

CHAPTER-VI

DUTY OF DISCLOSURE OF PERSONS CONNECTED WITH THE FORMATION AND MANAGEMENT OF THE COMPANY

1. PROMOTERS

The early Companies Acts, both in England and India contained no provisions dealing with the liabilities of promoters and even today they largely silent on the subject, except imposing liability for untrue statements in the prospectuses to which they were parties.

So far as India is concerned, the following provisions are made applicable to the promoters ;

Section 56 of the Act lays down matters to be stated and reports to be set out in the prospectus. A promoter may become liable under this section for non-compliance with the provisions of the section.

Secondly, section 62(1) holds promoters liable to the subscribers for mis-statement made in the prospectus.

Thirdly, they may also become liable for criminal liability for mis-statement under Section 63 of the Act.

Fourthly, under Section 478 a promoter is also liable to be publicly examined by the Court as to his conduct and dealings, where an order has been made for winding up of the company by the Court stating that fraud has been committed by the promoters in the formation or promotion of the company or in relation to the company since its formation. Similarly, under Section 543, he may be held liable to compensate the company, if he has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company.

1-A POSITION OF PROMOTERS IN ENGLAND AND INDIA :

It may be stated that the legal position of a promoter is somewhat peculiar, it is incapable of precise statement. However, Lindley L.J. Described his position as¹:

Although not an agent for the company nor a trustee for it before its formation, the old familiar principles of the law of agency and of trusteeship have been extended, and very properly extended, to meet such cases... It is perfectly well settled that a promoter of a company is accountable to it for all moneys

secretly obtained by him from it, just as the relationship of the principal and agent or the trustee and cestui que trust, had really existed between him and the company when the money was obtained".

Thus it appears that a promoter is neither an agent nor a trustee of the company under incorporation but certain fiduciary duties have been imposed on him.

In this connection, Lord Blackburn observed :

Those who accept and use such extensive powers are not entitled to disregard the interest of the corporation altogether. They must make a reasonable use of the powers which they accept from the legislature, and consequently they do stand, with regard to that corporation, when formed in what is commonly called a fiduciary relation to some extent².

1-B CONSEQUENCES OF BREACH OF FIDUCIARY DUTY :

Two important consequences follows from the fiduciary position of promoters :

(a) A promoter cannot be allowed to make any secret profits. If it is found that in any particular transaction, the promoter has obtained a secret profit for himself, he will be bound to refund the same to the company, and

(b) He is not allowed to derive a profit from the sale of his own property unless all the material facts are disclosed. If a promoter contracts to sell ^{to} the company a property without making a full disclosure, and the property was acquired by him at a time when he stood in a fiduciary position towards the company, the company may either rescind the sale or affirm the contract and recover the profit made from it by the promoters. The difficulty, however, is to decide how he is to make this disclosure, the company being an artificial entity. In the case of *Erlanger v. New Sombrero Phosphate Co.*,³ it was suggested that it was his duty to ensure that the company had an independent board of directors and to make full disclosure to them. In that case Lord Cairns said "that the promoters of a company stand... undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company; they have the power of defining how and when, and in what shape, and under what super~~stition~~dition, it shall start into existence and begin to act as a trading corporation... I do not say that the owner of property may not promote and form a joint stock company and then sell his property to it, but I do say that if he does, he is bound to take care that he sells it to the company through the medium of a Board

of directors who can and do exercise an independent and intelligent judgement on the transaction.."

This judgement imposes a duty on the promoters of the company to provide it with an independent board of director. But an entirely independent board of directors would be impossible in the case of most private and public companies and since Salomon case⁴ it has never been doubted that a disclosure to the members would be equally effective. In the famous case it was held that the liquidator of the company could not complain of the sale to it at an obvious over valuation of Mr. Salomon's business, since all the members were aware of it.

It is rightly pointed by Lord Lindley that, "after Salomon's case, I think it is impossible to hold that it is duty of the promoters of the company to provide it with an independent Board of directors, if the real truth is disclosed to those who are induced by the promoters to join the company".⁵

The disclosure may be made either :

- (a) to an independent board of directors, or.
- (b) Directly to prospective shareholders by means of prospectus or articles.

In relation to disclosure it must be kept in mind that the promoters must make full disclosure. A half disclosure is something worse than none. Thus in *Gluckstein v. Barnes*,⁶ a syndicate was formed to purchase a property called 'olympia' with a view to reselling it to a company. The syndicate first bought charges on the property at a discount and made a profit of £20,000- The syndicate afterwards bought the property, on which it held charges for £1,40,000 with a view of selling it to a company to be formed by it. The syndicate then sold the property to 'Olympia Ltd.' a company formed by it for £1,80,000. In the prospectus that was issued, the syndicate disclosed the profit of £40,000 and not the former one of £20,000. It was held that the trustees ought to have disclosed the profit of £20,000. that they had not disclosed and that they were bound to pay it to the company.

"Where promoters do not make disclosures of material facts while selling their property to the company, the sale may be set aside at the instance of the company. If, however, rescission has become impossible, the company is entitled to claim damages from the promoters and the measure of such damages is the profit made by the promoters upon the purchaser and resale of the property".⁷

Now in England as a result of the Misrepresentation Act, 1967 there is a clear legal basis for awarding damages in all cases where the promoters had made an actual misrepresentation and cannot prove that he had reasonable ground to believe and did believe upto the time the contract was made, that the facts represented were true. In India, though there is no specific statute similar to the Misrepresentation Act, 1967, but cases of misrepresentation made by promoter may be covered by Sections 17, 18 and 19 of the India Contract Act, 1872. According to section 17 of the Indian Contract Act, suppression of true facts or active concealment of facts amounts to Fraud and the aggrieved party is entitled to the right of rescission and also for damages under section 19 of the Act.

Further promoters may be liable to the subscriber in damages for fraud, if the promoters, has been party to a wilful false statement inducing subscriptions. Moreover, in the absence of actual fraud, they may be liable to pay compensation to any subscriber if they were a party to a false statement in any prospectus.⁸ Here it may be mentioned that in England, the misrepresentation Act, 1967; i.e. section 2(1) will not

afford any remedy in these cases since this provision applies only where a misrepresentation has been made by a party to the contract and the promoter will not normally be a party to the contract of subscription with the company. Whereas in India, section 62(1)(d) holds the promoters of a company liable to any compensation to every person who subscribes for any shares of debentures on the faith of the prospectus for any loss or damage sustained by reason of any untrue statement included in it.

Disclosure Regarding Remuneration :

A promoter is not entitled to remuneration for his services from the company unless there is a valid contract, enabling him to do so, between him and the company.

In re English and Colonial Produce Co.⁹ it was held that without such a contract he is not even entitled to recover his preliminary expenses, and in Re National Motor Mail Coach Co.¹⁰ it was held that promoter is not entitled to recover the registration fees and capital duties.

In practice, however, recovery of preliminary expenses and registration fees does not normally present any

difficulty. The Articles will contain a provision authorising the directors to pay them and although this does not constitute any contract between the company, it is a sufficient authority to the directors to repay expenses properly incurred.¹¹

Here it may be noted that the promoters will not be content merely to recover his expenses, certainly if he is a professional promoter, he will expect to be handsomely remunerated.

As in the case of *In Touché v. Metropolitan Rly. Warehousing Co.*,¹² Lord Hatherly said "The services of a promoter are very peculiar, great skill, energy and ingenuity may be employed in constructing a plan and in bringing it out to the best advantages". Hence it is perfectly proper for the promoter to be rewarded, provided he fully disclosed to the company the rewards which he obtains. The reward may take any form, whatever the nature of remuneration it must be fully disclosed in the prospectus, if paid within the preceding two years from the date of the prospectus.

1-C POSITION OF PROMOTERS UNDER THE FRENCH COMPANY LAW :

In France the promoters are known as Founders. The Decree of 23rd March 1967 provides that a list of

transactions entered into by the Founders in the name of the company, showing the obligation incurred, must be submitted either to the subscribers of the company's statutes, before they are signed or, in the case of a company which appeals to the public for funds to the subscribers for the company's shares at the Constitutive General Meeting, ie. meeting requires to be called for the registration of a company. If the company does not appeal to the public for funds, the list of transactions must be annexed to the statute when they are signed.

