

Section 297 - Board's sanction to be required for certain contracts in which particular directors are interested

(1) Except with the consent of the Board of directors of a company, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director, shall not enter into any contract with the company–

(a) for the sale, purchase or supply of any goods, materials or services; or

(b) after the commencement of this Act, for underwriting the subscription of any shares in, or debentures of, the company:

Provided that in the case of a company having a paid-up share capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government.

(2) Nothing contained in clause (a) of sub-section (1) shall affect–

(a) the purchase of goods and materials from the company, or the sale of goods and materials to the company, by any director, relative firm, partner or private company as aforesaid for cash at prevailing market prices; or

(b) any contract or contracts between the company on one side and any such director, relative, firm, partner or private company on the other for sale, purchase or supply of any goods, materials and services in which either the company or the director, relative, firm, partner or private company, as the case may be, regularly trades or does business:

Provided that such contract or contracts do not relate to goods and materials the value of which, or services the cost of which, exceeds five thousand rupees in the aggregate in any year comprised in the period of the contract or contracts; or

(c) in the case of a banking or insurance company any transaction in the ordinary course of business of such company with any director, relative, firm, partner or private company as aforesaid.

(3) Notwithstanding anything contained in sub-sections (1) and (2), a director, relative, firm, partner or private company as aforesaid may, in circumstances of urgent necessity, enter, without obtaining the consent of the Board, into any contract with the company for

the sale, purchase or supply of any goods, materials or services even if the value of such goods or cost of such services exceeds five thousand rupees in the aggregate in any year comprised in the period of the contract; but in such a case, the consent of the Board shall be obtained at a meeting within three months of the date of which the contract was entered into.

(4) Every consent of the Board required under this section shall be accorded by a resolution passed at a meeting of the Board and not otherwise; and the consent of the Board required under sub-section (1) shall not be deemed to have been given within the meaning of that sub-section unless the consent is accorded before the contract is entered into or within three months of the date on which it was entered into.

(5) If consent is not accorded to any contract under this section, anything done in pursuance of the contract shall be avoidable at the opinion of the Board.

(6) Nothing in this section shall apply to any case where the consent has been accorded to the contract before the commencement of the Companies (Amendment) Act, 1960 (65 of 1960).

Underlying Principle

The provisions enacted in Section 297 of the Companies Act are founded on the principle that the director is precluded from dealing on behalf of the company as himself and from entering into engagements in which he has a personal interest conflicting or which may possibly conflict with the interest of those with whom he is bound by fiduciary duty. A director occupies a fiduciary position in relation to a company and he must act bona fide in the interests of the company. If a director makes a contract with the company and does not disclose his interest, he will be committing breach of trust.

Section 297 embodies the principle of good faith and fiduciary relationship of a director and enjoins upon him certain statutory obligations.

Applicability of the Section

This section applies to :

1. all companies, public and private.
2. contract for sale, purchase or supply of any goods, materials or services in which a director or any person connected with a director in any of the ways mentioned in sub-section (1) of section 297 is interested,
3. contract for underwriting subscription of any shares in or debentures of the company,
4. oral contract, if it can be proved by circumstantial evidence. Under the Indian Contract act, a contract need not be in writing, and an oral contract is also valid in law. The provisions of Section 297 will accordingly also apply in respect of an oral contract.

This section does not apply to :

1. contracts between two public companies
2. transaction in immovable properties [*Letter No. 9/4190-CL-X, dated 27th March, 1990*],
3. contract of employment of a director or managing or whole-time director [*Circular No. 8/11/75-CL-V, dated 5th June, 1975*],
4. contract entered into by the company with a dealer on a principal to principal basis [*Circular No. FM 8/297/56-PR, dated 2nd August, 1956*],
5. professional services of the nature given by firms of solicitors and advocates, etc. [*Circular No. 8/11/75-CL-V, dated 5th June, 1975*],
6. indirect interest of a director as provided in section 299. unlike Section 299 this Section does not deal with indirect interest of a director, even though it may be substantial or real.
7. a government company in respect of contracts entered into by it with another Government company [*Notification GSR No. 233, dated 31st January, 1978*].
8. A company and a body corporate or a co-operative society in which a director or relative is a member or director.

Applicability of the Section is to be determined at the time of entering into the contract. If no permission under this section is required at the time of entering into the contract, subsequent permission is not necessary even though there may be a change of circumstances which would require permission to be taken for a fresh contract.

Scope of the Section

The Section requires the consent of the Board of Directors for all contracts [except those exempted under sub-section (2)] with the company by a director or a relative or a firm in which the director or relative of his, is a partner or any other partner of such firm or a private company in which such a director is a partner or a member.

This section does not apply to contracts between two public companies and also is not attracted to a transaction of loan made by a director to the company because it is not a sale or purchase of goods or a contract to render services.

For instance, if 'X' is a director of A Ltd and also a director/member of B Pvt. Ltd., then Section 297(1) will apply to contracts between these two companies, subject to the exceptions provided therein. However, if only the relatives of X are director/members of B Pvt Ltd. (and not X himself) the section will not apply.

It may be noted that all contracts, whatever their value, with the directors and other persons mentioned in the section require the previous approval of the Central Government. Contracts will include service contracts such as appointment to offices. Advertisement Services have been held to be covered by this section.

“goods” – definition

In the absence of any definition of “goods” in the Act, reference may be made to the definition given under the Sale of Goods Act, 1930 according to which “goods” means every kind of moveable property. Thus, for the purpose of the Section, sale or purchase as also lease of immoveable property is outside the scope of the Section. However, if the machinery is not permanently attached to the earth, it may fall in the category of goods within the meaning of this section.

