

Appointment of Sole Selling Agents (Sections 294 – 297)

Prohibition on payment of commission to sole selling agents for loss of office in certain cases (Section 294 A)

Question 1

Randhir was appointed as the sole selling agent of S Ltd. for a period of five years in a general meeting of the company. Exactly after 1-½ years, S. Ltd. was amalgamated with another company A. Ltd. Randhir was not appointed as the sole selling agent of A. Ltd. S Ltd. paid Randhir ₹ 6 lacs as selling agency commission during the said 1-½ years. Is Randhir entitled to any company and if yes what is the quantum.

Answer

Section 294A prohibits payment of compensation to the sole selling agent for the loss of his office in the following cases:

- (i) where the appointment of the sole selling agent ceases to be valid by virtue of section 294(2A).
- (ii) where he resigns his office as a result of reconstruction or amalgamation of the company and is appointed as the sole selling agent of the reconstructed company or the body corporate resulting from the amalgamation.
- (iii) where he resigns his office otherwise than in the circumstances envisaged in the foregoing clause (ii).
- (iv) where he has been guilty of fraud or breach of trust in relation to, or of gross negligence in the conduct of his duty as the sole selling agent; and
- (v) where he has instigated or taken part directly or indirectly in bringing about the termination of the sole selling agency.

In this case, Randhir has not been appointed as the sole selling agent of A Ltd. None of the other prohibitions also apply. Hence Randhir would be entitled to compensation.

The amount of compensation payable for the loss of office must in no case exceed the remuneration which he would have earned, if he had been in office for the unexpired residue of his term, or for 3 years, whichever is shorter. The amount thereof is to be calculated on the basis of the average remuneration actually earned by him during a period of 3 years immediately preceding the date on which he had ceased to be in office or his appointment was terminated. In case he had held his office for a period lesser than 3 years, the basis

14.2 Corporate and Allied Laws

would be the average remuneration that he had earned during such shorter period. The average remuneration earned is $6/1.5 = 4$ lakhs. The compensation payable would be $4 \times 3 = ₹ 12$ lakhs.

Question 2

On 1st January, 2001 the Board of Directors of XL Co. Ltd. appointed Mr. Y as Sole Selling Agent of the Company for a period of five years. On 6th February, 2001 XL Co. Ltd. in its General Meeting disapproved the appointment of Mr. Y as Sole Selling Agent of the Company. Explain:

- (a) *Is Mr. Y entitled to payment of compensation for Loss of Office?*
- (b) *Are there some other circumstances when compensation for loss of office is prohibited to a Sole Selling Agent?* **(November, 2002)**

Answer

- (i) According to Section 294(2) of the Companies Act, 1956, the Board of Directors of XL Ltd. "shall not appoint a sole selling agent for any area except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made".

It has been held that the appointment of a sole selling agent must be made by the company in its general meeting and such clause must be inserted as a mandatory condition in all appointments of sole selling agents; an appointment without such a clause being inserted is void ab-intio (Arante manufacturing Corp. vs. Bright Bills Private Ltd. 1967 Comp/ Case 759 Shelagram Jhaigharia vs. National Co. Ltd. 1965 Comp. Cas. 706) If the company in the general meeting disapproves the appointment it shall become invalid from the date of the general meeting.

In the given case, assuming that the general meeting of XL Co. Ltd. held on February 6, 2001 was their first general meeting after January 1, 2001 and the disapproval of the company, in this meeting will make the appointment of Mr. Y as sole selling agent invalid w.e.f. February 6, 2001.

- (ii) Section 294(A) prohibits payment of compensation to the sole selling agent for the loss of his office in the following cases in addition to the one discussed in part (2) above :
 - (a) Where the sole selling agent resigns his office as a result of reconstruction or amalgamation of the company, and is appointed as the sole selling agent of the reconstructed company or the body corporate resulting from the amalgamation.
 - (b) Where the sole selling agent resigns his office otherwise than in the circumstances envisaged in the foregoing clause (i)
 - (c) Where a sole selling agent has been found to be guilty of fraud or breach of trust in relation to, or of gross negligence in the conduct of his duty as the sole selling agent.
 - (d) Where the sole selling agent has investigated or taken part directly or indirectly in bringing about the termination of the sole selling agency.

Question 3

Mr. BPK was appointed as the sole selling agent of M/s KMP Ltd. with effect from 1st January, 2002 for a period of five years. Mr. BPK earned his remuneration as follows during the years 2002 to 2004:

Year	Amount of remuneration
2002	₹ 4,41,000
2003	₹ 6,32,000
2004	₹ 7,45,000

On and from 1st January, 2005, the sole selling agency agreement was terminated by M/s KMP Ltd. You are required to calculate the amount of compensation payable by the said company to Mr. BPK under the provisions of the Companies Act, 1956.

What would be your answer in a case where the said M/s KMP Ltd. was amalgamated with another company with effect from 1st January, 2005 and Mr. BPK refused to act as the sole selling agent of the amalgamated company after amalgamation. **(May 2005)**

Answer

As per provisions of section 294A(2) of the Companies Act, 1956, any compensation payable by a company to its sold selling agent for premature loss of office shall not exceed the remuneration which he would have earned if he would have been in office for the unexpired residue of his term, or for three years, which ever is shorter, calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which his office ceased or was terminated, or where he held his office for a period lesser than three years, then average remuneration actually earned by him during such lesser period.

Based on the above provision of the Companies Act, 1956, Mr. BPK is entitled to compensation for the unexpired residue of his term, i.e., for two years since it is shorter than three years. Such compensation shall be calculated on the basis of average remuneration received by him during the years 2002 to 2004. On the basis of figures given in the question, the amount of compensation shall be as follows:

Year	Amount of remuneration (₹)
2002	4,41,000/-
2003	6,32,000/-
2004	7,45,000/-
Total Remuneration	<u>18,18,000/-</u>
Average Remuneration per annum	<u>6,06,000/-</u>
Compensation payable to Mr. BPK for two years	<u>12,12,000/-</u>

As per provisions of section 294A(1) of the Companies Act, 1956, where the sole selling agent

14.4 Corporate and Allied Laws

resigns his office in view of amalgamation with any other company and he is appointed as sole selling agent after such amalgamation, then he is not entitled to any compensation and the company is also prohibited from paying any compensation to the sole selling agent. Thus, in second case, Mr. BPK shall not be entitled to any compensation for premature loss of office since he himself has refused to act as the sole selling agent after amalgamation.

