# Legality of Ex-Officio and Nominated Directors in a Company





Syed Ahmad Ashraf, FCMA
Advocate High Court
Corporate and
Tax Consultant, SR-Law

Lately a controversy is discussed in professional circles about the ex-officio and nominee directors in a company. This controversy has started from clarification which was sought from the Securities and Exchange Commission (SECP) through a letter which was addressed to the worthy Chairman of the SECP.

The subject of the letter was:

"Clarification regarding the composition of the board/election of directors' vis-à-vis the provision contained in the law vs the Articles of Association (AOA) of certain companies and ***regarding the ex-officio or nominated directors on the Board."***

Various divergent views and opinions are expressed and received from various quarters (however, the response of SECP is still awaited even after the lapse of three months). Those who have some interest in public sector companies, specifically those companies which are incorporated and licensed as not for profit under Section 42 of the Companies Act, 2017 (hereinafter "the ACT"), are keen to have the clarification.

Before indulging in the issue of ex-officio and nominated directors, it is appropriate that the author's understanding of the "natural" and "legal or artificial person" be given.

While the ACT does not specifically define the person, the Constitution of Pakistan in Chapter 5 mentions, **"person"** includes body politic **or corporate**. The Income Tax Ordinance, 2001, and the General Causes Act also have the definitions of the person. While there is a common consensus that a "natural person" is a living human being with finite life, a "legal or artificial person" is created by some kind of legislation or action by the natural person.

**Artificial persons act through natural persons (e.g., directors or managers) who make decisions on their behalf. Natural persons act independently.**

The purpose of the above discussion is to arrive at a point to mention that many of the companies incorporated under the ACT have shareholders who are legal or artificial persons in the sense of the discussion before. To elaborate, there are many companies in which other companies, mutual funds, other bodies corporate, provincial governments and/or the federal government are the shareholders. These artificial or legal share-holders cannot act on their own, so they act through their designated directors or managers, and in the case of the provincial or federal government, through their designated officers or employees. These designated natural persons are termed as "nominees" of the respective organisations or governments. In the case of the companies incorporated under the ACT if these nominees become members of the Board after following the due process, they are termed "nominee" directors in general commercial language.

The term **"ex-officio"** originates from Latin, meaning "from the office". It refers to someone who holds a position or role automatically due to their status or another position they occupy or by virtue of an office. For example, a vice president might serve **ex-officio** as the president of a committee simply because of his office. However, the term "ex-officio directors" is alien to the ACT and the scheme of directors' election on the Board. The word is not even remotely used for any situation in the scheme of constitution of the Board under the ACT but is surprisingly present in the Articles of Association (AOA) of many companies, especially the private and public sector companies.

In the backdrop of the preceding discussion in the following part of this article, an effort has been made to determine whether companies incorporated under the Act can have nominees or ex-officio. More specifically, can a person, by virtue of his office or by virtue of the provision in the articles, become a member of the Board without following the relevant provisions of the ACT, laid down in section 159 for the election of directors, and whether the sections related to the terms of office of directors, filling of casual vacancies, consent to act as directors and other eligibility to become a director will be applicable to them?

The above matter is discussed in the following paragraphs in light of the provisions of the Act.

It is mandatory for the companies incorporated under the Act to have got their memorandum and articles registered. Section 16 of the Act provides for the registration of memorandum and articles. Section 16 also provides for a declaration on the specified form, by an authorized intermediary or by a person named in the articles as a director, of compliance with all or any of the requirements of this Act and the rules and regulations made thereunder in respect of registration and matters precedent or incidental thereto.

Section 17 elaborates on the **effect of the memorandum and articles.** It states that the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by each member and contained a covenant on the part of each member, his heirs, and legal representatives, to observe and be bound by all the provisions of the memorandum and of the articles, **subject to the provisions of this Act.**

It is crystal clear from the above that all the provisions of the memorandum and articles of a company are subject to and subservient to the provisions of the Act. No provisions in the memorandum or articles can be made that can have in any way an overriding effect on any provisions of the laws, the rules, and the regulations made therein. Any such provision will be considered ultra vires of the law and void ab initio.

## Directors:

About the directors of a company, Section 18, Subsection (e) of the Act provides for the first directors of a company as follows.

Quote: "the persons named in the articles of association as proposed directors are deemed to have been appointed to that office. Un-Quote

However, section 156 makes it mandatory for the first directors to be the subscribers of the memorandum.

**"First directors and their term. —** (1) The number of directors and the names of the first directors shall be determined by the subscribers of the memorandum, and their particulars specified under section 197 shall be submitted along with the documents for the incorporation of the company."

It seems that there is a conflict between section 18(e), where it says that the person named in the articles at the time of registration is deemed to have been appointed to that office, whereas section 156 specifically mentions that the first director are the directors who are subscriber to the memorandum. It is implied from the rules of reading the statute that the first directors are not those directors as mentioned in articles but are those who subscribed to the memorandum. Irrespective of the fact that, as per law, all the directors must retire on the date of the first annual general meeting of the company.

The subsequent matters relating to the appointment and removal of directors of the companies and their related matters of the companies are stated in sections 153 to 180 of the Act. Small companies mostly adopt, as per subsection 2 of Section 36, all or any of the regulations contained in Table A in the first schedule of the Act.

Table A to Table F of the first schedule provides for the election of directors in the manner provided in section 159 of the Act, which inter alia prescribes that the directors are to be elected by the members of the company, and the number of directors to be elected in the general meeting is to be fixed by the directors in their meeting, which should not be later than thirty-five days before the convening of such meeting.

