

Procedure, etc., Where Director Interested (Sections 299 – 302)

Disclosure of interests by director (Section 299)

Question 1

Company Y with a paid-up capital of Rs.50 lakhs entered into a contract with company Z in which a director of Y is holding equity shares of the nominal value of Rs.50,000. The director did not disclose his interest at the Board meeting under section 299 of the Companies Act, 1956. Is the director liable for his act?

Answer

As per Section 299, the disclosure of interest by directors do not apply to any contract or arrangement within two companies where any of the directors of 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. In the present case, if the holding is less than 2%, the director is not liable.

Question 2

X Ltd. entered into a contract with M & Co. Ltd. for the purchase of raw materials for ₹2,50,000, at the prevailing market rate. The Director, of X Ltd. Mr. B was holding shares of the value of 1% of the paid up capital of M & Co. Ltd. Another Director, of X Ltd. Mr. C was holding shares of the value of 1.5% of the paid up capital of M & Co. Ltd. Mr. B at the beginning of the year, gave a general notice to X Ltd., that he was interested in M & Co. Ltd., but did not disclose the nature of interest. Mr. B claims that he had give notice to X :Ltd. as required under the Companies Act and that his holding being only 1% is within the limit prescribed under the Companies Act.

(November, 2000)

Answer

In the problem given the contract was entered between two public companies for the purchase of raw materials for Rs.2,50,000 at the prevailing market rate. Therefore, transaction of this type, which too between two public limited companies will be hit by Section 299 and not by Section 297 as it may apparently appear to be. Though Section 299 to some extent overlaps Section 297, it is wider in scope and covers all kinds of contracts and arrangements as proposed in Section 297. In the problem given, contract between X Limited and M & Co. Limited was entered into wherein the concerned directors of X Ltd namely Mr. B (holding 1% of paid up capital of M & Co. Limited) and Mr. C (holding 1.5% of the paid up capital of M & Co. Limited) have given a general notice to X Limited but did not disclose the nature of their interest. The consequences of non-disclosure of interest are that it will cause vacation of the

15.2 Corporate and Allied Laws

office of director under Section 283[1(i)] and will also subject to penalty under sub-section 4 of Section 299. However, in the opinion of the Department of Company affairs, (Company News & Notes dated 1.7.63) if a director has given a general notice in terms of sub-section 3 of Section 299, he will not be liable for prosecution provided the general notice covers the relevant contract in question. However, sub-section (6) of Section 299 provides that nothing contained in this section shall apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them holds or hold not more than 2% of the paid up share capital in the other company. By necessary implications it also means that where a director or two or more or all the directors hold more than 2% of the paid up share capital of another company, any contract or arrangement with that other company (in the instant case X LTD) will come within the purview of Section 299. In keeping with the spirit of Section 299 and in view of their occupying fiduciary position in the company, the concerned directors (namely Mr. B & Mr. C) should disclose their interest even if their individual holding is less than 2% of the paid up capital of the M & Co. Ltd and they should take steps to see that the disclosure is made at the next meeting of the Board of Directors. Hence the argument of Mr. B is not valid.

Question 3

Mr. Nanavati holding 3% shares in OPQ Ltd., became a director of this company on 1.5.2000. The company, prior to his appointment as director, had commenced transactions with A Ltd. In the next Board Meeting to be held on 10.5.2000, the Board proposes to discuss about price revisions sought for by A Ltd. Briefly explain:

- (i) *Whether Mr. Nanavati should make a disclosure of his interest in A Ltd., assuming that the company is going to have transactions with A Ltd. on a continuous basis; if yes, when and how? When should it be renewed?*
- (ii) *Can he vote in the price revision resolution in the Board Meeting?*

You are informed that Mr. Nanavati holds 1.5% of the share capital of A Ltd and that his wife holds another 3% of the share capital of a Ltd. **(November, 2000)**

Answer

OPQ Ltd. entered into certain transactions (arrangement/contract) with A Ltd. in which Mr. Nanavati is interested before his appointment as a director in OPQ Ltd. The issue is whether Mr. Nanavati should disclose his interest in A Ltd.

Section 299(2)(b) of the Companies Act, 1956 applies to a case of contract or arrangement in which a person was concerned or interested before he becomes a director and also to a case of a contract or arrangement in which he becomes concerned or interest after he becomes a director. The words 'becomes concerned or interested' occurring in the provision denotes a present state of thing. In the case of a person who was actually concerned or interested in the contract or arrangement, the liability for disclosure arises the moment he accepts office as director (*M.O. Varghese v. Thomas Stephen & Co. Ltd. (1970) 40 CC 1131 Kerala*).

Further, in this case, the Board proposes to discuss in the Board meeting to be held on 10.5.2000 the price revision sought by A Ltd.