The legal consequences of this rule is that 'the signature ~~of~~ the statutes by the subscribers automatically implies without further formality that the obligations incurred by the founders shall be transferred to the company as soon as it has been entered in the Commercial Register.

2. DIRECTORS

DIRECTOR'S DUTY OF DISCLOSURE :

While an existence of an element of faith is necessary and inevitable in conduct of human affairs, such as family affairs, business affairs, state affairs, etc.,

there is also an old saying that 'breach of faith occurs only in cases where faith is reposed, particularly in case of relation of fiduciary nature i.e. relation of trust and good faith. Obviously, where there is no faith there is no question of breach of faith. The statement holds good, in regard to directors in their relation to the company they managed. In corporate sector particularly in the companies registered under the Companies Act, Board of Director, is the principal organ of the company in whom vested the power to administer and manage the affairs of the company. As per provisions of the Act, public company must have minimum three directors and a private company two. Although, it would be constitutionally possible for a company in general meeting to exercise all the powers of the company, it clearly would not be practicable for day-to-day administration to be undertaken by such a cumbersome piece of machinery. Hence the statute provides for a Board of Directors with an implicit faith that this power will be exercise, for the benefit and in the interest of the company only.

The Board of Directors, like human brain, controls all the activities of an artificial person. The implicit faith for bonafide exercise of the powers of directors is reflected in well known classification of director being

either an agent or trustee or to quote the famous observation of Justice Romer 'as person standing in fiduciary relationship with the company!'.¹³

Each one of these relationship are essentially relationship based on good faith, confidence and expectation of trust. Law and Equity have expected the directors to come up, to the expectation of good faith, as can be seen, from the duties and liabilities, imposed on them in their dealing in company matters.

The power of directors of a company are so varied and vast, that it affords them equally varied and vast opportunity to mis-use them, invariably for their personal gains. This led William C. Douglas to observe, "the immense powers must be regulated for the public good and for the protection of those whose investment are involved in the company".¹⁴

Again power corrupts and absolute power(which virtually is the case with directors due to dispersed shareholdings and also for separation of ownership from control)corrupts absolutely, is found to be a truism in case of directors, in their managerial role.

Law supplemented by equity has tried to keep a check on directors, for which both legislature and the courts have tried to impose duties on directors, to enforce honest behaviour. However, nature of these duties are not easy to define, due to variety of situations in which directors exercise their power. In this respect Prof. Ballantine observed "in discharge of their duties, law expects directors to be (i) diligent (i.e. to act with utmost care and without negligence), (ii) they are to be obedient (i.e. to act within the scope of their power and not to exceed their authority); and (iii) they are to be loyal (i.e. to do all what a loyal person as depositary of faith and confidence would do). Probably all duties of directors can be traced to either Prof. Ballantine's expectation of loyalty or justice Romer's concept of fiduciary relationship.

The dilemma, has been, whether to define or not to define these duties of loyalty and fiduciary nature. While statutorily defined duties bring about certain and easy enforceability or to leave them undefined, flexible and vague to be determined by the Court. At present, the fiduciary duties are partly codified and partly left for judicial pronouncement, in exercise of their powers of equity and natural justice. Sacher Committee in its report

has made definite proposal regarding certain aspect of fiduciary duties of directors (regarding insider trading) leaving other untouched.¹⁵

Personal gains, happens to be the major motive for abuse or misuse of powers by person in power. Directors are not exception to it. Opportunities of secret profits and personal gains, at the cost of company arise :

(i) In contractual dealings while acting as an agent of the company, during negotiation and formation of contract, for and on behalf of the company;¹⁶ and

(ii) They can take advantages of their position as custodians of company's property including inside information and opportunities for which ⁱⁿ equity they are treated as trustee.

A profit derived from a fiduciary position must be accounted for unless previously disclosed and authorised. Dishonesty is not necessarily the reason for such accountability and it is no defence for a director to say that he was acting bonafide. All accrued gains will be regarded as secret profit for the purpose of fiduciary obligation, unless and until full and complete disclosure was made to the company.

The general principle of law of agency e.g. the agent is bound to pay his principal all sums received on his

account,¹⁷ not to amake secret profit(not to put himself in a position, where interest and duty conflict. etc.), is attempted to be enforced through the statutory provisions, keeping in view the position of directors, by the following provisions of the Companies Act, 1956.

It may be mentioned that if an agent do not disclose his interest in any transaction negotiated by him, on behalf of his principal, he is neither loyal nor confirming to the expectation of faith reposed in him, any gain in such situations, naturally will treat as secret gain, as there was no disclosure to the principal.

In India, Companies Act, 1913 imposed this duty of disclosure, by amending Act of 1936, in which section 86F, 86I, 91A and 91B were added, providing principle of disclosure to prevent secret gains. The present Act, has adopted those provisions with modifications as suggested by the Company Law Committee. Section 297 of the present Act, corresponding to section 86F of the previous Act, provides checks on mischief of individual director getting a chance of secret gains to himself or his associates.

2-A DISCLOSURE ON INTEREST IN ANY CONTRACT(SECTION 297) :

Section 297 lays down that except with the consent of the Board of Directors of a company, a director must not enter into any contract with the company :

- (a) for the sale, purchase or supply of any goods, materials or services, or
- (b) for underwriting the subscription of any shares or debentures of the company.

These restrictions also apply to the relatives of a director, a firm in which such a director or relative is a partner, any other partner in such firm, or a private company of which a director is a member or a director.

Sub-Section (4) provides the mode and time for taking consent. According to it, consent shall be accorded by a resolution passed at a meeting of the Board and not otherwise, i.e. oral consent or consent accorded otherwise than passing resolution will not be valid consent. Further, according to wording "at the meeting of the Board", consent cannot be accorded by passing resolution by circulation. So far as time is concerned, it provides that consent of the Board shall not be deemed to have been given unless the consent is accorded before the contract is entered into or within three months of the date on which it was entered into.

Here it may be stated that provisions relating to post facto consent i.e. within three months of the date on which it was entered into, is likely to create problem, e.g. if Board refused to accord consent, then in case of

executed contract, it would lead to litigation or it would compel the Board to accord consent, because something has already been done under the contract.

In this regard I would like to submit that provision relating to post facto consent should be deleted and only prior consent should be regarded as a valid consent. This is because, the object of this section is that the Board of directors should have knowledge of the extent of interest of a director in any contractual dealings with the company or of any person connected with the director^t in any of the way mentioned in sub-section (1) so that the Board may be in a position to satisfy itself as to fairness, reasonableness etc., of the contract from the point of view of the company, and then accord its consent to such dealings. In the case of post dated consent, if dealing is found to be unfair or unreasonable, Board might find it difficult to refuse consent.

In 1974 an amendment was made and a new proviso was inserted. By this new proviso additional restriction is now imposed on the contractual capacity of a company. It provides that where the paid up share capital of a company is not less than rupees one crore the afforsaid contract shall not be entered into except with the previous approval of the Central Government. This proviso expressly

forbids a company from entering into contract in which director or any person mentioned in Sub-Section (1) is interested, unless previously approved by the Central Government.

The reasons for the insertion of this proviso were:

"A fruitful source of misuse of power by director is that which is exemplified by contracts entered into with the company of which they are directors by themselves or through their relatives or firms or companies in which they are interested for sale or purchase or supply of goods, materials or services, as the case may be. Under the existing provisions of the Act for entering into such contract, the director concerned has only to disclose his interest in the subject matter of the contract, when the contract comes before the Board for director's sanction. This is not considered sufficient to safeguard the interest of the company, especially when directors are in a position to take advantage of inside information for personal gains. Hence, it is proposed to strengthen sections 297 under which the sanction of the Board is required, by further making obligatory for a company having a paid up capital of not less than rupees 25 lakhs to obtain the previous approval of the Central Government for entering into such contracts.¹⁸

Here it may be mentioned that the original Bill applied the proviso to all companies with paid up share capital of Rs. 25 lakhs and more. But the Joint Committee of Parliament limited its allocation to companies having paid up share capital of rupees one crore or more. The reason for this increase was in the words of the Committee "such provision may cause unavoidable inconvenience to many companies, particularly the small and medium sized companies and incidently increase unduly the workload of the Government in having to deal with large number of applications for its approval".¹⁹ It may be noted that all contracts whatever their value, of the directors and other persons mentioned in sub-section (1) require the previously approval of the Central Government, except those exempted under the section. Contracts will include also service contracts such as appointments to office. If so, appointment of such persons, coming under section 314 of the Act will also be covered. Section 314 provides that directors etc. not to hold office or place of profit.

