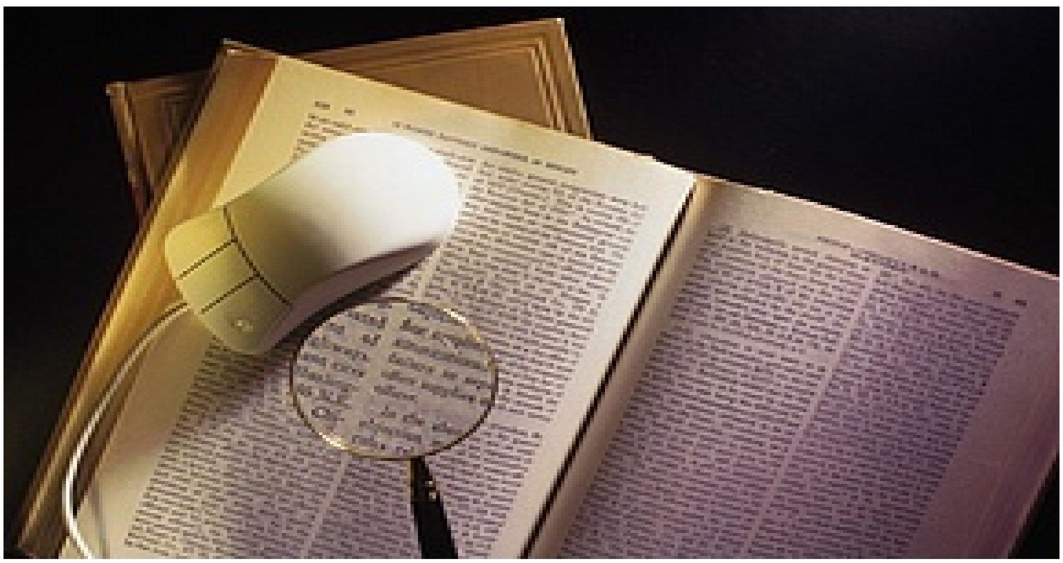
Corporate Research

Presents



Research Paper on the Indian Companies Act, 1956

- Interested Directors

By:

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Interested Directors

Premise of Section 297:

The object of the above section is to bring into the knowledge of the Board of directors, the extent of the interest of a director, in any contract proposed to be entered with the company by the Director or any of his specified associates.

Scope of section 297:

The contracts covered in section 297 relates to:

- Sale, purchase or supply of any goods, material or services or,
- Underwriting the subscription of shares or debentures of the Company

Parties to the Contract:

- Director of the Company
- Relative of any Director
- A Partnership firm wherein such Director or relative is a partner
- Any other partner of the same firm wherein the Director or his relative is a partner
- A Private Company in which Director is a member or Director

Legal Requirements:

A. BoD's Approval:

- Every contract covered under the section requires the consent of the BoD. The consent can be obtained only by a Board resolution and a resolution by circulation will not suffice.

- The BoD's consent should be obtained either before the contract was entered into or within 3 months of the date of contract.

B. Government's Approval:

- If the paid up capital of the company is Rs. 1 crore or more, *previous* approval of the Central Government (now Regional Director) shall also be required.

Contravention and Penalties:

- If the Central Government's approval is not required, failure to obtain the Board's consent will make a contract voidable at the option of BoD. The contract shall become void only when the BoD avoids it.
- Also, If the Central Government's approval is required, failure to obtain the same would render the transaction void.

Relaxations:

A. *Section 297 does not apply to:*

- Section 297 does not apply to a company if the other party to the contract is a public company
- Contract of employment of a director or services rendered by a firm of solicitors, advocates
- A Banking Company
- An insurance company
- The purchase or sale of goods for cash at prevailing market prices
- Transactions in immoveable properties
- Any contract for the sale, purchase or supply of goods, materials or services in which:
  a). the company or the other party regularly trade or does business and,
  b). the value of such contract is not more than Rs. 5,000 in the aggregate in a year.

B. *No previous consent of the Board:*

As per section 297(3) previous consent of the BoD is not required if-

- the circumstances are of urgent necessity
- Within 3 months, the consent of the Board is obtained by means of a resolution passed at a Board meeting.

