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Directors

"A corporation is an artificial being, invisible, intangible and existing only in contemplation of law."[1] "It has neither a mind nor a body of its own."[2] "A living person has a mind which can have knowledge or intention and he has hands to carry out his intention. A corporation has none of these, it must act through living persons."[3] This makes it necessary that the company's business should be entrusted to some human agents. Hence the necessity of directors. Section 252 of the Act, therefore, requires that "every public company shall have at least three directors and every private company shall have at least two directors".[4] By an amendment of the section by Amendment Act, 2000 it has been provided that a public company having a paid up share capital of rupees five crore or more and one thousand or more small shareholders, should have a director elected by the small shareholders. The manner of such election is to be prescribed. A small shareholder for this purpose means having shares of the nominal value of twenty thousand rupees or less in a public company.

POSITION OF DIRECTORS

The position that the directors occupy in a corporate enterprise is not easy to explain.[5] They are professional men hired by the company to direct its affairs. Yet they are not the servants of the company. They are rather the officers of the company. "A director is not a servant of any master. He cannot be described as a servant of the company or of anyone."[6] "A director is in fact a director or controller of the company's affairs. He is not a servant."[7] A director may, however, work as an employee in a different capacity. For example, in *Lee* v *Lee's Air Farming Ltd*:[8]

> The principal controller and a director of a company was also working as its pilot. Following his death while acting as a pilot, his widow recovered compensation under the Workmen's Compensation Act.[9]

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1 MARSHALL J in *Trustees of Dartmouth College* v *Woodward*, (1819) 17 US 518, 636, cited in Laski, *The Personality of Associations*, 29 Harv LR 404.

2 HALDANE LC in *Lennard's Carrying Co* v *Asiatic Petroleum Co*, 1915 AC 705 at 713: [1914-15] All ER Rep 280: 113 LT 195.

3 *Tesco Supermarkets Ltd* v *Nattrass*, [1977] AC 153 at 170, *per* Lord REID.

4 S. 252(2). "Public company", for this purpose, does not include a private company which has become a public company under S. 43-A. As long as the requisite figure is maintained the requirements of the Act are fully satisfied even if all or substantially all the powers are delegated to a single director as long as he is in office. *Whitehouse* v *Carlton Hotel (P) Ltd*, (1987) 70 Australian LR 251, High Court of Australia. Sub-section (3) says that directors collectively are referred to as the "Board of directors" or as "Board".

5 *Ram Chand & Sons Sugar Mills* v *Kanhayalal*, AIR 1966 SC 1899: [1966] 2 Comp LJ 224.

6 *Moriarty* v *Regent's Garage & Engg Co*, [1921] 1 KB 423. LUSH J at 431.

7 MCCARDIE J at 446, *ibid.*

8 1961 AC 12: [1960] 3 All ER 420 PC.

9 This principle will not apply where no proof of employment apart from being a director is available. Thus in *Parsons* v *Albert J. Parsons Ltd*, [1978] IRC 456: noted 1978 JBL 61, a person who was removed from directorship of a private company was not allowed to recover

The Companies Act makes no effort to define their position. Sub-section (13) of Section 2 only provides that "director includes any person occupying the position of a director, by whatever name called". The Nigerian Act carries a better definition: "Directors of a company registered under this Act[10] are persons duly appointed by the company to direct and manage the business of the company".[11] In the words of BOWEN LJ:[12]

> Directors are described sometimes as agents, sometimes as trustees and sometimes as managing partners. But each of these expressions is used not as exhaustive of their powers and responsibilities, but as indicating useful points of view from which they may for the moment and for the particular purpose be considered.

According to JESSEL MR:[13]

> "Directors have sometimes been called trustees, or commercial trustees, and sometimes they have been called managing partners, it does not matter what you call them so long as you understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and of all other shareholders in it."

Directors as agents

It was clearly recognised as early as 1866 in *Ferguson* v *Wilson*,[14] that directors are in the eyes of law, agents of the company. The Court said:

> The company has no person; it can act only through directors and the case is, as regards those directors, merely the ordinary case of principal and agent.

The general principles of agency, therefore, govern the relations of directors with the company and of persons dealing with the company through its directors. Where the directors contract in the name, and on behalf of the company, it is the company which is liable on it and not the directors. Thus where the plaintiff supplied certain goods to a company through its chairman, who promised to issue him a debenture for the price, but never did so and the company went into liquidation, he was held not liable to the plaintiff.[15] Similarly, where the directors allotted certain shares to the plaintiff, they were held not liable when the company, having exhausted its shares, failed to give

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compensation for unfair dismissal. Though the Employment Appeal Tribunal had allowed his claim, the court of appeal disallowed it.

10 Companies and Allied Matters Act, 1990.

11 *See* Ameze Guobardia, *The Criminal Liability of Directors of Failed Banks in Nigeria*, 1998 JBL 198.