Contract for supply of services may include contract for the supply of one's own services as well as supply of services of other persons. There is no reason to limit the scope of the expression. The clarification²⁰ given by the department of Company Affairs to the effect that

services of a professional nature are not covered by the reference 'supply of services' in clause (a) of sub-section (1). would seem to take a too restricted view of the scope of the section. If the professional services is of continuous nature, than it should be covered under sub-section (1).

In cases of appointment of such persons to office of profits not only the provisions of section 314 but also the requirements of proviso to sub-section (1) of section 297 will have to be complied with. There is no exception in this section as in section 314 of office carrying monthly remuneration below Rs. 500/- p.m. Sub-Section (3) which enables the entering into contracts in cases of urgent necessity without obtaining the consent of Board of directors does not dispense with the necessity of obtaining the previous approval of the Central Government, though it is possible that the Government, may by general order give general approval for certain class or kinds of contracts by notification.

Effect of Proviso :

As the proviso forbids the entering into contract with a director or any other person mentioned in sub-section (1), except with the previous approval of the Central Government, failure to obtain such previous approval will make the

contract illegal and void, the provisions of sub-section (5) making such contract voidable being confined only to cases where the consent of Board of directors has not been accorded to the contract. Further it may be mentioned that this proviso also affects the provision relating to post facto approval by the Board, it becomes inoperative in cases covered by the proviso.

Clarification of the Proviso by the Central Government :

"that instances have come to notice in which applications were made simultaneously for seeking approval of the Central Government under proviso to section 297(1) of the Act as well as other provisions viz- section 269 or section 294- A or section 314 (IB) of the Act in respect of some contracts/ transactions. The heed for according approval under both the sections of the Act has been examined... the provisions of section 297 are of general nature and those of section 269, 294 AA and 314 (IB) are of special nature. In view of this it has been decided in the interest of administrative convenience, and also to avoid multiplicity of application that where facts and circumstances of a case require approval of the Central Government under section 269 or 314 (IB) or 294AA

of the Act would be enough and no separate approval under section 297 of the Act is necessary.²¹

It may be submitted that this view of the Central Government is only advisory and not legally binding. Where in any approval accorded by the Central Government express reference is not made to the proviso to section 297 (1) will open to question. This is because an administrative circular cannot be modified or change the operation of the express statutory provisions, for administrative convenience. As the legality or validity of the contracts will be open to question, there is no justification for watering down the statutory requirement by Departmental circular.

Department of Company affairs view as regard the need for previous Approval of the Central Government :

"Section 297 (1) 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, materials or services entered into by the company with a director of the company, or his relative or a partner. The proviso to this section requires that in the case of a company having paid up share capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government. Services of the nature of a legal practitioner are not

obtained on the basis of say lowest tender but on account of their professional expertise irrespective of the cost involved. Such services cannot be bracketed with a contract for supply of goods or materials. The Department view is that these services fall outside the scope of section 297 of the Act and the scope of section does not extend to supply of professional services of the nature given by firms of solicitors and advocates etc.

A question has been raised whether proviso to Section 297 (1) applied to a contract of employment of a director as a managing director or whole time director. In this connection, it is pointed out that it is a basic principle of company law that director are agents and trustees and they stand in fiduciary position not only to the company but also to members and creditors. Thus position is not changed merely by entrusting them with additional responsibility for managing the affairs or rendering of services of a professional nature though they are remunerated for those services in accordance with the articles of association of the company subject to the provisions of the Companies Act; for regulating such an appointments. Therefore, the Department view is that proviso to section 297(1) does not apply to the contract of employment of a director as managing or whole time director".²²

It may be stated that this view of the Department is in conformity with the philosophy of company law. Section 269 lays down separate specific provisions for appointment and reappointment of managing or whole time director.

However, it may be submitted that the view of the Department that 'services of a professional nature are not covered by the reference to 'supply of services' in clause (a) of section 297 (1) would seem to take a far restricted view of the scope of the section. The object of the section is that the Board of directors should be made aware of all contracts for sale, purchases or supply of goods, material and services, in which any director, person mentioned in sub-section (1) of section 297 is interested, so that the Board may be in a position to satisfy itself as to the fairness, reasonableness of the contract from the point of view of the company and then accord its consent thereof. If contracts of professional nature are excluded from the scope of the section then the directors will get opportunity of appointing and utilising the services of his own less efficient relative, partners etc., in preference to more efficient person available outside, if any professional posts are required to be filled up in the company's service, and this they can do

without getting the approval of the Board. Surely the object of the section is that the consent of the Board of directors accorded at a meeting of the Board should be necessary not only in respect of contract of sale, purchase and supply of goods and materials but also as regards the supply of services to the company, whatever may be the nature of the services, whether professional or otherwise in all cases where any director or his relative or partner or firm of private company is the party supplying the service or services. In cases where the paid up share capital is rupees one crores or more, it is further necessary that the previous approval of the Central Government should also be obtained.

After taking into consideration all these matters the Sacher Committee²³ has rightly recommended for deletion of the proviso to sub-section (1) of section 297. It has also recommended that words 'five thousands' be substituted by the words 'twenty five thousands' in sub-section (2) of the section 297.

Sub-Section (2) provides for certain exceptions from the purview of sub-section. These exceptions are subject to the proviso. It provides that 'such contract or contracts do not relate to goods or materials the value of which or services the cost of which, exceeds five thousands rupees in the aggregate in any year comprised in the period of the contract or contracts.

It may be submitted that in the corresponding section 86-F of the 1913 Act, it was not clear whether the previous consent of the directors would be necessary for such contracts or the subsequent approval of such contracts by the directors would suffice.

In the present section this doubt has been removed by insertion of specific provisions. Sub-Section provides that every consent of the Board required under this section shall be accorded by a resolution passed at the meeting of the Board and not otherwise; and the consent of the Board shall not be deemed to have been given within the meaning of that sub-section unless the consent is accorded before the contract is entered into or within three months of the date on which it was entered into.

The section requires the consent of the Board of directors for all contracts except : (a) contracts for the purchase of goods from the company or sale of goods to the company for cash at prevailing market prices; or (b) contracts for the sale, purchase or supply of goods in which either of the parties regularly trades or does business, provided, the value of the goods does not exceed Rs. 5000/- in any year; or (c) any transaction of a banking or insurance company in the ordinary course of business with the company by a director or any other person mentioned in

sub-section (1) of section 297.

It may be mentioned that unlike section 299, this section does not deal with indirect interest of a director, eventhough it may be substantial and real. Nor is a public company included eventhough the director may have controlling interest in it.

Further under section 86-F of the 1913 Act, non-compliance of the provisions of the section lead to vacation of the office by the director. This sometimes led to absured result, as in the case of Walchandnagar Industries Ltd v. Ratanchnad, Ghagla C.J.²⁴ was compelled to held that a director who had supplied one tin of Chee to the company without obtaining the sanction of the Board had thereby vacated office. The sub-section 297(2) seems to be framed with a view to obviate this difficulty.

2-B. DUTY OF DISCLOSURE UNDER SECTION 299-300 :

The general law of agency, expects that agents shall avoid situation of conflict of interests i.e. personal interest with that of the principal, and in all transations between the principal and agent, the latter shall furnish full information, to enable the principal to arrive at an independent decision, without being prejudicial by the biased opinion of the interested agent. On the same analogy, the directors of the company must disclose all the facts

in relation to a particular transaction to the company.. Human nature, being what it is, chances are that such an agent will serve his own interest rather than sacrificing it. It is possible of course that a person may be altruistic and in coming to arrangement in which he is concerned, he would give better conditions to the other party, but person of such despositions are not usually found, among the directors of the company.²⁵ Therefore, for the proper exercise of the functions of a director, it is essential that he be disintrested and that he should be free from situations where he has to take decisions in which his personal interest may be conflicting with that of the company.²⁶ This position has been assured by incorporating two principles in the Companies Act, 1956 :

(i) Full disclosures of interest of any kind - direct or indirect, by directors to the Board of directors,

(ii) The interested directors, should not be involved in decision process, regarding transaction in which his personal interest is involved.