In view of the above, Mr. Nanavati should make a disclosure of his interest in the first meeting to be held on 10.5.2000 after he became a director. Such disclosure may be made by a general notice under section 299(3) to the effect that he is a member or a director of a specified body corporate. Such notice is valid only for the financial year in which it is given and therefore, it should be renewed in the last month of every year, where necessary.

Another issue is whether Mr. Nanavati can vote in the price revision resolution in the Board Meeting. As per section 300(1), no director of a company shall, as a director, take any part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement. As per sub-section (2) the provision of sub-section (1) shall not apply to any contract or arrangement entered into or to be entered into with a public company, in which the interest of the director aforesaid consists solely in his being a member holding not more than two percent of its paid-up share capital.

In the given case, Mr. Nanavati is holding 1.5% of the share capital of A Ltd., and his wife is holding another 3% in the share capital of A Ltd. and, therefore, it cannot be said he is interested only to the extent of less than 2% of the paid-up share capital of A Ltd. [The word 'solely' is used in section 300(2)(d)]. Hence Mr. Nanavati should not participate and vote in the Board Meeting to be held on 10.5.2000.

Question 4

The Articles of Association of a company states that a director shall not vote in respect of a contract in which he is interested. In a resolution put up for approval of the shareholders, can a director exercise his voting right in favour of a contract in which he is interested?
(November, 2001)

Answer

When a director exercises his voting right as a shareholder, he is free to vote in his own best interests like any other shareholder.

A provision in the articles of association of a company stating that a director shall not vote in respect of a contract in which he is interested does not preclude him from voting thereon as a shareholder in the general meeting of the company. A shareholder may vote as he pleases even when his interests are different from or opposed to those of the company. Shareholders are not trustees for the company or for one another.

However, in *Cooks vs. Deeks*, it was held that if directors use their position as directors to obtain for themselves the property of the company, as for example, by means of a beneficial contract, they cannot, by using their voting power as shareholders in general meeting, prevent the company from claiming the benefit of it.

15.4 Corporate and Allied Laws

Further section 182 makes it clear that a public company or a private company which is subsidiary of a public company shall not put any restriction on voting right of members except the one specified in section 181 (i.e. restriction on exercise of voting right of members who have not paid calls).

Hence the director can exercise his voting right at a general meeting in favour of a contract in which he is interested.

Question 5

P, son of A, who is the Managing Director of ABC Limited, proposes to give his flat on lease to the company. The paid-up share capital of ABC Limited is Rs.10 crores. Advise the company explaining the restrictions, if any, under the Companies Act, 1956.

(CA Final, New Course, November, 2008)

Answer

Lease of flat: Section 297 of the Companies Act, 1956 requires certain contracts on which the directors of a company are interested to be sanctioned by the Board of Directors of the Company and in certain cases (i.e. where the paid up share capital of the company is Rs.1 crore or more) it is also required to be approved with the previous approval of Central Government. Section 297 applies only to contracts of sale, purchase or supply of goods, materials and services or for underwriting the subscription of any shares in, or debentures of the company. Providing premises on a rental or lease basis by a director or his relative to company is not covered by Section 297. Since this Section does not apply to transactions in immovable properties, hence the proposed lease does not require either board resolution or approval of the Central Government.

However it is an arrangement in which the Managing Director is interested and as such he is required to make a disclosure under Section 299 of the said act and he should not participate or vote in the Board's proceedings (Section 300) and the lease arrangement must be entered in the Register of Contract maintained under Section 301 of the said Act.

Question 6

M/s. Raman Limited having a paid up share capital of ₹5 crores owns an agency of Cement Corporation of India Ltd. and proposes to supply cement, on credit, to M/s. Raman Enterprises Private Limited. Mr. Raman is a common Director in both the companies.

State the requirements of the Companies Act, 1956, if any, to be complied with by the company on the facts of this case.

Will it make any difference, if -

- (i) *M/s. Raman Enterprises Private Limited were a public company;*
 - (ii) *M/s. Raman Limited were carrying on real estate business and it proposes to sell a flat to M/s. Raman Enterprises Private Ltd. for ₹50 lakhs?*
- (November 2006)**

Answer

Under Section 297 of the Companies Act, 1956 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 director or relative is a partner; or a private company of which the director is a member or director, shall not enter into any contract with the company for the sale, purchase or supply of any goods, materials or services. Where the paid up capital of the company is not less than ₹ 1 crore, it will also require previous approval of the Central Government. Exemption from the said provisions are available in the following circumstances -

- (i) the purchase of goods and materials from the company or sale of goods and materials to the company is for cash at prevailing market prices;
- (ii) any contract for sale, purchase or supply of goods, materials and services in which the company, or director etc. regularly trades the cost of which does not exceed ₹ 5,000 in any year.

