ANALYSIS
SECTION 297 OF THE COMPANIES ACT, 1956

1. Applicability

Section 297 of the Companies Act, 1956 deals with the <u>Contracts in which Directors are interested</u>. It is applicable to <u>all private limited and public limited companies</u>

2. Meaning

- Section 297(1) of the Companies Act, 1956 states that the Company can not enter into contracts <u>(as mentioned in para 3)</u> **<u>with certain specified persons</u>** <u>(as mentioned under para 4)</u> except with the consent of the <u>Board of Directors or Central government in certain cases.</u>

- If the **<u>paid up share capital is Rs. 1 crore or more</u>**, then prior approval of Central Government will also be required by the company to enter into the contracts with such specified persons.

3. **Contracts covered:**

- Contract for **sale, purchase or supply** of **any goods**, **materials or services**; or
- Contract for Underwriting the subscription of any shares/debentures of the company

4. Specified persons covered

Following are the persons with whom the Company cannot enter into contracts without the consent of the Board of Directors and prior approval of Central Government (in case where paid up share capital is Rs. 1 crore or more)

1) **Director of the Company**
2) **Relative of such Director (as defined in para 4.2 below)**
3) **Firm in which such director is a partner**
4) **Firm in which relative of such director is a partner**
5) **Any other partner of such firm in which director is a partner**
6) **Any other partner of such firm in which relative is a partner**
7) **Private company in which such director is a director**
8) **Private company in which such director is a member**

4.2 List of Relatives (Schedule I-A of the Companies Act, 1956)

i. Father
ii. Mother (including step-mother)
iii. Son (including step-son)
iv. Son's wife
v. Daughter (including step-daughter)
vi. Father's father
vii. Father's mother
viii. Mother's mother
ix. Mother's father
x. Son's son
xi. Son's son's wife
xii. Son's daughter
xiii. Son's daughter's husband
xiv. Daughter's husband
xv. Daughter's son
xvi. Daughter's son's wife
xvii. Daughter's daughter
xviii. Daughter's daughter's husband
xix. Brother (including step-brother)
xx. Brother's wife
xxi. Sister (including step-sister)
xxii. Sister's husband

5. Transactions under which no Board sanction is required

Under the following circumstances, no sanction of the Board of Directors or Central government is required: -

- Purchase/Sale of goods and materials with specified persons is **<u>for cash at prevailing market prices</u>** *[A cheque may be treated as the equivalent of a cash payment for the purpose of this section*

- Contracts between the company and specified persons for any Purchase/Sale/Supply of goods, materials and services in which either the company or such specified persons regularly trades or does business and the value of goods/materials or cost of services **<u>does not exceed Rs. 5,000/- in the aggregate in any year comprised in the period of the contract.</u>**

- Banking/Insurance Company in the ordinary course of business of the company with such specified persons.

6. Board's Approval within 3 months of the contract

- If the value of goods or cost of services is more than Rs. 5,000/- in the aggregate in any year comprised in the period of the contract and at the time of contract, no approval of the Board was taken, the Company can enter into contracts and approval of the Board can be taken **within 3 months of the date of the contract.** However **No such power is available in case, Central Government approval is required**, i.e. Where paid up capital is more than Rs.1 Crore.

7. Consent of the Board

- The consent of the Board means – (a) resolution should be passed at a meeting of the Board of Directors and (b) consent is accorded Before the contract is entered or Within three months of the date of contract.

8. Approval of Central Government

- If the **paid up capital of the company is more than Rs. 1 crore**, no contract can be entered by the Company with the specified persons without prior approval of the Central Government. In short, before entering into contract previous approval of the Central Government is to be taken

- **In case of approval of Central Government, application is to made under Form No.24A.**

9. Non applicability of Section 297

Section 297 does not apply in the following cases:

1. Contracts between two Public Limited Companies.
2. Contracts between two government Companies.
3. Loan given by Director to the Company.
4. Contracts for sale, Purchase or lease of immoveable property.
5. Contracts for Plant & Machinery which is permanently attached to the earth.
6. Appointment of Additional Director who is related to a Director.
7. Contract of employment of a Director as managing/ whole time director.
8. Contract with a dealer on a principal to principal basis.

10. Consequences & Penalty

- If no consent of the Board is taken than in that case anything done in pursuance to the contracts shall be voidable at the option of the Board.

- Default or non-compliance with the section in the cases where approval of Central Government is necessary would render the transaction void.

- The section does not provide any penalty for non compliance. The penalty shall therefore be as per the provisions of Section 629-A (Section 629-A gives penalty for such sections of the Companies Act, 1956 in which no penalty is provided);

Accordingly the penalty is as follows:

Company and every officer of the company who is in default or such other person shall be fined upto Rs. 5,000/-. Where the offence is continuing one, a further fine may extent to Rs.500/- for every day after the first during which the contravention continues.

11. Others

- The section does not deal with indirect interest of a director, even though it may be substantial and real.

- The 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 permissions is not necessary even though there may be a change of circumstances which would require permission to be taken for a fresh contract. (For e.g. where contracts entered into by the companies when their paid up capital was less than Rs. 1 Crore, and raised upwards subsequently, approval of the Central Government would not be necessary until the expiry of the contract)

- The section is also applicable to contracts which are not in writing i.e. oral contracts.