To provide for disclosures, the first legislative attempt in connection with directors was made in 1914 when section 91A and 91B were inserted in the then Companies Act, 1913. At present sections 299 and 300 of the Companies Act, 1956 deals with the subject. Section 299 is anologous

to section 199 of the English Companies Act, 1948.

Where as there is no corresponding section under English Act to section 300 of the Companies Act, 1956.

It may be stated that these new provisions are more elaborate and effective in comparisons of previous Act, which were found to be deficient and inadequate in certain respects. The Company Law Committee while making the following recommendation kept in mind the corresponding section 199 of the English Companies Act, 1948, and the Report of Millian Commission in South Africa.

While making the recommendation the Company Law Committee observed :

"It is necessary to provide that the general notice which a director is entitled to give to the company of his interest in a particular company or firm under the proviso to Sub-Section (1) of section 91-A should be given at a meeting of the directors or director should take reasonable steps to ensure that it is brought up and read at the next meeting of the directors after the notice is given. Otherwise the general notice may well remain unnoticed by the other directors of the company and the object of giving such notice may easily be defeated. In this connection attention may be invited to the proviso to sub-section (1) of section 199 of the English Act... the general notice

to be given under the same proviso should be renewed from year to year. As the Millian Commission in South Africa observed".

"Under the present provisions, new directors joined the Board cannot know of it unless they take the trouble to read the minutes, it may be for years past, and it would be convenient for creditors, if they were in a position to confine their research for such a notice to cover any particular transaction to the minutes of the year in which the transaction occurred.

The general notice to be given under proviso to Sub-Section (1) is a relaxation of the strict requirements of this sub-section, and we agree with the Millian Commission in South Africa that there can be no hardship if it has to be renewed from year to year, so as to appear in the minutes for each year in which it is to be effected."²⁸

Section 299, requires disclosure of all direct or indirect personal interest of directors in all contracts and arrangements to be approved by the Board of Directors. This section, essentially deals with the personal interest of directors, rather than of his relatives and partners, etc, which are covered by section 297. It may be stated that section 299 to some extent overlaps section 297, however

it is wider in scope and covers all kinds of contracts and arrangements and also proposed contracts and arrangements including these covered by section 297, but the main thrust of section is to check the mischief of personal advantage to the director, who is required at first opportunity, in the meeting of the Board, to disclose his interest, or concern which may be direct or indirect. It is significant that if he gets interested in a transaction after a meeting of the Board had taken place, he has to inform the Board in the next meeting, whether he himself attended or not. The purpose being earliest and full disclosure, to ensure compliance with the fiduciary obligation of section 299. The interest here is not necessarily personal or pecuniary in nature,²⁹ which permits courts to interpret this provision with wide application. In the case of Venkata Chalapathi V. Guntur Mills,³⁰ it was held 'the purpose of disclosure, is to be kept in mind, therefore, if something is well known and is in common knowledge of the others directors need not be disclosed. Non disclosure renders the directors liable to account for any secret profit'. And in Public Prosecutor V. Khaitan,³¹ it was held that 'it is not necessary to disclose ~~an~~ interest/concern which is not conflicting with duties towards the company, and not cover any case where there is no personal interest involved.

As per the present provision the decision of Madras High Court in the case of Venkata Chalapathi V. Guntur Mills is not good law.

(I) MEANING OF 'CONCERN' OR 'INTEREST' :

The interest in the transaction to be disclosed by a director is that which in a business sense might be regarded as influencing judgement; the essence of the matter being that any kind of personal interest which is material in the sense, of not being insignificant must be revealed.³² Interest is not personal interest only, not is it confined to pecuniary interest only. If, to the knowledge of the director concerned, a relative of his coming within the list in Schedule I-A, is concerned in a contract or arrangement, director must disclose the same to the Board. The expression used in the section is 'in any way, directly or indirectly concerned or interested', seems to include within its purview, also an interest in his relatives being concerned in any contracts or arrangements with the company. Otherwise, an unscrupulous director may evade the provisions of the section by not disclosing information about contracts or arrangements entered into, by or through his influence for the benefit of his relative, without the Board knowing of the fact of their being his relatives and his being interested.

The concern or interest may arise ^{of} outblood relationship or fiduciary relationship. The word 'concern' is of general import, it cannot be limited in the sense of financial interest only. This, where a director who was for long, the solicitor of some other directors in their private business, it was held to be concerned interested in those other directors so as to be bound to disclose at the meeting of the Board, his concern or interest in those other directors and also to remain aloof and not do take part in the discussion or vote on any contract or arrangement in which those other directors were concerned.³³ However, recently in the case of Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.,³⁴ the supreme Court held that 'interest or concern spoken of by this section and section 300 cannot be merely sentimental or ideological concern. A relationship or friendliness with Directors interested in a contract or even a mere lawyer-client relationship will not disqualify a director from action under section 300 as an interested director.

Company Law Department's View :

As regards the meaning and scope of expression 'interest and concern', in view of its importance and in view of the desirability of avoiding hitch with the Government Authority, the following interpretation and explanation

given by the Company Law Administration :

(1) Section 299 of the Act, ~~of the Act~~, provides that every director who is in any way, whether directly or indirectly concerned or interested in a contract or arrangement entered ~~into~~ into or to be enter^{ed} into by or on behalf of the company, shall disclose the nature of his interest at a meeting of the Board of directors.

(2) The word 'concern and interest' has not been defined in the Act, though it is stated in Sub-section (3) (a) of the said section that where a director gives a general notice to the Board of the effect that he is director or member of a specified body corporate or member of a specified firm and is to be regarded as concerned or interested in any contract or arrangement which may be entered into with such body corporate or firm such notice shall be deemed to be a sufficient disclosure of concern or interest in relation to any contract or arrangement so made. Thus, where no such general notices has been given by the director or the other contracting party is not a body corporate or firm, the director will have to disclose, the nature of his concern or interest as specified in Sub-section (1).

(3) "It has been held in the public Prosecutor V. Khaitan,³⁵ as also by the Court earlier that the contract or arrangement hit by section is the one in which director

has personal interest conflicting with his duties towards the company and does not cover any case where there is no personal interest involved".

(4) "Thus, where the director has transferrêd the shares in a company exceeding the form of transfer and delivery of share certificâte, but the transferee for reasons best known to him, has not got the shares registered in his name, the director even though continuing as registered holder of the shares in the book of the company, cannot be said to have any personal interest in the shares or in any contract made with any company by virtue of such shareholding, so there should be no need for his to give any notice of interest in respect of such contracts".

(5) "Generally in regard to share held non-beneficially, a director, say on behalf of a trust the director has no personal interest. He is not a free agent in regard to these shares and cannot exercise any right pertaining thereto without the consent from the other trustees. This would especially the case where the director happens to be a trustee registered as one of the joint holders in respect of any shares and his name does not appear in the first position among the joint holders. Though quite a member of the company, even the formal right of such a interest in regard to such shareholding. Thus, the director in such cases need not give any notice of concern or interest as the

same does not exist".

So long as a director (the transferor) continues as registered holder of the shares in the register of members of the company he may be deemed prima facie to have an interest or concern in the arrangement or contract by virtue of such shareholdings. Accordingly, it will be advisable for him to disclose the facts relating to his shareholdings in the company at the meeting of the Board in accordance with section 299 (1), adding if he consider necessary, that his shares having been transferred, he is no longer personally interested in the company or contract.

Where a director is a trustee, since the trustee is the owner of the shares, it would be necessary in such cases to disclose to the company his interest arising out of his membership in the companies concerned as a joint holder or as a trustee, as the case may be.³⁶

It is expected that the Court will keep these guidelines in view, while interpreting section 299, to bring about certainty and uniformity of application of this important provisions which has serious consequences in case of breach or default".