Question 4

M/s FAB Electronics Ltd. (FEL) has appointed four private companies as its selling agents for sale of its white goods in the four regions of the country. A complaint has been made to the Registrar of Companies, new Delhi that the four selling agents are in fact functioning as sole selling agents and that the terms and conditions of their appointment are not in the interest of FEL. Advise FEL about the provisions of the Companies Act and the action that may be taken by the authorities under the Act.
(November 2007)

Answer

According to Section 294(6) of the Companies Act, 1956 where a company has more selling agents than one, by whatever name called and it appears to the Central Government that it is necessary to obtain information about the terms and conditions and appointment of such agents for the purpose of determining whether any of those selling agents are in fact working as sole selling agents. The Central Government has the power to call for such information as may be necessary to find out the correct position. On the basis of the information obtained, the Central Government may by an order declare that selling agents be the sole selling agent for the area so related with effect from such date as may be specified in the order. From the date so specified in the order, the appointment of the sole selling agent shall be regulated by the terms and conditions as may be varied by the Central Government. It shall be the duty of the company to furnish all information and documents and refusal to do so will involve penalty which may extend upto ₹ 50,000/-. Thus it is imperative for the company to furnish all the information and documents in its possession to the Registrar of Companies or any authority making any enquiry in this regard that the selling agents are not functioning as sole selling agents.

Question 5

On 24th January, 2010, the Board of Directors BUI Limited appointed Mr. A as the company's Sole Selling Agent for a period of 5 years. At the first general meeting of the company, held after the Board meeting, on April 10, 2010, the above appointment was disapproved. Referring to the provisions of the Companies Act, 1956.

- (i) *State the date from which the above appointment comes to an end.*
- (ii) *What would be your answer in case a condition in the above appointment that "the appointment must be made by the company in General Meeting" was not attached thereto?*
(May, 2010)

Answer

According to Section 294(2) of the Companies Act, 1956, the Board of Directors of BUI Ltd. shall not appoint a sole selling agent for any area except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made. It has been held that the appointment of a sole selling agent must be made by the company in its general meeting and such clause must be inserted as a mandatory condition in all appointments of sole selling agents; an appointment without such a clause being inserted is void ab-initio (*Arante manufacturing Corp. Vs. Bright Bills Private Ltd. 1967 Com/Case 769, Shelagram Jhaigharia Vs National Co. Ltd. 1965 Com. Cas. 706*). If the company in the general meeting disapproves the appointment, it shall become invalid from the date of the general meeting.

- (i) Thus, appointment of Mr. A as the sole selling agent will come to an end on 10th April 2010.

Yes, as discussed above, in absence of the above clause, the appointment of Mr. A as the sole selling agent of the company will be void ab-initio.

Question 6

Mr. Agent having 'substantial interest' in ABC Ltd is appointed as a Sole selling agent by the Board of Directors for a period of 5 years. The company's paid-up share capital is Rs.49 crores. The Board did not place the matter in the AGM and communicated to Mr. Agent about his appointment, who in turn accepted the offer.

Examining the provisions of the Companies Act, 1956,

- (a) *Whether the appointment is in order?*
(b) *What course of action you would take as the Secretary of the company, in case Mr. Agent does not have substantial interest?*

Answer

Appointment of Sole Selling Agent: Section 294 and 294AA of the Companies Act, 1956 regulate the appointment of sole selling agents. These sections provide that:

1. No company shall appoint a sole selling agent for any areas for a term exceeding 5 years at a time and the term may be extended for another period but not exceeding 5 years on each occasion. [Section 294(1)].
2. The Board of Directors may appoint a sole selling agent but only subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made. In case, the company in general meeting, as aforesaid, disapproved the appointment, it shall cease to be valid with effect from the date of that general meeting [Section 294(2) and (2A)].
3. Where the Central Government is of opinion that the demand for goods of any

14.6 Corporate and Allied Laws

category, to be specified by that government is substantially in excess of the production or supply of such goods and the services of sole selling agents will not be necessary to create a market for such goods, the Central Government may by notification in the Official Gazette, declare that sole selling agents shall not be appointed by a company for the sale of such goods, for such period, as may be specified in the declaration.

4. No company shall appoint any individual firm or body corporate, who or which has a substantial interest in the company as sole selling agent of that company unless such appointment has been previously approved by the Central Government.
5. A company having a paid-up share capital of ₹ 50 lakhs or more shall not appoint a sole selling agent except with the consent of the company accorded by a special resolution and the approval of the Central Government.
6. The Central Government may vary the terms and condition of appointment of a sole selling agent if those are found to be prejudicial to the interest of the company.
7. In case a company has more than one selling agents in any area, the Central Government may declare any one of such agents as the sole selling agent for such area after obtaining from the company and considering the terms and conditions of appointment of the selling agents.

Procedure for appointment of sole selling agents:

1. Call a meeting of the Board of Directors and determine the name of the sole selling agent to be appointed. If the paid-up share capital of the company is less than Rs.50 lakhs and the appointee does not have a substantial interest in the company, the Board may also resolve to appoint him as sole selling agent subject to the approval of the general body meeting. Date for the general meeting may also be fixed by the Board in its meeting, appointing the sole selling agent.
2. In case the appointee either has a substantial interest in the company, or the paid-up share capital of the company is Rs.50 lakhs or more, application for the approval of the Central Government should be made in Form 1 of the Companies (Appointment of Sole Agents) Rules, 1975.
3. See that the terms and conditions of appointment or reappointment do not contain the tenure exceeding 5 years, at a time.
4. Issue notices for holding the general meeting. Where the paid-up share capital of the company is Rs.50 lakhs or more, it shall require passing a special resolution; otherwise an ordinary resolution shall be sufficient.
5. Forward three copies of the notices and a copy of the proceedings of the general meeting to the Stock Exchange(s) with which the shares of the company are listed (if listed).
6. If the proposed sole selling agent is to be appointed in a foreign country, obtain the prior permission of the RBI.

Thus applying the above provisions (i) the appointment of J is not in order, as there have been a number of violation on the part of the company as per the Companies Act, 1956. Appointment without the approval of the general meeting and without the approval of the Central Government is not valid since the company's paid-up share capital is more than Rs.50 lakhs in this case. Moreover, since J has substantial interest in the company, approval of Central Government in Form 1 is must. Thus, the appointment of J is not in order.

In the second question (ii), the answer would not be different, as the capital (paid-up share capital) is more than 50 lakhs Rupees. In this case though the appointee (J) does not have substantial interest, but the company's paid share capital is more than 50 lakhs, consent of the company in general meeting (special resolution) and the approval of the Central Government is required.