In the present case, Mr. Raman is a common director in both the contractee companies. Accordingly, apart from the approval of the Board, previous approval of the Central Government (power delegated to Regional Director) is also required for entering into the proposed contract of supply of cement on credit. The provisions of Section 299 and 300 of the Companies Act, 1956 have also to be complied with and

in the Board meeting Mr. Raman shall disclose his interest in the contract and shall not participate in the discussions on this item and shall not vote for the same. The particulars of the contract be also recorded in the Register of Contracts.

- (i) Section 297 does not apply to a contract where both the contractee companies are public companies. If Ram Enterprises happens to be a public company, section 297 will have no applicability.
- (ii) Section 297 does not apply to a contract relating to immovable properties being the sale of flat in case of Raman Ltd. is a real estate company. The expression 'goods' used in the section has been defined in the Sale of Goods Act, 1930 according to which its means every kind of movable property. Hence, sale of flat will not amount to sale of 'goods' for purposes of section 297 of the section.

Question 7

Premier Machineries Limited having a paid-up share capital of Rs.90 lakhs proposes to enter into a contract with the following parties for supply of components with effect from 1st January, 2008 for a period of 3 years:

- (a) *XYZ Metal Forging Private Limited in which Mr. John, a Director of Premier Machineries Limited, is a Director and member.*
- (b) *ABC Casting Limited in which Mr. Philips, a Director of Premier Machineries Limited, holds 30% of the paid-up share capital.*

15.6 Corporate and Allied Laws

- (c) *The capital of Premier Machineries Limited was increased to Rs.1.50 crores on 1st January, 2009 by issue of further shares.*

Briefly discuss the legal requirements to be complied with under the Companies Act, 1956 to give effect to the above proposals taking into account the increase in the paid-up share capital as on 1st January, 2009.
(CA Final, New Course, November 2009)

Answer

Under section 297 of the Companies Act, 1956 as Mr. John, a director of Premier Machineries Ltd. is interested in XYZ metal Forging Private Ltd. as a director and a member of the Company, a resolution in the meeting of the Board of Directors is required to be passed before entering into a contract with XYZ Metal Forging Private Ltd. If due to urgency it is not possible to pass a Board resolution before entering into the contract, the requisite consent of the Board shall be obtained within three months of the date on which the contract was entered into under Section 299, Mr. John must disclose his interest to the Board and not participate in the said meeting/deliberations.

Since the paid up capital of the Company is Rs.90. lakhs, approval of the Central Government is not necessary. In this case, the paid up capital was increased to Rs.1.50. crore subsequent to the date of entering the contract. No approval of the Central Government will be required as on the material date of entering into the contract, the paid up capital was less than Rs 1 crore.

Section 297 does not cover cases of Public Limited Companies, hence aforesaid approvals will not be necessary. In both the cases the interested directors must make disclosure of interest as required under section 299 and also comply with section 300. Entries are also required to be made in the Register of Contract under section 301.

Interested director not to participate or vote in Board's proceedings (Section 300)

Question 8

A Limited had four directors. At one of its convened Board meeting only two of them attended and they appointed two additional directors who were their relatives. Is the appointment of those additional directors valid?

Answer

Section 300 provides that a director shall not take part in the discussion of or vote on any contract or arrangement entered into or to be entered into by or on behalf of the company if he is in anyway whether directly or indirectly concerned or interested in the contract or arrangement. The Department of Company Affairs has clarified that the word interested as used in the section should be given a restrictive interpretation and thus excludes a director who has no pecuniary interest. Accordingly, the relationship of the director with the contracting party will not per se make the director concerned or interested in the contract or arrangement.

The scope of the expression 'contract' or 'arrangement' was examined by the Madras High Court in *Madras Tube Co. Ltd. vs. Hari Krishan Somani*, (1985) 1 Comp LJ 195 (Mad). The question before the court was whether the appointment of an additional director would come

within the scope of the word 'contract' or 'arrangement'. The company had four directors. Only two of them attended the meeting. They appointed two additional directors who were related to them as brother and wife, respectively. The court came to the conclusion that although appointment as director does not come within the scope of the expression 'contract' because the position of a director may be conferred on a person by any method other than contract, became interested directors. Without them there was no independent quorum. Consequently the appointments were a nullity.

The Bombay High Court re-examined the matter in *Shailesh Harilal Shah vs. Matushree Textiles Ltd., (1994)* and after giving due consideration to the authorities which influenced the Madras decision nevertheless came to the conclusion that the appointment as an additional director of a person who is related to a director does not violate the requirement of Section 300(1) because the position of a director may be conferred on a person by any method other than contract but that it would amount to an arrangement. The attending directors, therefore, became interested directors. Without them there was no independent quorum. Consequently the appointments were nullity.