Here attention may be drawn to the case of Commissioner of Income Tax (Madurai) V. M. Ramaswamy,³⁷ wherein it was

held that, where, as between the transferor and the transferee, all formalities have been gone through, such as the execution of a document of transfer and the physical handing over of the shares by the transferor to the transferee, though until the transfer of shares is registered in the company's book in accordance with company law, the transfer would not enable the transferee to exercise rights of a shareholder vis-a-vis the company.

Following the decision of the Supreme Court in *Shelat V. P.J. Thakar*,³⁸ it was held that the ownership of the shares stood transferred from the assessee to the purchaser, notwithstanding the fact that the transfer of shares had not been registered in the company's books.

It may be stated that the consequence of this decision is that a person may be a owner of shares without being a member and a member of a company without being a owner of shares.

Time of Making of Disclosure :

Sub-section (2) lays down time of disclosure. In the case of proposed contracts or arrangements the disclosure of concern or interest must be made in a Board of director's meeting where the question for entering into the contracts or arrangement is to be disclosed. Whereas in the case of

contracts or arrangements, already entered in to disclosure must be made in the first meeting held after the director becomes concerned or interested in the contract or arrangement.

For the purpose of Sub-Sections (4) and (2) the director must give a notice to the Board, to this effect. The notice is not of any effect unless it is given at the meeting of the Board, or the director concerned takes reasonable steps to secure that it is brought up and read at the first meeting of the Board after it is given. The notice is also required to be given a fresh year after year in order that new director who may be coming into the Board may be made aware of such interest. It expires at the end of the financial year in which it is given.³⁷

So far as sub-section (4) is concerned, which lays down punishment for non-compliance with the provisions, of section 299, a question arise whether or not director is entitled for any relief under section 633 of the Act, which empowers the Court to grant relief in certain cases. Here it may be submitted that definition of officer under section ~~(2)~~ (30) includes director, secretary, manager or any person in accordance with whose direction or instruction the Board of directors or any one of more of the directors is or are accustomed to act. The object of section 633 is to provide

against undue hardship in deserving cases and give relief from liability to persons who have acted honestly and reasonably and having regard to the circumstances of their case they ought fairly be excused from the charge made against them. For instance in the case of *Re. Claridge's Patent Asphalte*,³⁹ it was held that "where the director applied the funds of the company for a purpose which was honestly believed to be within the powers of the company, but which was later on held to be ultra vires, relief may be given under this section."⁴³

However, in the case of *Ramachandra & Sons (Private) Ltd. v. State*,⁴¹ it was held that where a director or officer acts in violation of his statutory duties, it cannot be said that he has acted honestly or reasonably.

It may be submitted with due respect that learned Justice has not taken into consideration, sub-section (1) of section 633 which expressly provides the words 'Breach of duty' and it includes statutory duty too.

Further, there is difference of opinion as to whether the section enables the Court to grant relief against possible criminal prosecution. The Kerala High Court⁴² held that it does, and Allahabad High Court⁴³ held that Court cannot grant relief from criminal prosecution.

In *M.O.Varghese V. Thomas Stephen & Co. Ltd.*⁴⁴ the Kerala High Court held that 'no relief can be granted in respect of the cessation of the office of a director under section 283 (1) or 299 (1) as by the statutory termination of his office, director does not incurred liability civil or criminal.

So it may be submitted that duty of disclosure imposed by section 299 is rather strict, it is also a fiduciary duty, and director who commits breach of this duty cannot be said to have acted honestly or reasonably and therefore cannot relieve a director of the consequences of breach of duty by exercising its discretion under section 633.

Steps require to be taken by the Chairman of the Board of Directors :

In order to avoid all these consequence, it will be advisable for the Chairman of the Board to draw attention of the provisions and requirements of section 299 and request them to disclose their concern or interest in any contract or arrangement listed in the agenda of the meeting and secondly it is also advisable for every director to make it a routine to give written notice to the Board at the meeting, mentioning the companies and firms in which he is interested, and to this at regular intervals so that he may guard himself against contravening the section. As

the consequences of contravention are serious, every director will be well advised to review his own private interests whenever the company enters into any contracts or arrangement in order to see whether there is anything therein requiring disclosure on his part.

As pointed out by Lord Denning,⁴⁵ "when a director fails to disclose his interest, the effect is the same as non-disclosure in contracts of uberrimaefidei or non-disclosure by promoters, who sells to the company property in which he is interested. Non-disclosure does not render the contract void or nullity. It renders the contract voidable at the instance of the company and makes the director accountable for any secret profit which he had made".

Further as per section 299 director is under legal obligation to make disclosure of his interest. A question arises, whether he is bound to disclose breach of other duties.

In the case of *Healey V. S.A. Francaise Rubastic*,⁴⁶ it was held "even under the basic equitable principles the obligation to make full disclosure only arises when the contract is to be entered into with the company. Thus a director is not under a general duty to disclose his own

breach of other duties.

On the other hand he may be under a duty to disclose the misdeeds of other directors and officers. It is, apparently, more blessed to denounce the sins of other than to confess one's own.

(II) NATURE OF DUTY :

Recently in the case of Globe Motors Ltd. V. Mehta Teja Singh & Co.,⁴⁷ it was held that the 'agreement (sole selling agent) could not be said to be invalid on the ground that there was violation of section 299, since the Board had approved the agreement and the director interested had disclosed his interest therein and there was no requirement that the agreement had to be placed before the general body of shareholders of the company', it was further held that, however, 'in order that the company might be entitled to avoid the agreement, it was not necessary to prove fraud in its execution. The test to be applied was -- had the company been a going concern and had made some payments in pursuance of the agreement to the firm, could the company have asked for rescission of the contract? The fact that the Companies Act, did not forbid a contract being entered into by the company with a firm in which one of the directors was a partner, and the fact that the director disclosed his interest in the agreement before the board at the meeting had

to approve it did not by themselves automatically prove that the arrangement which was entered into by the company was not of such a nature which keeping in view of the fiduciary relationship of a director, should not have been so entered into thus giving a right to the company to avoid the contract... it was further held that the 'term of the agreement left no doubt that the only interest that was kept in view was the special benefit of the interested for directors and that to at the great cost and to the gross detriment of the interests of the company. The agreement was vitiated and void and the official liquidator representing the company was entitled to ask for its rescission... Directors are not only the agents but they are in some sense and to some extent trustees or in the position of trustees.

The director may be shown to be so placed and to have been so closely and so long associated personally with the management of the company that he will be deemed to be not merely cognizant of but liable for fraud in the conduct of the business of the company even though no specific act of dishonesty is proved against him personally. He cannot shut his eyes to what must be obvious to everyone who examines the affairs of the company even superficially. If he does no he could be held liable for dereliction of duties undertaken by him and compelled to make good the

losses incurred by the company due to his neglect even if he is not shown to be guilty of participating in the commission of fraud. It is enough if his negligence is of such a character as to enable frauds to be committed and losses thereby incurred by the company. One of the remedies provided to the company is rescission of the contract, and another is accounting for profits.

(III) CONFLICT OF DUTY AND INTEREST :

Compliance with the requirements of sub-sections (1) and (2) of section 299 does not by itself exonerate a director from liability under other provisions of the general law. The rationale of this rule as set out in sub-section (5), which provides that nothing in this section shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contracts or arrangements with the company, requires an examination of the history of its development.

Gover has summarised the historical background for enactment of section 199 of the English Companies Act, corresponding to section 299 of the companies Act, 1956 as follows :⁴⁸

"As fiduciaries, directors must not place themselves in a position in which there is a conflict between their duties to the company and their personal interests. Good-faith, must not only be done but must manifestly be seen to be done, and the law will not allow a fiduciary to place himself in a situation in which his judgement is likely to be biased, and then to escape liability by denying that in fact it was biased. Most important application of the principle is in contract by directors with the company of which they are directors. At the middle of the last century, it had been clearly established, that the trustee like position of the directors vitiated any contract which the Board entered into on behalf of the company with one of its members.