Power of CG to prohibit the appointment of sole selling agents in certain cases (Section 294 AA)

Question 7

The Board of Directors of 'X Ltd. having a paid-up share capital of ₹ 40 lakhs appointed 'Y Ltd, as sole selling agent for a period of 5 years with effect from 1st January, 2003 and the said appointment was approved by the company in the Annual General Meeting held on 30th April, 2003. The Directors of 'Y Ltd. was holding fully paid-up shares of face value of ₹ 3 lakhs in 'X Ltd.' Answer the following explaining the relevant provisions of the Companies Act:

- (i) *Is the appointment of the sole selling agent in order?*
- (ii) *Would your answer be different if both are Private Companies or if the Directors of Y Ltd. (acquired the aforesaid shares in 'X Ltd.) on 1st April, 2003?*

Answer

- (i) **Sole Selling Agents:** (i) According to Section 294AA(2) of the Companies Act, 1956 a company shall not appoint any individual, firm or body corporate, who or which has a substantial interest in the company, as sole selling agent of that company unless such appointment has been previously approved by the Central Government.

Here a body corporate is appointed as sole selling agent. A body corporate can be said to have "substantial interest" in the company, if such body corporate or one or more of its directors or any relative of such director, whether singly or taken together hold beneficial interest in the shares of the company, the aggregate amount paid-up on which exceeds ₹ 5 lakhs or 5% of the paid-up share capital the company, whichever is less. Here 5% of the paid-up share capital of X Ltd. works out to ₹ 2 lakhs. The directors of Y Ltd. were holding fully paid-up shares of face value of ₹ 3 lakhs in X Ltd.. and hence Y Ltd. can be said to have substantial interest in X Ltd. Therefore, the appointment of Y Ltd. as sole selling agent requires prior approval of the Central Government under Section 294AA(2). In this case the appointment has been made by the Board of Directors and approved by the company in general meeting. As the prior approval of the Central Government has not been obtained, the appointment is not in order and the company has contravened the provisions of Section 294AA(2).

14.8 Corporate and Allied Laws

- (ii) Section 294AA is applicable to both private and public limited companies. So it is immaterial whether X Ltd. is a private or public company. Again the body corporate includes both private and public companies. Hence the provisions of Section 294AA(2) are attracted even if the sole selling agency company is a private company. Therefore even if both the companies are private companies, the appointment of sole selling agent without approval of the Central Government is not in order.

It has been clarified by the Department of Company Affairs that in case the provisions of Section 294AA(2) are not attracted to the appointment of sole selling agents the time of entering of agreement with them, it will not be obligatory on the companies to comply with the said provisions for the continuance of the said appointments for the remaining duration of their current tenure even if the provisions of Section 294AA(2) become applicable after the appointment due to the sole selling agents acquiring substantial interest as defined in the explanation under the Section. If the directors Ltd. were not holding shares in X Ltd. at the time of appointment but acquired the shares subsequently the appointment is in order and it does not violate the provisions of section 294AA(2).

Question 8

Randhir was appointed as the sole selling agent of S Ltd. for a period of five years in a general meeting of the company. Exactly after one and half years, S Ltd. was amalgamated with another company A Ltd. Randhir was not appointed as the sole selling agent of A Ltd. S Ltd. paid Randhir Rs.6 lacs as selling agency commission during the said one and half years. Is Randhir entitled to any compensation and if yes, what is the quantum? (November, 2000)

Answer

Section 294A prohibits payment of compensation to the sold selling agent for the loss of his office in the following cases:

- (i) Where the appointment of the sole selling agent ceases to be valid by virtue of section 294(2A).
- (ii) where he resigns his office as a result of reconstruction or amalgamation of the company and is appointed as the sole selling agent of the reconstructed company or the body corporate resulting from the amalgamation.
- (iii) where he resigns his office otherwise than in the circumstances envisaged in the foregoing clause
- (iv) where he has been guilty of fraud or breach of trust in relation to, or of gross negligence in the conduct of his duty as the sole selling agent; and
- (v) where he has instigated or taken part directly or indirectly in bringing about the termination of the sold selling agency.

In this case, Randhir has not been appointed as the sole selling agent of A Ltd. None of the other prohibitions also apply. Hence Randhir would be entitled to compensation.

The amount of compensation payable for the loss of office must in no case exceed the remuneration which he would have earned, he had been in office for the unexpired residue of his term, or for 3 years, whichever is shorter. The amount thereof is to be calculated on the basis of the average remuneration actually earned by him during a period of 3 years immediately proceeding the date on which he had ceased to be in office or his appointment was terminated. In case he had held his office for a period lesser than 3 years, the basis would be the average remuneration that he had earned during such shorter period. The average remuneration earned is $6/1.5=4$ lacs. The compensation payable would be $4 \times 3 = \text{Rs.} 12$ lacs.

Question 9

Ram and Co. Ltd. having paid up share capital of ₹ 40 lakhs appointed on 1st January, 1995 Lakshman and Co. Pvt. Ltd. as sole selling agent for a period of 5 years with effect from 1st January, 1995 with the approval of the company in general meeting. The directors of Lakshman and Co. Pvt. Ltd. were holding 40,000 equity shares of ₹ 10 each fully paid-up in Ram and Co. Ltd. since 1st December, 1994.

State with reasons whether the appointment is valid. Will your answer be different, if Lakshman and Co. Pvt. Ltd. had acquired the aforesaid shares only on 1st December, 1995?

(May, 2003)

Answer

Under section 294AA, no company can except with the prior approval of the Central Government, appoint any individual, firm or body corporate, who or which has a substantial interest in the company as sole selling agent of that company. A person holding paid-up capital exceeding Rs.5 lakhs or 5% of the paid-up capital of the company whichever is less is deemed to have substantial interest in that body corporate [Explanation to Section 294AA].

Thus Ram & Co. should have obtained prior approval of the Central Government for appointing Lakshman & Co. Pvt Ltd as sole selling agents as the latter holds 10% of the paid-up capital of the former company. The appointment is accordingly not valid.

The situation shall be different if shares were acquired by Lakshman & Co. on 1st December 1995. According to a clarification issued by the Department of Company Affairs, if the provisions of Section 294AA(2) are not attracted to the appointment of selling agents at the time of entering into the agreement with them, it will not be obligatory on the company to comply with the said provision for continuance of said appointment for the remaining duration of the current tenure, even if the provisions of section 294AA(2), became applicable after the appointment due to sole selling agents acquiring substantial interest.

However Lakshman & Co. Ltd can continue as sole selling agents for period of 5 years i.e. upto 31st December, 1999, if it acquired the shares only on 1st December 1995 i.e after its appointment on 1st January 1995.

14.10 Corporate and Allied Laws

Question 10

The Board of Directors of ACE Limited having a paid up share capital of ₹ 70 lakhs reappointed Bre Ltd. As sole selling agent for a period of 5 years W.E.F. 2 May, 2007. The Directors of BRE Ltd. were holding fully paid up shares of face value of ₹ 3 lakhs. In ACE Ltd. the reappointment was approved by the company in the next AGM held on 30th September, 2007 but Central Government approval was not obtained until 31st December, 2007. Give your opinion explaining the relevant provision of the Companies Act, 1956.