The term of office of directors is provided in section 161 of the ACT which is three years, and subsection (2) of the same section also states that any casual vacancy occurring among the directors may be **filled up by the directors,** and the person so appointed shall hold office for the remainder of the term of the director in whose place he is appointed.

To this point of discussion, it is established, though, that there is no provision under which a company can have an ex-officio director. The natural person who intends to represent an artificial or legal person may be elected to the Board and will be known as the nominee of that artificial or legal person. Section 164 provides a restricted and limited space for nominee directors under the following cases also.

1) Directors nominated by the company's creditors or other special interests by virtue of contractual arrangement.
2) Directors nominated by the federal or provincial government where the credit facility is extended by a federally or provincially owned entity.

The nominated directors on the board as per above will be in addition to the directors elected under section 159, and the term of office of directors under section 161 will not be applicable to them.

At this point it is important to discuss section 165 of the ACT which excludes the application of section 158 (Retirement of first and subsequent directors), section 159 (Procedure for election of directors), section 161 (Term of office of directors), section 162 (Fresh election of directors) and section 163 (Removal of directors) to the directors under sub-sections (a), (b) and (c) of section 165. All of these sub-sections exclude the director nominated by virtue of investment made in the company by the government or any entity owned by it. It also excludes the directors nominated by foreign equity holders under arrangements with the government.

Reading section 164 and section 165 together, it can be construed that the investors, whether government or private, can nominate directors on the board of the company to safeguard their interest over and above the directors elected under section 159. However, when subsection 2 of section 165 is read, it talks of votes computed in the manner laid down in subsection (5) of section 159. This subsection can only make sense if we read investment as equity or shares in subsections (a), (b) and (c) of section 165; otherwise, subsection (2) does not make any sense.

In addition, subsection (3) of this section adds more confusion, which reads, "A director nominated under sub-section (1) shall hold office during the pleasure of the nominating body." In many circles, subsection (3) is interpreted as the nominated directors elected by virtue of shares held in a company in the election of directors can continue till their nomination is cancelled by the nominating body under sub-sections (a), (b) and (c) of section 165; others interpret this clause to construe that they can hold office during the pleasure of the nominating agency but limited to the term of three years as given in section 161(1) and in case of casual vacancy, which is to be filled up by the directors as given in subsection (2) of section 161.

My opinion on this is that the pleasure of the nominating body is limited to a term of a maximum of three years as given in section 161, and the pleasure can not extend the term of three years. A clarification from SECP is awaited on this section from the last three months.

Before parting with the discussion and forming any opinion, it is in the fitness of things to discuss the provision related to the election of directors in:

1) Listed Companies (Code of Corporate Governance) Regulations, 2019 (Regulations);
2) Public Sector Companies (Corporate Governance) Rules, 2013 (Rules); and
3) State-Owned Enterprises (Governance and Operations) Act, 2023 (the SOE ACT) read with the State-Owned Enterprise Ownership and Management Policy (the Policy)

There is no mention of the "Ex-Officio" and "Nominee Director" in the Regulations and Rules; however, the SOE ACT promulgated on January 31, 2023, and the Policy as required under the SOE ACT which was circulated on 27th November 2023, clearly defines the nominee directors and directors in section 2, subsections (g) and (h), as given below:

**(g) "nominee director" means—**

1. a director who represents the federal or provincial government; and

(ii) a director who represents another state-owned enterprise

**(h) "director" means—**

- in the case of a company, a director appointed under the Companies Act, 2017 (XIX of 2017); and

o in the case of a statutory state-owned enterprise, a member of the governing body designated under the applicable law.

But the term "ex officio director" is used several times in the SOE Act and Policy, but no definition has been provided as to who the ex-officio director is. As a matter of general practice, the dictionary meaning given earlier will be taken as applicable. Banking on that definition and the definition of "director" as given above, an inference can be drawn that an ex-officio director as mentioned in the SOE ACT and Policy cannot become a director in a company unless he is also a nominee director as referred to before.

Since the SOE ACT and policy are also applicable to statutory bodies like WAPDA, NHA and Railways, the intent of the legislature seems to be that these bodies can have ex-officio directors if provided in their statute. This also gains strength from the definition of "director" given in section 2, subsection (g), as quoted before.

## Conclusion

To juxtapose the preceding discussion, it is concluded that there is no provision in the ACT for an ex-officio director. Any provision which exists in the Articles of Association of any company incorporated under the ACT is not in accordance with the ACT and needs to be revisited.

Further nominee director means a natural person nominated by the artificial or legal person by name to act on its behalf as director and does not mean any person holding a certain specific position. Such a specific person holding a specific position will not be a deemed nominee director. The entity extending a loan or credit facility can nominate directors on the board of the company, and the nominated director will be on top of the elected directors.

It is also worth mentioning that by virtue of Section 4 of the ACT, which is a non-obstante section, the ACT will have an overriding effect on other acts, so any provisions in the SOE ACT will have to pass the legitimacy test under the ACT.

***About the Author: Syed Ahmad Ashraf*** *is a Fellow Member of ICMA and an Associate Member of ICSP. He holds a law degree, a postgraduate diploma in taxation, and a master's in business with a focus on fiscal management. With over 35 years of experience in finance and corporate affairs in both public and private sectors, he is currently associated with SR Law as a corporate and tax consultant. He handles complex matters including mergers and acquisitions, and represents clients before SECP, the Competition Commission, FBR, and provincial tax authorities. He has also authored several articles on tax and corporate issues published in professional journals and newspapers.*