This principle receives, its closed expression in *Aberdeen Rly. V. Blackie*,⁴⁹ where a contract between the company and a partnership in which one of the directors was a partner was avoided at the instance of the company, notwithstanding that its terms were perfectly fair. This was applied even in cases where the directors were indirectly interested. Such contract in general could be voidable at the instance of the company. Lord Cranworth L.C. said on that occasion ;⁵⁰

"A corporate Body can only act by agents and it is of

course, the duty of those agents so to act as best to promote the interest of the corporation whose affairs they are conducting. Such agents have duties to discharge of fiduciary nature towards their principal. And it is a rule of universal application that no one having such duties to discharge, shall be allowed to enter into engagement in which he has, or can have, a personal interest conflicting or which possibly may conflict, with the interests of those whom he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into..." "It may sometime happen, that the terms on which a trustee has dealt or attempted to deal with the estate or interests of those for whom he is a trustee have been as good as could have been obtained from any other person-- they may even at the time have been better. But still so flexible is the rule that no inquiry on that subject is permitted.

This principle was applied, even in cases where the directors were indirectly interested.

The need for approval of the contracts of directors with the company received statutory recognition in section 29 of the Joint Stock Companies Act, 1844. This mandatory

provision, however, changed its status to the optional article in Table B in 1856 which provided for the vacation of office by the director if he was directly or indirectly interested in a contract with the company. Such an articles naturally was not acceptable to the corporate business community. Thus, it became the practice to waive the same. Further Table A under the 1948 Act expressly stated that the director are not disqualified by contracting with the company (Art. 84 (3)). Hence disqualification is of little practical importance to day except in the case of statutory companies formed under the Companies Clauses Acts.

The basic equitable principle invalidating contracts was, and is, the more serious snag. Contracts, such as serious agreements, became increasingly common, and contracts in which the directors were interested, more common still. And the directors were unwilling to suffer delay, embarrassment and possible frustration entitled by having to submit all such contracts to the company in general meeting. But just as the normal obligations of trustee can be waived or modified by express provisions in the trust deed under which they were appointed, so can the normal fiduciary duties of directors be modified by express provision in the company's constitution. Such provisions became common in the Articles. Those were known

as exclusion clauses. Alarmed by the growing ambit of exclusion clauses, the legislature by the 1929 Act, made the disclosure of director's interest mandatory. The relevant provisions are now embodied in section 199 of English Companies Act, 1948.

According to Gower three main questions are in relation to section 199:

- (i) What is the effect of failure to disclose?
- (ii) To whom disclosure be made?
- (iii) How extensive must ~~be~~ disclosure be?

So far as the first question is concerned, the consequences of the breach are :

- (i) Fine to the director not exceeding £ 100; and
- (ii) The contract is voidable at the option of the company and the profit made by the interested directors are recoverable. But failure to comply with the section does not make the contract void.

Here it may be mentioned that in India, failure to comply with the requirements of section 299 the concerned director will vacate the office of the director and will also subject him to the penalty under sub-section (4).⁵¹

2-C. DISCLOSURE TO WHOM :

In England in marked contrast with the basic equitable principles (and also the provisions in the 1844 Act) the disclosure is not to the general meeting but to the Board of Directors. In India also the disclosure is required to be made to the Board of directors.⁵⁷

(I) EXTENT OF DISCLOSURE :

It is in respect of contract which are brought before the Board. It is not sufficient to disclose merely that one is interested, the nature of the interest is also required to be disclosed. This normally involves disclosing the exact extent of the profit which the director will make as a result of the contract.⁵³ As Lord Radcliff observed "If it is material to their judgement that they should know not merely that he has an interest, but what is and how far it goes, then must see to it that they are informed". Similarly interest has to be disclosed even if it is too small to be material. Interest need not be immediate. The section is purely negative in operation. It does not have validating effect on the contract even if it is fully complied with. Sub-section (1) and (2) of section 299 of the Act are borrowed verbatim from section 199 of the English Companies Act, 1948. A further restriction is placed by the proviso to sub-section (1) of section 297. Sub-section

(5) of this section has to be viewed in the context of this development of the law. It means that mere disclosure of interest or concern with, a contract entered into by the company will not by itself exonerate the director from liability under any other law.

In England, the Jenkin Committee⁵⁴ recommended subsequent public disclosure of certain type of management contract. It was hoped that, when implemented, would remove some of the defects of section 199. Disclosure would then be limited to material interest but would extend to contracts whether or not, they came before the Board. A general notice of interest would be permissible and not merely those arising from membership of another company or firm, but in all cases the nature and extent of interest would require to be stated and the general notice would not be sufficient unless, at the time when the contract was first taken into consideration the extent of the interest was not greater than that stated in the general notice.

Sub-section (6) lays down qualifying condition for disclosure in the case where the concern or interest of a director of a company arises by reason of being director or member of another company. It provides that nothing in section 299 applies where the total holding of the director in the company, with which the contract is entered into

does not exceed 2%. The question that arise is as to whether the exemption under section 299 (6) applies at the date when the contract is entered into and the director holds interest exceeding 2% of the paid up capital of the other company or at the date on which the disclosure is required, to be made in case the interest becomes less than 2%. In this connection Ramaiya observed that 'if on the date when the contract is entered into, the concern or interest in the contract does not exempt the director under section 299(6), the obligation to make the disclosure would remain notwithstanding the fact that the exemption applies on the date of disclosure.⁵⁵

By necessary implication Sub-Section (6) also means that, where a director or two or more or all the directors hold more than two percent of the paid up share capital of another company, and contract or arrangement with that other company will come within the purview of this section.

Here attention may be drawn to similar provision, which has been made under section 13 of the Industrial Reconstruction Bank of India Act, 1984, which provides that "no member of the Board shall have an interest, direct or indirect, in any business industry or concern to which any assistance has been given or is to be given by the

Reconstruction Bank under this Act, and if any subh member acquires such interest at any time during the continuance of such assistant, he shall immediately disclose it to the Board and shall either resign his membership of the Board or dispose of his interest in such manner and withing such time as the Board may direct. In the recent case of Shree Farm Chemicals Pvt. Ltd. in re.⁵⁶ it was held that non-mention of full details relating to interest of directors does not invalidate scheme-was not fatal to the application under section 391(3).

(II) RESTRICTION : - INTERESTED DIRECTOR NOT TO PARTICIPATE OR VOTE IN BOARD'S PROCEEDINGS (Section 300) :

Section 300 corresponding to section 91-B of the previous Act, lays down restrictions on the interested director. It prohibits an interested director from participating in the decision process of the Board of Directors, when the transaction, in which his interest is involved, is to be decided. The presence of the director is not counted even for the purpose of quorum of the meeting.

This section gives effect to the following suggestions of the Company Law Committee :

"Section 91-B of the Act prohibits an interested

director from voting on any contract or arrangement in which he is directly or indirectly concerned or interested and also provides that his presence shall not be counted for the purpose of forming a quorum at the time of voting, and that if he votes his vote should not be counted.

This section which was amended by the Amendment Act of 1936 has been the subject of some criticism. It was suggested to us that the provisions of the section should be strengthened by the requirement that an interested director should withdraw from the meeting of the Board at which any subject in which he is interested is being discussed. We do not accept the suggestions, for we consider that person holding the position of director, should possess sufficient integrity and independence of judgement not to be influenced by the mere presence of one of the colleagues at a meeting of the Board. We have, however, provided that the interested director should not take part in the proceedings of such meeting... the quorum at the Board's meeting should either be two or one third of the number of directors whichever is higher... as per the Committee the object of this provision is ^{to} do away with the present practice of incorporating into articles of association clauses constituting one single director as a quorum when other directors are interested..."⁵⁷

It may be submitted that the new provision is a positive improvement over section 91-B of the 1913 Act. Under section 91-B the language used was 'and if he does vote, his vote shall not be counted, under the present section, the expression is "and if he does vote, his vote shall be void". The difference between the two is that while under the old section, the irregularity of counting an improper vote could be cured by ratification, by a subsequent meeting, under the present section the use of the word 'void' shows that it is a nullity incapable of subsequent ratification.