- (i) *Is the reappointment of the sole selling agent in order?*
- (ii) *Will your opinion be different if the directors of BRE Ltd. do not hold any shares in ACE Ltd?*
- (iii) *If the reappointment is valid. When will the reappointment take effect from?*
(November 2008)

Answer

Section 294AA of the Companies Act, 1956 contains the powers of Central Government to prohibit the appointment of Sole Selling Agents in certain cases. The section further provides that no company shall appoint any individual, firm or body corporate, who or which has a substantial interest in the company, as Sole Selling Agent of that company unless such appointment has been previously approved by the Central Government (Section 294AA (2)).

Also no company having a paid up share capital of rupees fifty lakhs or more shall appoint a Sole Selling Agent except with the consent of the company accorded by a Special Resolution and the approval of the Central Government (Section 294AA(3)). Section 294AA (7) provides that if the company in general meeting disapproves the appointment referred to in sub-section (3), such appointment shall, notwithstanding anything contained in sub-section (6), cease to have effect from the date of the general meeting.

The explanation to this section provides that “appointment” includes “re-appointment “ and “substantial interest “ in relation to a body corporate, means the beneficial interest held by such body corporate or one or more of its directors or any relative of such director, whether singly or taken together, in the shares of the company , the aggregate amount paid up on which exceeds five lakhs of rupees or five per cent of the paid up share capital of the company, whichever is the lesser.

- (i) So the re- appointment of BRE Ltd. as sole selling agent is in order as general meeting approval was obtained by way of special resolution. Further, ACE Ltd. has to obtain the approval of the Central Government as required under Section 294AA (3) and the same was also obtained by 31st December 2007.
- (ii) No, even if BRE Ltd. does not hold any shares in ACE Ltd. the appointment shall remain valid as ACE Ltd has obtained the approval of the Central Government under Section 294AA(3).
- (iii) Effective date of reappointment is the date from which he is re appointed by the company. As such the re-appointment shall be valid from 2nd May 2007.

Question 11

A company proposes to appoint a Sole Selling Agent for its products. State the cases in which such appointment requires approval of Central Government. Draft a Board Resolution to appoint a sole selling agent in a case where such appointment does not require approval of Central Government.
(CA Final, New Course, November, 2009)

Answer

Appointment of sole selling agents

Under Section 294AA of the companies Act, 1956, in following cases, appointment of sole selling agents will require approval of Central Government:

An individual firm or body corporate who has a substantial interest in the company cannot be appointed as a sole selling agent without prior approval of Central Government [Section 294 AA(2)]. Substantial interest means shares of Rs.5. lakhs or 5% paid up capital of the company, whichever is less. The shareholding may be singly or together with relatives (in the case proposal Sole Selling Agent being an individual), partners and their relatives (in the case of a firm) directors and relatives of directors (in the case of a body corporate (Explanation (b) to Section 294AA).

- (a) Any company having paid up share capital of Rs.50 lakhs or more cannot appoint sole selling agent with approval in general meeting by a special resolution and also approval of Central Government [Section 294AA(3)]. These restrictions apply to all Companies is both Private and Public Companies.

Board Resolution

Resolved that pursuant to the provisions of section 294 of the Companies Act, 1956, and subject to the approval of the Company at a general meeting by ordinary resolution, the Board approves the appointment of 'X' as the company's sole selling agent for the sale of in the territory of for a period of five years with effect from on the terms and conditions set out in the draft agreement produced to this meeting and initiated by the chairman for purposes of identification or with such modifications (not being less advantageous to the company) as may be mutually agreed by the Board and 'X'

Loans to directors, etc (Section 295)

Question 12

A director of a public company has taken a loan from the company without the approval of the Central Government. State in this connection

- (i) *is it possible to avoid prosecution by applying to the central Government for approval or by refunding the loan?*
- (ii) *whether the offence is compoundable before or after institution of prosecution and the authority can compound the offence?*

14.12 Corporate and Allied Laws

Answer

- (i) According to Section 295 of the Companies Act, no public company shall make any loan to any of its directors either directly or indirectly without obtaining the previous approval of the Central Government. As the Act envisages prior approval, Central Government will not entertain any application from the company seeking approval for a loan already given to its director.

The company has, therefore, contravened the provisions of Section 295(1) and for this offence every person who is knowingly a party to this contravention including the person to whom the loan is made shall be punishable either with fine which may extend to ₹ 50,000 or with simple imprisonment for a term which may extend to six months [Section 255(4)]. Where any such loan has been repaid in full, no punishment by way of imprisonment shall be imposed and where the loan has been repaid in part, the maximum punishment, which may be imposed by way of imprisonment, shall be proportionately reduced. So, by refunding the loan in full, it is possible to avoid punishment in the form of imprisonment, but it is not possible to avoid prosecution and punishment in the form of fine.

- (ii) All offences other than offences which are punishable under the Companies Act with imprisonment only or with imprisonment and also with fine are compoundable under Section 621A. As the offence under Section 295 is punishable with fine or imprisonment, it is compoundable but with the permission of the Court [Section 621A(2)]. The offence may be compounded either before or after the institution of prosecution. If the offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, either by the Registrar or by any shareholder or by any person authorised by the Central Government. Where the composition of any offence is made after the institution of any prosecution, such composition shall be brought to the notice of the court by the Registrar in writing and on such notice of the composition of the offence being given, the company or its officer in relation to whom the offence is so compounded shall be discharged [Section 621A(4)].

The offence may be compounded by the Regional Director where the maximum amount of fine, which may impose for such offence, does not exceed ₹ 50,000 and in other cases by the company Law Board. In this case, Regional Director may compound the offence, as the maximum fine is only ₹ 50,000. On receipt of applications from the persons liable for penalty under Section 295(4) along with the comments of the Registrar, the Regional Director may specify the amount not exceeding the maximum fine which shall be paid to the Central Government for compounding of the offence.

Question 13

A company is offering one of its flats on sale to one of its directors on the condition that 50% of the price to be paid in cash and the rest in equated instalments. Comment on the situation, whether this could be treated as a loan under Section 295 of the Companies Act, 1956.

Answer

- (i) This transaction does not per se amount to a loan so as to violate Section 295 of Companies Act, 1956. The burden of proving otherwise lies with the prosecution. (*M.G. Electronics Components Ltd v. Asst. Registrar of Companies*).
- (ii) The deposit of the cost of purchase of property cannot be regarded as a loan or advance to the M.D. or book debt attracting the provisions of section 295 or section 296 of the Companies Act. It is no concern of the M.D. on what terms the company secures premises for residential accommodation for him.
- (iii) In a petition in *Dr. Freddie Ardeshir Mehta v. Union of India* seeking quashing of a prosecution launched under Section 295, the Bombay High Court came to the conclusion that a company selling one of its flat to one of its directors on receiving half price in cash and agreeing to accept the balance in instalments does not give a loan to the director. It is accredit sale. It cannot continued be described even as an indirect loan. In view of this decision, the transaction in question does not amount to a loan to a director requiring approval of the Central Government.

