

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)****Problem 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 Rs. 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.

Solution

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

- a. where the appointment of the sole selling agent ceases to be valid by virtue of section 294(2A).
- b. 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.
- c. where he resigns his office otherwise than in the circumstances envisaged in the foregoing clause).
- d. 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
- e. 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 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 $4 \times 3 = \text{Rs. } 12$ lakhs.

Problem 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)*

Solution

(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.

Problem 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 Rs.4,41,000

2003 Rs.6,32,000

2004 Rs.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 solution 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)

Solution

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, whichever 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 Problem, the amount of compensation shall be as follows:

Year Amount of remuneration

(Rs.)

2002 4,41,000/-

2003 6,32,000/-

2004 7,45,000/-

Total Remuneration 18,18,000/- Average Remuneration per annum 6,06,000/- Compensation payable to Mr. BPK for two years 12,12,000/- As per provisions of section 294A(1) of the Companies Act, 1956, where the sole selling agent 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.

Problem 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)

Solution

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 Rs. 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.

Problem 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 solution 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)

Solution

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-intio (*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.

Problem 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?

Solution

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 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 Rs.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 Problem (ii), the solution 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)

Problem 7

The Board of Directors of 'X Ltd. having a paid-up share capital of Rs. 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 Rs. 3 lakhs in 'X Ltd.' Solution the following explaining the relevant provisions of the Companies Act:

- (i) Is the appointment of the sole selling agent in order?
- (ii) Would your solution 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?

Solution

(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 Rs. 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 Rs. 2 lakhs. The directors of Y Ltd. were holding fully paid-up shares of face value of Rs. 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).

(ii) Section 294AA is applicable to both private and public limited companies. So it is immaterial whether X Ltd. is a private in 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).

Problem 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)

Solution

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 sold 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.

Problem 9

Ram and Co. Ltd. having paid up share capital of Rs. 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 Rs. 10 each fully paid-up in Ram and Co. Ltd. since 1st December, 1994. State with reasons whether the appointment is valid. Will your solution be different, if Lakshman and Co. Pvt. Ltd. had acquired the aforesaid shares only on 1st December, 1995? (May, 2003)

Solution

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 paidup 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.

Problem 10

The Board of Directors of ACE Limited having a paid up share capital of Rs. 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 Rs. 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)

Solution

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.

Problem 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)

Solution

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:

(a) 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 294AA(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). (b) 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'