However, the Department has opined that in case of a company having a paid up capital of Rs. 1 crore or more, the above relaxation of section 297(3) shall not apply.

Disclosure of Director's interest (Section 299):

Every director who is any way, directly or indirectly, interested in a contract or arrangement shall disclose the nature of his interest.

Mode of Disclosure:

A. Specific Disclosure:

- The specific disclosure is made to bring to the notice of the BoD the interest of the particular director in a specific contract.
- Where the contract with interested director is proposed to be entered by the company, the disclosure shall be made at the BoD meeting at which the question of entering into the contract is first considered.
- In other cases, the disclosure shall be made at the first BoD meeting held after the director becomes interested.

B. General Disclosure:

- *Via* general notice, a director agrees to be regarded as concerned or interested in every contract, which may be entered into with that body corporate or firm in the future.
- The general notice has to be given only at a BoD meeting and it should be brought up and read at the first board meeting at which it is given. The concerned director has to take all reasonable steps that the notice is brought up and read in the meeting.
- The general notice expires at the end of the financial year at which it is given. It may be renewed for one financial year at a time by giving a fresh notice.

Contraventions and Penalties:

- The office of director shall become vacant if he fails to disclose his interest u/s 299.
- Every director who fails to disclose his interest in the prescribed manner shall be punishable with a fine of Rs. 50,000.

Relaxations:

- Section 299 does not apply to a contract or arrangement entered into between two companies, where any of the director(s) of one company holds *not more than* 2% of the paid up share capital of the other company.
- Also, Disclosure of a fact can be made only if such a fact is not known to others. "*Where the fact that the person being taken in employment was the daughter of managing director, was already known to all, it was held that managing director was not required to disclose his interest.* "
  - *A Sivasalem v Assistant Registrar*

Note: Section 299 is wider in scope than section 297. Section 297 applies only in the transactions of purchase/sale or underwriting of shares, but section 299 applies to every kind of contract in which a director is interested.

Interested Director not to participate or vote (Section 300):

A Director who is directly or indirectly interested in a contract or arrangement shall not –

- be counted for the purpose of quorum at the time of discussion and voting on any such contract or arrangement
- participate in the discussion on any such contract or arrangement
- vote thereon and if he does vote, his vote shall be void

A contravention of the above provisions shall render the director punishable with a fine of Rs. 50,000.

Non-applicability of section 300:

- a private company which is neither a subsidiary nor a holding company of a public company
- a private company which is a subsidiary of a public company, when it enters into a contract with its holding company
- a public company specifically notified by the Central Government
- a contract of indemnity against any loss which the directors may suffer for being sureties for the company
- if the director is not holding more than 2% of the paid up share capital of other public company

- *"If an interested director votes on a contract in which he is interested, his vote will be void. But, the contract does not become void. It is voidable at the option of Board and not at the option of another party".* ***[Movitex Ltd. V. Bulfield 1988 BCLC 104 (Ch D)]***

- *"Voting by an interested director will make a contract void in the following two cases:*
  If his exclusion from quorum would have resulted in 'no quorum'.
  If exclusion of his vote would have resulted in failure of such resolution".
  [Victors Ltd. V. Lingard (1927) 1 Ch 323]

Maintenance of Registers of particulars:

- Section 301 requires every company to keep one or more registers containing particulars of all contracts covered u/s 297 or 299.
- The particulars of every contract *i.e.* date of contract, name of parties thereto, principal terms and conditions, directors voting in favor and against of the contract has to be specified.
- The register has to be kept at the registered office of the company.
- Entries in the register shall be made within 7 days of the approval of BoD. After every entry, the register shall be placed before BoD in subsequent meeting and shall be signed by all directors present.
- The provisions as regards inspection of the register and obtaining copies of the same shall apply as provided in section 163 of the Act.

  However, for a contract or agreement whose value does not exceed Rs. 1,000 in aggregate in one year and for a contract or arrangement (to which section 297 or, as the case may be, section 299 applies) by a banking company for the collection of bills in the ordinary course of its business, the above requirement of maintenance of register shall not apply.

  Further, sections 303 to 308 prescribe the maintenance of register of basic details and shareholdings of directors, managing director and other managerial personnel.