electronic means.

A further responsibility of serving notice of the board meeting is on the Chief Executive. There are no specific consents required for shorter notice. Proviso to sub-section (3) of section 378V, says – ‘Provided that a meeting of the Board



may be called at shorter notice and the reason thereof shall be recorded in writing by the Board'. There is a separate framework w.r.t calling board meeting with shorter notice. Sub-section (3) of Section 179 will not apply to producer companies.

For the general meeting, a quorum is one-fourth of the total members. This is a very high requirement as compared to other companies.

Looking at these conflicting provisions a view may be taken that Chapter XXIA is a Complete Code in itself. Secretarial Standards will not be applicable.

CHAPTER XXIA IS A COMPLETE CODE?

Section 378ZQ which is a non-obstante clause provided in Chapter XXIA states that “the provisions of said chapter shall have effect notwithstanding anything inconsistent therewith contained in this Act or any other law for the time being in force”.

If we refer to Section 378ZQ, it appears that this Chapter is complete code in itself. However, word inconsistency used in this section creates anomalies. It creates confusion as to which and up to what extent any provision of other chapters of the Act will be applicable to the Producer Company. We have illustrated some of the examples of such anomalies in this article. There can be many such anomalies if we compare provisions of Chapter XXIA with other chapters of the Act.

If it is a national priority, it should be introduced as a separate law rather than making it part of the Act.

REFERENCES:

1. <https://pib.gov.in/PressReleaseDetail.aspx?PRID=1808325>
2. Sub-Sec(5) of Sec. 378(c) Formation of Producer Company and its registration
3. Se. 378ZR. Application of provisions relating to private companies
4. Sub-sec (6) of Section 378P – Appointment o Directors
5. Sub-sec (3) of Se. 378P

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