In the case of Narayandas Shreeram Somani V. Sangli Bank Ltd.⁵⁸, decided with reference to section 91-B of the 1913 Act, the Supreme Court has held that the contravention of the provisions of that section would only make the contract or arrangement liable to be avoided by the company. But the company, if it chooses, waive the irregularity and affirm the transaction. But in view of deliberate substitution of the words shall be void in the present section in the place of words 'and shall not be counted' used under the old Act, the effect will be, as pointed out, in the Firestone Tyre & Rubber Co's case to make the contract or arrangement void and not merely voidable.⁵⁹

It may be submitted that there is no words in sub-section (1) making the contract or arrangement void for

contravention of the sub-section. The section expressly provides that, he shall ~~not~~ vote, i.e. an interested director is statutorily prohibited from exercising his vote at the Board's meeting. If an interested director votes at the meeting, it amounts to contravention of the express provision of the Act, and is punishable under sub-section (4) and his vote has to be ignored because of the wording 'if he does ~~note~~ his vote shall be void'. It will not effect the transaction itself.

Problem of Quorum :

Where on account of more than one director being concerned or interested, there is difficulty in having a quorum. So far as quorum ~~is~~ for meeting of Board of directors is concerned, section 287(2) provides that 'the quorum for a meeting of the Board is one third of its strength or two directors, whichever is higher, Where at any time the number of interested director exceeds or is equal to two thirds of the total strength, then the remaining directors who are not interested, present at the meeting shall be the quorum'. The proper course in this situation would be to summon and get the approval of the general meeting or if there is a provision for appointing additional directors, sufficient number of

additional directors may be appointed so as to have a quorum of independent directors.

Further, where all the directors are interested, the Board cannot pass a resolution at all, as none of the directors can validly vote in respect of the resolution, besides there is no quorum of directors who are not interested. In such case the only proper course is to seek approval of the company in general meeting. In a recent decision of the Madras High Court,⁶⁰ on the facts stated in the judgement, the learned judges who upheld as valid a resolution of the Board allotting shares to themselves in lieu of remuneration due to them, shows no awareness of and the learned judge attention was apparently not drawn to the provision of section 300 (1) as in that case all the directors were interested and, therefore, none of them could vote on the resolution allotting shares to themselves, and there was no quorum of disinterested directors.

Sub-section (2) empowers the Central Government to exempt any company from the operation of this section, if such exemption is in the public interest.

It may be submitted that section 299 and 300, seems to be a fairly satisfactory set of provisions in ensuring

the disclosure, and the prevention of secret gains by disclosure, by obliging them with duty of full disclosure, and further providing that the decisions regarding transaction, will be by independent board of directors.

There is, however, scope of improvement in these provisions on the following counts :

(a) Disclosure to the Board of directors as provided presently may not serve the real purpose as in many cases the Board may overlook the mischief in the transaction in which a brother director is interested. It is, therefore, suggested that disclosure be provided to the general body of the shareholders, at least in transactions which are of serious nature. This incidently, will also satisfy the fiduciary obligation of disclosure to whom the duty is owed.

(b) The Act must further provide for disclosure of interest/concern in detail in the prescribed form. It is suggested that the information disclosed should at least include the extent of profit likely to accrue to the interested director. This is necessary as no purpose is being served by the formality of disclosure prescribed at present, particularly under sub-section (3) of section 299, which requires just a general notice to the Board,

that a particular director is interested in a particular transaction.

(c). Further, recently, the English Companies Act, 1980, has provided in section 63(3), the applicability of section 199 of English Act, 1948, to a new category of person called SHADOW DIRECTORS. A shadow director is a person, in accordance with whose directions and instructions, the directors are accustomed to act. This could include a controlling shareholder, who may not be formally appointed as director or any other person acting on behalf of the managing director, though lacking the formal authority, but apparently representing the company to outsiders.

Under section 63(3) of the English Act of 1980, such shadow directors are required to declare their interest by a notice in writing, before, the date of meeting of the Board, in which, if he had been director, a declaration will be required under section 199. Further a general notice, according to section 199 (3) corresponding to section 299 (3) will be treated as sufficient declaration of interest.

It is suggested that similar provision for person resembling shadow directors, in our Act is worth having as

in India, quite often the Board of directors is packed with dummy, who act according to wishes of a person not holding any formal position or relationship, which are covered by either section 297 or 299.

(d) Lastly it may be submitted that sometime mere presence of person makes a lot of difference in the meeting particularly, when such person is influential person. In case of a company, a director may be a man of power and resources, and in his presence, directors may not like to displease him. In order to avoid such situation, a provision may be made that an interested director should withdraw himself from the meeting during the discussion and voting of an item in which he is interested. This type of provision will also prevent undue influence.

(III) DISCLOSURE TO MEMBERS OF DIRECTOR'S INTEREST IN THE CONTRACT APPOINTING MANAGER; MANAGING DIRECTOR:

In order to bring to the notice of members of the company, the contents of contract appointing manager or managing director in which director is interested, section 302 (1) provides that where a director is interested in a contract by which a manager or managing director is appointed, the company must, within twenty-one days, send to every member, an abstract of the contract together with a statement clearly specifying the nature of the director's

interest. It further provides that where a company varies any such contract already in existence and in which a director is concerned or interested, variation must also be sent to every member of the company.

So far as sub-section (4) is concerned, it may be noted that it applies to all cases of any director becoming interested in the appointment of a manager or managing director after the appointment has been made. If, during the period of office of a manager or managing director, a person concerned or interested in the manager or managing director becomes a director, the provisions of this sub-section must be complied with, otherwise, it will be a default punishable under sub-section (5).

As per the Sub-section (6) company must keep all contracts entered into by it for the appointment of a manager, managing director at the registered office of the company and it is immaterial whether the directors are interested in them or not. Further by virtue of sub-section (7) the provisions of section extends also to a whole time director though he may not be managing director.

2-D. BOARD OF DIRECTOR'S REPORT (Section 217)

As per section 217 a company is required to attach with every balancesheet laid before the members in general

meeting, a report by its Board of Directors. In this report the Board must make disclosure in respect of :⁶¹

- (a) the state of company's affairs,
- (b) the amounts, if any, which it proposes to carry to any reserves in such balance sheet,
- (c) the amount, if any, which it recommends, should be paid by way of dividend,
- (d) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the balance sheet relates and the date of the report.

Under sub-section (2) the Board is required to make further disclosure in respect of any changes which have occurred during the financial year :

- (a) in the nature of the company's business,
- (b) in the company's subsidiaries or in the nature of the business carried on by them; and
- (c) generally in the classes of business in which the company has an interest.

A new sub-section (2-A) was inserted by the Companies (Amendment) Act, 1974, imposing an additional liability on the Board of directors for including a statement in the

report disclosing the name of every employees of the company who :

- (i) if employed throughout the financial year was in receipt of remuneration for that year which, in the aggregate, was not less than thirty six thousand rupees; or
- (ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than three thousand rupees per month.

Further any such employee is a relative of any director or manager of the company, and if so the name of such director and any other particulars as may be prescribed.

It may be mentioned that this sub-section is analogous to section 8 of the U.K. companies Act, 1967 which requires that the report of the Board of directors should include a list showing the names of employees of the company who are in receipt of emoluments in excess of £ 10,000 per annum and should also indicate the names of such employees and their relationship, if any, with any of the directors of the company.

The particulars requires to be disclosed as per sub-section (2-A) and rules framed thereunder are :

- (a) designation of the employees,
- (b) remuneration received,
- (c) nature of employment, whether contractual or otherwise,
- (d) other terms and conditions,
- (e) nature of duties,
- (f) date of commencement of employment,
- (g) the age of employee,
- (h) the last employment held by such employee before joining the company.

So far as these particulars are concerned, the Department of Company Affairs issued a circular, stating that "the expression 'remuneration received' occurring in the rules will include all expenses incurred by the companies in providing any benefit or amenity to the employee and the word 'remuneration' has the meaning assigned to it in section 198 of the Companies Act. All companies should, therefore, indicate the salary and perquisite drawn by the employees in terms of the actual expenditure incurred by the company".⁶² This was necessitated because of improper compliance by some of the companies with the rules of 1975.