Object of the Section

The object of the Section is that the Board of Directors should have knowledge about the extent of interest of a director in any contractual dealings with the company, or of any person connected with the director in any of the ways mentioned in sub-section (1), and accord their consent to such dealings.

Specific consent of the Board

It is the specific consent of the Board of directors which is required for entering into contracts of the kinds specified in section 297. Such consent must be accorded by a resolution passed at a meeting of the Board and not by means of a resolution passed by circulation.

The consent contemplated is not a general consent but a consent referable to each particular or specific contract or contracts. Consent requires knowledge of the specific facts and materials which leads to the consent and cannot be given in a general or abstract manner.

However, sub-section (3) lays down that in case of urgent necessity, a contract may be entered into without obtaining the consent of the Board, even if the value of such goods or cost of such services exceeds Rs. 5000 in the aggregate in any year, provided consent of the Board is obtained within 3 months of the date on which the contract was entered into. It must be noted that this sub-section does not dispense with the necessity of obtaining previous approval of the Central Government, though it is possible that the Government may, by general order or notification, give general approval for certain classes or kinds of contracts.

The applicability of section 297 of the Act is to be examined at the time of entering into the contract and the consent should be obtained within three months of entering into the contract. If a director becomes interested after the contract is entered into, there is no need to get Board’s consent. The term ‘director’ includes alternate director for the purpose of section 297 of the Act

Procedure

The Company Law Board in the case of *Yashovardhan Saboo v Groz-Beckert Saboo Ltd.* has observed that Section 297, 299 and 300 of the Companies Act are founded on the principle that a director occupies a fiduciary position in relation to a company. The are related provisions and have a combined effect. Thus the procedure for carrying out contracts in which any of the Company's director is interested or concerned combines the provisions of Section 297, 299 and 300 and applies to all companies, public and private but not to contracts between two public companies.

1. A Board meeting shall be convened to consider the terms of the contract. Board's consent must be accorded by a resolution passed at a meeting of the Board and not by circulation.

2. Directors interested or concerned shall disclose the nature of their interest or concern at the meeting of Board of directors in Form No. 24AA of Companies General Rules and Forms as required under section 299(3).

It may be noted that so far as section 299 is concerned, instead of disclosing interest or concern every time, a general notice may be given annually in the last month of the financial year. Thus, the validity of such notice given by the director is for one financial year and it has to be renewed every year.

Such general notice should be placed before the Board meeting for its recording by means of a resolution.

3. If the paid-up capital of the company is Rs. One Crore or more, an application shall be made to the Regional Director in Form No. 24A of Companies General Rules and Forms for its prior approval.

The Section requires such an application to be made to the Central Government but the Central Government has delegated to the Regional Directors at Bombay, Calcutta, Madras and Kanpur the powers and functions under the Section vide Notification No. GSR 563 (E), dated 19-8-1993.

4. In case the Board cannot have requisite quorum of disinterested directors, then the contract shall be approved by shareholders by convening a general meeting.

5. Necessary entries shall be made in the register of contracts maintained under section 301, within 7 days of the Board meeting, and it shall be signed by all the directors present in the next Board meeting.

6. Except for some of the cases mentioned in section 300(2), an interested director shall not take part in the proceedings of Board meeting or voting in respect of a contract or arrangement in which he is interested or concerned. Such an interested or concerned director will not be counted for the purposes of quorum. Where the number of such interested directors exceeds or is equal to two-thirds of the total strength of the Board, then two disinterested directors present in the meeting will be deemed to be proper quorum.

Exceptions

Sub-section (2) lays down three exceptions to the rule under sub-section (1). They are as follows :

- a) When the transaction for sale or purchase of goods and material is on cash basis at prevailing market prices the consent of the Board is not required. A cheque is considered equivalent to cash for the purpose of this section.
 - b) Where a party to the contract as specified in sub-section (2)(b), regularly trades or does business, provided that the aggregate value of transactions over a calendar year do not exceed Rs. 5000.
 - c) In the case of banking or insurance company, any transaction with any director, etc., in the ordinary course of its business.
- Such transactions will neither require the consent of the Board nor the previous approval of the Central Government.

Non-compliance

The only consequence of not obtaining the consent of the Board is that in such case the Board is given the option to avoid the contract. If the Board chooses to condone the defect and pass a resolution not to avoid the contract or gives ex post facto consent, there is an end of the matter. The company in general meeting cannot interfere unless the Board's act amounts to a breach of trust, resulting in loss to the company.

Apart from consent of the Board, previous approval of the Central Government is also required where the paid – capital of the company is Rupees One Crore or more. In the absence of approval of the Central Government where necessary the contract shall be void.

Thus, it appears that, where contracts entered into by companies when their paid – capital was less than Rupees One Crore, and raised upwards subsequently, approval of the Central Government would not be necessary until the expiry of the contract.

Offence, Penalty and Compoundability

Section 297 does not provide any penalty for non – compliance. The penalty therefore will be as per the provision of Section 629A. Entering into certain contracts with the company in which particular directors are interested without Board's sanction and where paid-up share capital is not less than Rs. One Crore, without the previous approval of the Central Government (now Regional Director) the company and every officer in default shall be punishable with fine upto Rs. 5000 and further fine upto Rs. 500 for each day of default [sub-section (1)]. The offence punishable is compoundable under section 621A read with section 629A.

Conclusion

A fruitful source of misuse of power by directors is that which is exemplified by contracts entered into with the company of which they are directors by themselves or through their relatives or firms or companies in which they are interested for the sale, purchase or supply of goods, materials or services, as the case may be. Section 297 and its subsequent amendments strive to safeguard the interest of the company especially when directors are in a position to take advantage of inside information for personal gain. It provides for a two fold measure of ensuring that the interest of the company is not affected by a breach of trust by the directors.