Question 14

A & Co. Ltd. wants to sell its products to its following customers: (a) A partnership firm in which two of the directors of the company are partners; (b) A private company in which one of the directors of the company is a member; (c) A public company in which one of the directors of the company is a director. In these three cases what steps are required to be taken by A & Co. Ltd.?

Answer

(a) & (b) According to Section 297, except with the consent of the Board of Directors of a company, *firm* in which the director or directors of the company is/are partners or a *private company* of which such director or directors is or are a member or members shall not enter into any contract with the company for the sale, purchase or supply of any goods, materials or services. Therefore, the public company in the instant two cases should obtain the consent of its Board of Directors. This consent shall have to be taken by a resolution passed at the Board meeting and not otherwise. The resolution according the consent must be passed before the contract to sell the product is entered into or within 5 months of the date on which it was entered into; otherwise consent shall not be deemed to have been given. If the consent is not accorded, anything done in pursuance of the contract shall be voidable at the option of the Board. Care should be taken to ensure that the interested directors do not vote on the motions and their presence is not counted for the purpose of quorum for the meeting. Also it is to be seen that such directors have disclosed their interests in the contract pursuant to Section 299 of the Companies Act unless any of them is enjoying the exemption under sub-section (6) of the above section.

The consent contemplated above is not a general consent but consent referable to each particular or specific contract or contracts. Consent requires knowledge of the necessary facts

14.14 Corporate and Allied Laws

and material, which lead to the consent and cannot be given in general or abstract manner (*Watchand Nagar Industries Ltd. vs. Ratanchand, A.I.R. Bom. 256*). Therefore, the Board of the public company should take appropriate steps in this regard.

(c) The point of the case in question relates to disclosure of interest by directors. According to Section 299(6), nothing in Section 299 shall apply to any contracts entered into or to be entered between two companies where one of the directors of the one company or two or more of them together holds or hold not more than 2% of the paid up share capital in the other company. This point is not clear from the facts in the problem. This is a contract to be entered into between two companies. And if the director of the first company holds 2% or less of the paid-up share capital in the second public company, the provisions of Section 299 will not apply to this case.

If, however, the said director holds more than the aforesaid 2% then the Board of Directors should see that the director, pursuant to Section 299, discloses his interest or concern at the meeting of the Board. This disclosure has to be made at the Board meeting at which the contract is considered. If the interest is acquired subsequent to the meeting then it is to be disclosed at the immediately next meeting.

The Board of the first-mentioned public company should ascertain whether the interest of director aforesaid consists solely (i) in his being a director of such company and the holder of not more shares of such number and value therein as is requisite to qualify him for appointment as a director thereof, he having been nominated as such director by the company or (ii) in his being a member holding not more than 2% of its paid-up share capital. Also, there is no restriction on voting, etc. by an interested director if a notification had been issued by the Central Government under Section 300(3) exempting the company from the purview of Section 300. If, on such assertion, the interest is not found to be so consisting as aforesaid, the Board of the company should see that interested director does not participate in the discussion or vote on the contract and that his presence is excluded from the computation of quorum.

Question 15

Mr. X is a director of M/s ABC Ltd. He has approached M/s Housing Finance Co. Ltd. for the purpose of obtaining a loan of Rs.50 lacs to be used for construction of building his residential house. The loan was sanctioned subject to the condition that M/s ABC Ltd. should provide the guarantee for repayment of loan instalments by Mr. X. Advise Mr. X. (November, 2001)

Answer

According to section 295 of the Companies Act, 1956, no company shall make a loan or give any guarantee, or provide any security in connection with a loan made by any other person to any director of the lending company unless the previous approval of the Central Government is obtained in this behalf. Thus, Mr. X has to approach his company ABC Ltd by stating the full details of the loan transaction and the stipulation of M/s Housing Finance Company Ltd. Thereafter M/s ABC Ltd has to make an application to the Central Government for approval

under Section 295 along with the prescribed fees. Only on receipt of the approval M/s ABC Ltd can provide guarantee to M/s Housing Finance Co. Ltd.

The company is also required to comply with the provisions of section 292 (i.e. Board Resolution) and section 372A (special resolution in a general meeting if required).

Question 16

In the light of the conditions laid down by Section 295 of the Companies Act, 1956, examine if the following transactions can be considered as loans to Directors:

- (i) *Advance payment of salary to the employee who is also the spouse of the Managing Director of the Company.*
- (ii) *A sale of flat of the company at the Current Market Rate and Price. The Director pays sixty per cent Cash immediately and contracts to pay the balance in ten monthly instalments.*
- (iii) *A loan to a firm in which the Director of the company is a Partner. (November, 2002)*

Answer

A company's power of lending money to its directors is strictly regulated by the Companies Act, 1956. The Act prohibits the company not only from directly lending money to its directors but also from giving any guarantee for a loan taken by a director from any other person, and providing any security for such loan. Section 295 deals with loans to Directors.

- (i) This transaction does not per se amount to a loan so as to violate Section 295 of the Companies Act, 1956. The burden of proving otherwise lies with the prosecution. Thus in the absence of any evidence that there has been circumvention of the section by disguising the loan to the wife of the director, who is an employee, as salary advance, the court refused to accept the case for prosecution. *M.R.Electronic Components Ltd. vs. Assistant Registrar of Companies (1987) 6 Comp. Case 8 (Mad).*
- (ii) In a petition, *Dr. Freddie Ardeshir Mehta V. Union of India* seeking quashing of a prosecution launched under section 295, the Bombay High Court came to the conclusion that a company selling one of its flats to one of its directors on receiving more than half the price in cash and agreeing to accept the balance in installments does not amount to giving a loan to the directors. It is a credit sale. It can not even be described as indirect loan.
- (iii) Through the loan given by the company to the firm may not be direct loan to the directors of the company, yet the provisions of Section 295 of the Companies Act, 1956 prohibit any loan to a firm in which one or more of the company directors are partners. Since one of the directors of the company is a partner of this firm, a loan to this firm is in contravention of the provisions of Section 619.

14.16 Corporate and Allied Laws

Question 17

Mr. X is a director of several companies. He has approached the following companies in which he is a director for financial help to start his own personal business.