Another important provision of this section is Sub-section (3) according to which the Board of directors is required to

give fullest information in its reports alongwith proper explanation on any reservation, qualification or adverse remarks contained in the auditor's report.

(III) DISCLOSURE IN RESPECT OF RESERVE :

According to sub-section (1) (b) of section 217 the Board is required to disclose the amounts, if any, which it proposes to carry to any reserves in such balance sheet.

It may be stated that the term 'reserve' is not defined in the Act, however, for purposes of balancesheet and profit and loss account, a negative definition is provided in Schedule VI, namely that the expression 'reserve' shall not include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability. This was based on the definition given in part 27 of part IV of Schedule VIII of the English Act, which, however, has been amended by the Companies Act, 1967 which further excludes 'any sum set aside for the purpose of its being used to prevent undue fluctuations in charges of taxation. It may be mentioned that additions made in the definition of English Act, by 1967 Act has not been incorporated under Schedule VI of the Companies Act.

According to the Institute of Chartered Accountant, England, reserve means 'amount set aside out of profits and other surpluses which are not designed to meet any liability, contingency, commitment or diminution in value of assets known to exist at the date of the balance sheet'.

In the case of Income-tax Commissioner V. Century Spinning and Manufacturing Company Ltd.⁶⁷ it was held that the reserves may be general or a special reserve, but there must be clear indication to show whether it was reserved either of the one or the other kind. The fact that it constituted a mass of undistributed profits cannot automatically make it a reserve.

It may be submitted that view of Punjab & Haryana High Court in C.I.T. v. Oswal Woodden Mills Ltd.⁶³ that the date creating the reserve relates back to the date of Board resolution, with due respect, is not correct. The reason is that according to section 217 (1) (b), the authority competent to create a general reserve, is only the general body though it acts on the proposals made by the Board of directors, General reserve is finally created only when the company's general body adopts the balance sheet and the report of the Board of directors.

Disclosure of Material Changes :

As per section 217 (1) (d) the Board is required to disclose in its report the material changes which have occurred between the end of the financial year of the company to which the balance sheet relates and date of the report. This duty of disclosure is conditional and not absolute, this is because of the wording of the clause (d) which says 'material changes and commitment, if any, affecting the financial position of the company'. If changes which have taken are not likely to affect the financial position of the company then the Board is not required to disclose such changes in its report.

The changes which are considered to be material changes are :⁶⁴

- (1) The purchase, sale, or destruction of a plant or the destruction of inventories.
- (2) A material decline in the market value of inventories or investments.
- (3) The expiration of a patent which had given the company a virtual monopoly in the sale of its principal products.
- (4) The settlement of tax liabilities of prior period and settlement of any legal proceedings either favourably or adversely, if they were pending at the balance sheet date.

(5) The institution of important proceedings against the company.

(6) Material change in the capital structure resulting from the issuance, retirement or conversion of share capital or stock.

In this connection it may be noted that the Fourth Directive of Company Law issued by the Council of Ministers of the European Economic Community also contains a provision as follows :

"The annual report will have to include indication of the company's likely future developments and of any important events that have occurred since the year end".

In connection with clauses (d) a question arises as to whether the Board of directors is bound to disclose in its report change of Law or change in industrial policy of the Government which is likely to affect the financial position of the company. Looking to the present trend of the Governmental policy to have tighter control on the organised sector, it is desirable for the Board of Directors to bring such changes to the notice of the general body by making disclosure in its report. This may be affected either in the body of the report itself or by way of footnotes or other techniques. This would help the members in framing their opinion as to future development of the company.

(III) LIABILITY FOR STATEMENT MADE IN THE REPORT :

So far as liability for statements made in the director's report is concerned, it may be stated that on the principle laid down in the case of Hadley Byrne & Co. Ltd. v. Heller and Partners Ltd.⁶⁵ a director may incur liability to individual shareholders who act in reliance upon a negligent mis-statement made, e.g. in the director's report, since the relationship between a director and members will normally be such as to impose a duty to take care in making such statements.

In present day, in the case of public companies it has become common to circulate the statement made by the Chairman at the annual general meeting and to publish this in the press. Though these statements are sometimes interlarded with fulminations about nationalisation or aspect of the Government economic policy, they have in the past tended to be considerably more informative about company's affairs than the director's report. In England Jenkin Committee recommended that tendency should be recognised by permitting information to be provided in the Chairman's statement rather than in the director's report. This recommendation, however, has not been adopted. Nevertheless the Chairman's statement should never be overlooked as a possible source of additional information.

The Sacher Committee had made certain recommendations in respect of Board's report. According to it the Board's report should contain following additional informations:

(a) Amount of deposit received from the public during the year and the total repayment made and outstanding with a break-up of dues within one or more years.

(b) Particulars of prosecutions launched against the company resulting into fine or imprisonment of any of the directors or officers of the company.

(c) Particulars as regards unclaimed and unpaid dividends.

(d) Details of investment in other bodies corporate, firm or joint ventures exceeding five percent of the company's paid up capital and free reserves as have not yielded any returns and the reasons thereof

(e) Information relating to any material liability of the company and of any matter likely to adversely affect the profit and loss or assets and liability of the company during the current year.

(f) statement showing the commitments and liabilities for which no provisions have been made in the accounts and reasons thereof.

(g) Steps taken by the company in various spheres with a view to discharging its social responsibilities, and future plan of the company in this regards.

(h) Statement indicating losses, if any, incurred by the company in any division of its activities.

(i) Ratio of current Assets to Current Liabilities; of inventories to sale etc.

(j) Key-limiting factors that have prevented the full utilisation of installed capacity of plant and machinery.

(k) Number of shares held by each director in the company so long as such shares carry not less than two percent of the total voting rights.

(l) Particulars of any contract with the company that subsists at the end of the financial year or subsisted at any time during the year in which a director or his spouse or his dependent children should be considered as having a significant interest in a contract or contracts with the company if the interest in such contracts shall in aggregate, represent in amount or value, a sum equal to or more than one percent of the company's total purchase, sale, payment or receipt.

(m) Statement indicating that the statutory norms and guidelines have been complied with in respect of :

- (i) managerial appointment and remuneration and
- (ii) inter company investments and loans.⁶⁷

So far as sub-section 2-A is concerned, the committee accepting the failure or futility of the provisions of sub-section, suggested that it will be suffice, if information relating to employees drawing a remuneration of three thousand or more per month is filed with the Registrar alongwith the annual return so that such information is available at the disposal of the Government at all times and is open for inspection by members of the public who might be interested in knowing such details. It also recognises that, should any shareholder require the information regarding all executives who receive the remuneration in excess of that drawn by managing or whole time director, the company will be bound to furnish such information.

It further recommended that so far as the information that is required to be published alongwith the balance sheet, it be limited to :

- (a) the particulars of directors and their relatives drawing a remuneration of not less than three thousand rupees per month if they were employed for a part of the financial year or not less than thirty six thousand rupees during a financial year if the employed though out the year.

(b) The particulars of executives of the company in receipt of remuneration in excess of that drawn by managing or whole time director if such executive by himself or alongwith his spouse and dependent children holds not less than two per cent of equity share of the company.

(c) Statement of number of employees in each category i.e. number of employees drawing a remuneration of less than five hundred rupees and one thousand rupees per ^omnth, number of employees drawing a remuneration between one thousand rupees and two thousand rupees per month.

It had also recommended that particulars of all payments including remuneration, salaries and perquisites to managing director, whole time director, directors and employees drawing three thousand rupees or more per month should be quantified in monetary terms of the outgo of the company and shown separately in profit and loss account and not on the basis of income tax rules.⁶⁸

It may be submitted that if all the recommendations are accepted, the Director's report will become a bulky document. No doubt the Committee's recommendation for providing information in respect of step taken in discharge of social responsibility is worth and should be implemented.

Secondly recommendation relating to list of person drawing a remuneration of thirty six thousand rupees per year is concerned, it may be submitted that looking to the present rate of inflation, it should be made more realistic by raising the limit upto a reasonable level. Further it should be restricted to those employees who are the relatives of the directors.

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