The provisions mentioned above shall not apply to:

- (i) a private company, which is neither a subsidiary nor a holding company of a public company
- (ii) a private company, which is a subsidiary of a public company in respect of a contract or an arrangement, entered into by the private company with the holding company;
- (iii) any contract of indemnity against any loss, which the director may suffer by reason of becoming surety for the company;
- (iv) any contract or arrangement entered into (or proposed contract or arrangement) with a public company or a private company which is subsidiary of a public company in which the interest of the director consists a) in his being a director of such company and the holder of not more than the requisite qualification shares and he having been nominated as such director, or (b) in his being member holding of more than 2% of its paid up-share capital
- (v) a public company or a private company which is subsidiary of a public company in respect of which the Central Government in the public interest issues a notification thereof having regard to the desirability of establishing or promoting any industry, business or trade. However, the Central Government may direct that the provision of Section 300(1) shall apply to these companies subject to such exceptions, modifications and conditions as it may specify in the notification in the foregoing circumstances. [Sections 300(2) and (3)].

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

15.8 Corporate and Allied Laws

except with the consent of the Board of Directors [sub-section (1)]. According to the provision to sub-section (1) in the case of a company having a paid-up capital of Rs.1 crore or more no such contract shall be entered into *except with 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)].

If the consent is not accorded to any contract under Section 297, anything done in pursuance of the contract shall be voidable at the option of the Board. [sub-section (5)]. Before we proceed on to discuss the other provisions contained in Sections 297(2) and (3) let us examine a situation.

Question 9

With the knowledge of all the Directors of a Public Limited Company, a mortgage was created over the property of the company in respect of a loan given by the brother of one of the Directors of the company. But the interested Director neither disclosed his interest nor abstained from voting at the Board Meeting, when the loan transaction was approved.

Examine with reference of the provisions of the Companies Act, 1956 whether there is any ban on such contracts and whether non-disclosure of interest and voting by the interested Director would make the contract void.

(November, 2003)

Answer

Section 299 of the Companies Act, 1956 requires the disclosure of interest by a director while Section 300 prohibits an interested director to participate or vote on Boards' proceedings. But where a whole body of directors is aware of the facts relating to an interest of a director, a formal disclosure is not necessary. [*Venkatachalapathy V.S. Guntur Collton Mills, AIR 1929 Mad. 353*].

- (i) The mere voting by an interested director will not render the contract void or voidable unless with the absence of that vote, there would have been no quorum. The mere fact that voting under such situation is an offence punishable with fine under Section 299(4) and 300(4) of the Act, does not *ipso facto* render the contract void or violable. In this case, there is no allegation of earning secret profits. Thus the action of the company will fail as the contract of mortgage is fair and in the interest of the company.
- (ii) Under Section 299 and 300 of the Act, there is no ban on a contract in which a director is interested. The only requirement is that the interest should be disclosed, bonafide and fair [*P. Leslie & Co. vs. V.O. Wapshare AIR 1969 SC 843*].

Even where the interest is not disclosed the transaction is only voidable against the interested director, and not void. [*Narayan Das Shreeram Somani vs. Sangli Bank AIR 1966 SC 170*].

Question 10

A Mortgage was created over the property of a public company. The loan was advanced by the son of the director. All the directors already knew this fact. Thus the director was

interested in the transaction. But he has neither disclosed his interest nor abstained from voting while approving the said transaction. Later on a suit was filed for setting aside the mortgage on the ground that since the interested director voted on the matter, the contract was void. Advise with reasons.

(i) *Whether the contract became void due to non-disclosure of interest by the concerned director?*

(ii) *Is there any ban on such a contract under the Companies Act, 1956?* **(June 2009)**

Answer

Section 299 of the Companies Act, 1956 requires the disclosure of interest by a director while section 300 prohibits an interested director to participate or vote in respect of that particular transaction at the Board meeting. Further his presence will not be counted for quorum also. But where a whole body of directors is aware of the facts relating to an interest of a director, a formal disclosure is not necessary. (*Ramakrishna Rao vs. Bangalore Race Club*).

The mere voting by an interested director will not render the contract void or voidable unless with the absence of that vote, there would have been no quorum. The mere fact that voting under such situation is an offence punishable with fine under section 299(4) and 300(4) of the Act does not *ipso facto* render the contract void or voidable. In this case, there is no allegation of earning secret profits. Thus the action against the company will fail as the contract of mortgage is fair and in the interest of the company.

Under section 299 and 300 of the Act, there is no ban on contract in which a director is interested. The only requirement is that the interest should be disclosed, bonafide and fair. (*P. Leslie & co. vs. Vo Wapshare*)

Even where the interest is not disclosed the transaction is only voidable against the interested director, and not void. (*Narayan Das Shreeram Somani vs Sangli Bank*).