- (i) *Expandable Industries Ltd.*
- (ii) *Expensive Gadgets Private Ltd.*
- (iii) *Easy Finance Ltd.*

The first named company has agreed to grant a loan of ₹ 50 lakhs. The second company also offered another loan of ₹ 50 lakhs. The third company has agreed to provide guarantee for the repayment of a loan sanctioned to Mr. X by a Private Bank to the tune of ₹ One crore. Advise Mr. X about the legal provisions that should be complied with under the Companies Act, 1956 and the consequences if there is a non – compliance. **(November 2008)**

Answer

According to Section 295 of the Companies Act, 1956 no public company shall directly or indirectly make any loan to or give any guarantee or provide any security in connection with a loan made by any other person to a director of the company without obtaining the previous approval of the Central Government. Thus M/s. Expandable Industries Ltd, being a public company has to take approval of the Central Government before the loan amount of ₹ 50 lakhs is disbursed. However no approval of the Central Government is required in the case of Expensive Gadgets Private Ltd. being a Private Company. However, if the said Private Company is a subsidiary of a Public Company, the approval of Central Government is required. In the case of Easy Finance Ltd. the approval of Central Government is required and thereafter only the transaction can be entered into without committing violation of the provision of the Companies Act, 1956. If there is any violation, Mr. X the director will vacate his office as a director as provided in Section 283 (1) (h) of the Act. The said violations is however compoundable under Section 621A of the Act.

Question 18

- (i) *Mr. KMP is director of XLS Ltd. He intends to construct a residential building for his own use. The cost of construction is estimated at Rs.1.50 Crores, which Mr. KMP proposes to finance partly from his own sources to the tune of Rs.60 lacs and the balance Rs.90 lacs from housing loan to be obtained from a housing finance company. For the purpose of obtaining the loan, he has approached the housing finance company which has in principle agreed to grant the loan, but has put a condition. The condition put by the housing finance company is that the Company XLS Ltd. of which Mr. KMP is a director should provide the guarantee for repayment of the loan and interest as per the terms of the proposed agreement for granting the loan to Mr. KMP. You are required to advise Mr. KMP on the matter with reference to the provisions of the Companies Act, 1956.*
- (ii) *Draft a Board Resolution of XLS Ltd. For providing guarantee for ₹ 90.00 lacs in respect of a Loan to be obtained by Mr. KMP, a director thereof from a Housing*

Finance Company for construction of a residential house for his own use.

(CA Final, New Course, June 2009)

Answer

- (a) (i) According to the provisions of Section 295 of the Companies Act, 1956, no company shall make any loan or give any guarantee or any security in connection with a loan made by any other person to any director of the lending company unless the previous approval of the Central Government is obtained in this respect.

In view of the above provisions of the law, Mr. KMP is required to approach XLS Ltd. intimating the company the full details of the loan transaction and the condition imposed by the housing finance company. The company XLS Ltd. is required to pass a Board Resolution as required by Section 292 of the Companies Act, 1956 and also a special resolution in terms of Section 372A if the facts of the case so require. Thereafter, the company is required to make an application to the Central Government for obtaining the approval under Section 295 of the Companies Act, 1956. On receipt of the approval of the Central Government, XLS Ltd. can provide the guarantee to housing finance company in respect of the loan proposed to be granted to Mr. KMP

- (ii) **RESOLUTION PASSED IN THE MEETING OF THE BOARD OF DIRECTORS OF XLS LTD. HELD ON _____**

“RESOLVED that, subject to the approval of the Central Government, sanction be and is hereby accorded to the proposal of furnishing the guarantee in respect of a loan of Rs.90.00 lacs to be obtained by Mr. KMP, a director of the Company, from M/s _____, a housing finance company as per terms and conditions contained in the draft loan agreement to be entered into between the said housing finance company and Mr. KMP, a copy of which is placed before this meeting and initialed by the Chairman for the purpose of identification.

RESOLVED FURTHER that Mr. _____, Secretary of the Company by and is hereby authorized to digitally sign the e-form 24AB, submit the application to the Ministry of Corporate Affairs and comply with all other formalities in this regard.”

Question 19

- (a) *X Ltd. whose paid up share capital to Rs.3 crores proposes to purchase raw material of Rs.20 lakhs from Y Limited. It proposes to purchase raw material of Rs.10 lakhs on cash basis and the balance on 90 days credit. A who is the Managing Director of X Limited is also a director and shareholder of Y Limited. Advise the procedure.*
- (b) *Z Limited has four directors and all of them are interested in a contract. Guide?*

14.18 Corporate and Allied Laws

Answer

- (a) The provisions of Section 297 are not applicable when the company from whom the materials will be purchased is a public limited company. Mr. A has to comply with the provisions of Section 299 and disclose his interest at the Board Meeting and is not to participate in discussion at the meeting, when the above contract is put up for approval of the Board. Even if the shareholding of Mr. A in Y Ltd. together with the shareholding, if any, of the directors is 2% or less in Y Ltd., disclosure of his interest as director in Y Ltd. shall be made.
- (b) In terms of provision of Section 287 of the Companies Act, 1956, Quorum for meeting of Board of Directors of the Company shall be one third of its total strength or two Directors whichever is higher. Interested Directors presence shall not be considered for the purpose of quorum. In the present case, there will be no quorum in the board meeting in respect of a contract as all the directors are interested therein.

The remedy in such case seems to be to increase the strength of Board by appointing at least two disinterested directors as additional directors who are not interested in said contract, if so authorised by Articles and if the said appointment shall be within the maximum number of directors as fixed by the Articles. If this is not found practicable it would be desirable to place the proposed contract before General Meeting for consent. [Department of Company Affairs Letter No. 816(I)61-P-R dated 9/5/81].

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

Question 20

X Ltd., recently went in for public issue of shares and for this purpose it paid brokerage to a share broking firm in which one of the Directors of the company is a partner in that firm. State in this connection:

- (i) *Whether the concerned interested director should disclose his interest in the firm to the Company. If so, when?*
- (ii) *Should he still disclose, if the company already knew of this fact.*
- (iii) *What would be your answer, if the concerned director merely acted as a broker between the firm and the company?*

Answer

- (i) According to Section 297, 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, must not enter into contracts with company for the sale, purchase, or supply of goods, materials or services or for underwriting shares or debentures except with the consent of the Board of Directors. If the company is having a paid-up capital of Rs.1 crore or more no such contract shall be entered into except with the previous approval of the Central Government. The consent

of the Board is deemed to have been given only if it is accorded by a resolution of the Board and not otherwise, either before or within three months of the date of entering into the contract. [sub-section (4)].

In view of the legal position as states above, the appropriate brokerage can be paid to the broking firm if the contract had been entered into with the consent of the Board of Directors of X & Co. Ltd. the director in question is to disclose his concern or interest at the first meeting of the Board meeting held after the director becomes concerned or interested in the contract. A general notice given in this regard to the Board is deemed to be sufficient disclosure of his concern or interest, if either it is given at the meeting of the Board of Directors concerned or he takes reasonable steps to ensure that it is brought up and read at the first meeting of the board after it is given.

The condition under which the sanction of the Board of Directors in respect of contracts by directors or persons connected therewith would not be required [as contained in sub-section (2) of Section 297] have been liberalised. The restrictions do not apply to:

- (a) the purchase of goods and materials from, or sales thereof to, the company for cash at prevailing market prices;
- (b) any contract or contracts between the company and directors or persons connected therewith in respect of sale, purchase or supply of goods in which the parties to the contract regularly trade or do business in; provided they are in respect of goods and materials or services the value whereof or the cost of service would not exceed Rs.5,000 in aggregate in any year comprised in the period of the contract;
- (c) the transactions by banking or insurance company entered into with any director, relative, firm, partner, etc. in the ordinary course of his business.

Section 297(3) provides that a director or persons connected with him may enter into a contract in the circumstances of urgent necessity without obtaining consent of the Board, even if the value of such a contract exceeds ₹ 5,000 in the aggregate, but in such a case the consent of the Board must be obtained at meeting within three months of the date of entering into the contract.

- (ii) The term 'disclosure' means to make others aware of something, which they are not aware. The disclosure of interest by a director has been provided in Section 299 only with a view to know that the director occupies fiduciary position in the company should disclose his interest in any arrangement or contract either directly or indirectly so that the company is in a position to know whether he is acting in any way prejudicial to the interest of the company or for his own benefit. When board is aware of the fact of the interest of a director in a particular transaction, it would not be necessary for such a director to formerly disclose his interest. (*Ramakrishna Rao vs. Bangalore Race Club*, 40 Comp. Case 674 (Mysore). *A. Sivasailam vs. Registrar of Companies* {C.A. No. 11/621A/SRB/94 decided on 31.5.94 (CLB)}).

14.20 Corporate and Allied Laws

- (iii) A contract to act as broker where the duty of the broker is merely to bring together the two contracting parties, namely, the company, on the one hand, and the purchaser of shares or debentures, on the other, does not seem to be covered either by clause (b) or by clause (a) of sub-section (1) of Section 297. It is not covered by clause (b) for two reasons: First, clause (b) specifically refers to underwriting and importing into that clause the act of broking is not permissible. Secondly, there is a good deal of difference between underwriting and broking. In the case of the former, the obligation extends far beyond the mere bringing together the two contracting parties together, while in the case of latter, the broker earns his commission only when he succeeds in bringing the two parties together and not otherwise. To act as a broker is also not covered by clause (a) because commission earned as a broker is not earned by supplying services. The Madras High Court has rightly held that "rendering of services should consist of the doing of an act for the benefit of another which is more than the mere making of a contract and which goes beyond the performance of an obligation undertaken in the course of an ordinary commercial contract". (*Radhakrishna Rao vs. Province of Madras AIR 1952 Mad. 718*)

Question 21

Examine whether the following contracts require previous approval of the Central Government keeping in view the effect of the proviso to Section 297(1) of the Companies Act, 1956.

- (i) *Contracts for purchase of goods from a public company having a paid-up share capital of more than rupees one crore by a firm in which a director of the public company is a partner. The purchase is for cash at prevailing market prices.*
- (ii) *Contracts attracting Section 297(1) to be entered into by a Public Company having a paid-up share capital of Rupees one crore in circumstances of urgent necessity.*

(May, 2004)

Answer

Section 297(3) provides that a contract attracting Section 297(1) may be entered into by the company without obtaining the consent of the Board in circumstances of urgent necessity. But the consent of the Board must be obtained within three months of the date on which the contract was entered into. While section 297(2) provides an exemption, Section 297(3) provides only relaxations that too only with one of the requirements i.e. consent of the Board. In the case under reference as the paid-up share capital of the company is ₹ 1 crore, both the consent of the Board as well as approval of the Central Government are required. Hence, the relaxation provided in Section 297(3) does not apply to a company which has a paid-up share capital of Rs.1 crore. The company must obtain approval of the Central Government before entering into contract even in circumstances of urgent necessity.

Question 22

Examine whether the following contracts require previous approval of the Central Government keeping in view the effect of the proviso to Section 297(1) of the Companies Act, 1956:

Contracts for purchase of goods from a Public Company having a paid-up Share Capital of more than Rupees one crore by a firm in which a director of the Public Company is a partner. The purchase is for cash at prevailing market prices. (May 2004)

Answer

Section 297(a) of the Companies Act, 1956, provides that consent of the Board of Directors of a company shall be necessary for a contract for the sale, purchase or supply of any goods, material or services entered into by the company with a director of the company or his relative or a firm in which such a director or relative is a partner. The proviso to this sub-section requires that in the case of a company having paid up share capital of not less than Rs.1 crore (i.e. Rs.1 crore or more), no such contract shall be entered into except with the previous approval of the Central Government.

Certain exemptions are provided in Sub-section (2) of Section 297. One such exemption is that nothing contained in clause (a) sub-section (1) shall affect the purchase of goods and materials from the company by any director, relative, firm stated in Section 297(1) for cash at prevailing market prices. As the contract referred to in the question qualifies for exemption under section 297(2)(a), approval of Central Government is not required.

Question 23

PQR Machines Ltd. Entered into a contract with MN forgings, in which wife of P, a director of the company is a partner. The contract is for supply of certain components by the firm for a period of three years with effect from 1st September, 2005 on credit basis. The paid-up Share Capital was increased from ₹ 70 lakhs to ₹ 140 lakhs on 1st March, 2006. Explain the requirements under the Companies Act, 1956, which should have been complied with by PQR Machines Ltd. before entering into contract with MN Forgings. Whether there is any additional requirement which is required to be complied with by PQR Machines Ltd. in view of the increased paid-up Share Capital on 1st March, 2006.

What would be your answer in case MN forgings is a Private Company in which P's wife is holding substantial shares? (May 2006)

Answer

The contract for supply of components entered into between PQR Ltd. and MN Forgings, a partnership firm (on which wife of P, a director of the company is a partner) attracts Sections 297, 299, 300 and 301 of the Companies Act, 1956.

The contract cannot be entered into unless it is approved in the meeting of the Board of Directors of PQR Ltd. Specific Board resolution is required (Section 297). However, in case of urgent necessity such consent of the Board may be obtained within 3 months of the date on which the contract was entered into (Section 297(3))

P, the interested director must disclose his interest at the Board meeting at which the question of entering into the contract has been taken up for consideration (Section 299(1) & (2)). P, the

14.22 Corporate and Allied Laws

interested director should not have taken part in the discussion at the said board meeting and he should not have noted on the resolution in respect of that contract (Section 300)

Prescribed particulars of the contract must be entered into the Registrar of Contract maintained under Section 301 within 7 working days of the Board meeting (Section 301).

In the given case the contract was entered into on 1.9.2005 for supply of components for a period of 3 years. As the paid-up share capital was only ₹ 70 lakhs (i.e. less than Rs.1 crore) on 1.9.2005 proviso to Section 297(1) requiring prior approval of the Central Government is not attracted. Subsequent increase in the paid up share capital beyond ₹ 1 crore will not make it necessary to get the approval of the Central Government for continuation of the contract for the remaining period. Hence, there is no additional requirement.

If MN Forgings is a private company the provisions of Section 297 are not attracted as the director of PQR Ltd. is a director or member of MN Forgings Private Ltd.

Section 299 is also not attracted for the reasons given below:

If the contract or arrangement is between companies, a director is deemed to be interested only if he singly or along with other directors hold 2% or more shares in other company (Section 299(6)). While calculating the 2% shares in other company, only investment of directors is considered. Here P, a director of PQR Ltd. is not holding any shares in MN forgings Pvt. Ltd. Shares held by P's wife are not to be considered. Hence the provisions of Section 299 are not attracted. Sections 300 and 301 are also not applicable.

Question 24

LMB Ltd., Kolkata is a multiproduct manufacturing company having paid up capital of ₹ 5.00 crores. In order to increase the product portfolio, the said company intends to procure certain machines and equipments worth ₹ 1.00 crore from a partnership firm, namely, M/s MLPK, in which the son of managing director of LMB Ltd. is a partner. The contract for purchase of said machines and equipments is to be placed before the board of directors of the company for its consideration.

In view of above facts, you are required to explain briefly the procedure under the provisions of the Companies Act, 1956 to be followed by the LMB Ltd., to enter into the said contract.
(May 2005, May 2008)

Answer

As per provisions of section 297 of the Companies Act, 1956, when a Company enters into a contract in which some of the directors are interested, then consent of the Board of Directors of the Company is required to be obtained. In the present case since the Managing Director of LMB Ltd. is interested in the contract for the purchase of machines and equipments because of his son's partnership in the supplier firm, the same should be approved by the board of directors of the company.

Proviso to Section 297(1) states that in the case of a company having a paid-up capital of not less than rupees one crore, no such contract shall be entered into except with the previous

approval of the Central Government. Since the paid up capital of LMB Ltd. is ₹ 5 crore, the company is required to take over prior approval of the Central Government.

For this purpose, following steps are required to be taken:

- (i) Hold a board meeting and place the terms of the contract for consideration. The managing director should disclose the nature of his interest as required under Section 299 of the Companies Act, 1956.
- (ii) The managing director should not participate in discussion when in the board meeting, the matter in respect of the abovementioned contract is being discussed. He must not also vote on the relevant resolution. Moreover, his presence shall also not be counted for determining the quorum of the board meeting. [Section 300 of the Companies Act, 1956]
- (iii) The consent of the board of directors must be accorded by way of a resolution and not otherwise.
- (iv) An application to the Central Government (by delegation to Regional Director) should be made in prescribed form (Form No. 24A). Following enclosures should be made with the said form:
 - (a) a certified true copy of the board resolution approving the contract
 - (b) a copy of the proposed agreement
 - (c) a copy of the Memorandum and Articles of Association of the company
 - (d) a copy of latest audited annual accounts with directors' and auditors' reports thereon.
 - (e) bank draft or treasury challan evidencing the payment of prescribed fees.
- (v) Necessary entries are to be made in the Register of Contracts (Section 301)

On receiving the approval from the Central Government (Regional Director), the company can proceed to enter into the contract for supply of machines and equipments with the firm M/s MLPK in which the son of Managing Director is a partner.

Question 25

A & Co. Ltd. wants to sell its products to its following customers: (a) A partnership firm in which two of the directors of the company are partners; (b) A private company in which one of the directors of the company is a member; (c) A public company in which one of the directors of the company is a director. In these three cases what steps are required to be taken by A & Co. Ltd.?

Answer

(a) & (b) According to Section 297, except with the consent of the Board of Directors of a company, *firm* in which the director or directors of the company is/are partners or a *private company* of which such director or directors is or are a member or members shall not enter

14.24 Corporate and Allied Laws

into any contract with the company for the sale, purchase or supply of any goods, materials or services. Therefore, the public company in the instant two cases should obtain the consent of its Board of Directors. This consent shall have to be taken by a resolution passed at the Board meeting and not otherwise. The resolution according the consent must be passed before the contract to sell the product is entered into or within 5 months of the date on which it was entered into; otherwise consent shall not be deemed to have been given. If the consent is not accorded, anything done in pursuance of the contract shall be voidable at the option of the Board. Care should be taken to ensure that the interested directors do not vote on the motions and their presence is not counted for the purpose of quorum for the meeting. Also it is to be seen that such directors have disclosed their interests in the contract pursuant to Section 299 of the Companies Act unless any of them is enjoying the exemption under sub-section (6) of the above section.

The consent contemplated above is not a general consent but consent referable to each particular or specific contract or contracts. Consent requires knowledge of the necessary facts and material, which lead to the consent and cannot be given in general or abstract manner (*Watchand Nagar Industries Ltd. vs. Ratanchand, A.I.R. Bom. 256*). Therefore, the Board of the public company should take appropriate steps in this regard.

(c) The point of the case in question relates to disclosure of interest by directors. According to Section 299(6), nothing in Section 299 shall apply to any contracts entered into or to be entered between two companies where one of the directors of the one company or two or more of them together holds or hold not more than 2% of the paid up share capital in the other company. This point is not clear from the facts in the problem. This is a contract to be entered into between two companies. And if the director of the first company holds 2% or less of the paid-up share capital in the second public company, the provisions of Section 299 will not apply to this case.

If, however, the said director holds more than the aforesaid 2% then the Board of Directors should see that the director, pursuant to Section 299, discloses his interest or concern at the meeting of the Board. This disclosure has to be made at the Board meeting at which the contract is considered. If the interest is acquired subsequent to the meeting then it is to be disclosed at the immediately next meeting.

The Board of the first-mentioned public company should ascertain whether the interest of director aforesaid consists solely (i) in his being a director of such company and the holder of not more shares of such number and value therein as is requisite to qualify him for appointment as a director thereof, he having been nominated as such director by the company or (ii) in his being a member holding not more than 2% of its paid-up share capital. Also, there is no restriction on voting, etc. by an interested director if a notification had been issued by the Central Government under Section 300(3) exempting the company from the purview of Section 300. If, on such assertion, the interest is not found to be so consisting as aforesaid, the Board of the company should see that interested director does not participate in the discussion or vote on the contract and that his presence is excluded from the computation of quorum.