12 In *Imperial Hydropathic Hotel* v *Hampson*, (1882) 23 Ch D 1: 49 LT 150. *See* also *A. J. Judah* v *Rampada Gupta*, AIR 1959 Cal 715.

13 *Forest of Dean Coal Mining Co, Re*, (1878) 10 Ch D 450 at 451-452.

14 (1866) 2 Ch App 77: 36 LJ Ch 67: 15 LT 230.

15 *Elkington & Co* v *Hurter*, [1892] 2 Ch 452: 66 LT 764. *Kurinkos* v *PKV Group Industries*, (2002) 111 Comp Cas 826 Ker, a director was held to be not personally liable in a suit against a private chit fund company. Attachment of the property of the managing director was held to be not permissible.

effect to the allotment.[16] Just as notice to an agent in the course of business amounts to notice to the principal so it is true of directors in relation to the company.[17] But notice to a director will amount to notice to the company only if the director is, like an agent, bound in the course of his duty to receive the notice and to communicate it to the company. It was held in *Hampshire Land Co, Re*,[18] that where one person is an officer of two companies, his personal knowledge is not necessarily the knowledge of both the companies unless he is under a duty to receive the notice and to communicate it to the other.[19] Like agents, they have to disclose their personal interest, if any, in any transaction of the company. It should, however, be remembered that they are the agents of an institution and not of its individual members, except when that relationship arises due to the special facts of a case.[20]

For a loan taken by a company, the directors, who had not given any personal guarantee to the creditor, could not be made liable merely because they were directors.[21]

As trustees

On the position of directors as trustees, the Nigerian Act contains this provision:[22]

> "Directors are trustees of the company's money, properties and their powers and as such must account for all the moneys over which they

16 *Ferguson* v *Wilson*, (1866) 2 Ch App 77: 36 LJ Ch 67: 15 LT 230. *See* also *Belvedere Fish Guano Co* v *Rainham Chemical Works*, 1921 AC 465, 488. *Hrashikesh Panda* v *Indramani Swain*, (1988) 63 Comp Cas 368 Ori, a director held not personally liable for the debts of the company. *Kundan Singh* v *Moga Transport Co*, (1987) 62 Comp Cas 600 P&H where the court said that there is no provision in the Companies Act or in the Industrial Disputes Act which makes the managing director of a company personally liable for claims against the company; so is true of liability in respect of taxes. *Tikam Chand Jain* v *State Govt*, (1987) 62 Comp Cas 601 P&H. A managing director was not allowed to be put under arrest and detention for company's debts, *Maruti Ltd* v *Pan India Plastic (P) Ltd*, (1995) 83 Comp Cas 888 P&H.

17 *See*, for example, S. 229 of the Indian Contract Act, 1872 and *T. R. Pratt Ltd* v *M. T. Ltd*, AIR 1938 PC 159, common directors of three companies in a group were supposed to know that the assets of one company were mortgaged for the loan to another.

18 [1896] 2 Ch 743.

19 Followed in *Sree Meenakshi Mills Ltd* v *Ratilal Thakar*, AIR 1941 Bom 108: 43 BLR 53. Receipt of money by directors from agents known to them for investment in the company when those agents knew that it was misapplied trust money.

20 *See*, for example, *Allen* v *Hyatt*, (1914) 30 TLR 444. It is a matter of evidence in each case whether a director can be regarded as a principal officer or agent for income tax purposes, *Shyam Sundar Jalan* v *State*, (1977) 47 Comp Cas 61 Cal. Directors who issued duplicate share certificates against those which were lying under pledge with the company were held personally liable to the deceived person. The company was not liable because the directors resorted to the tactics to combat a take over bid as a part of their own game plan, *Shoe Specialities Ltd* v *Tracstar Investments Ltd*, (1997) 88 Comp Cas 471 Mad. The company was held liable where its directors in order to promote the company's business gave unfounded estimates to a person to persuade him to accept the company's franchise, *Williams* v *Natural Life Health Foods Ltd*, (1996) 1 BCLC 288, affirmed by the court of appeal, (1997) 1 BCLC 131 CA. *Ray Cylinders & Containers* v *Hindustan General Industries Ltd*, (2001) 103 Comp Cas 161 Delhi, permission granted to file a suit against a company was not allowed to be treated as a permission against directors as well.

21 *Indian Overseas Bank* v *RM Marketing P Ltd*, (2001) 107 Comp Cas 606 Delhi.

22 S. 283 of the Companies and Allied Matters Act, 1990.

exercise control and shall refund any moneys improperly paid away, and shall exercise their powers honestly in the interest of the company and all the shareholders, and not their own sectional interests."

Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes to their hands or which is actually under their control; and ever since joint stock companies were invented directors have been held liable to make good moneys which they have misapplied upon the same footing as if they were trustees.[23] In *Ramaswamy Iyer* v *Brahmayya & Co*,[24] the Madras High Court observed that:

> The directors of a company are trustees for the company, and with reference to their power of applying funds of the company and for misuse of the power they could be rendered liable as trustees and on their death, the cause of action survives against their legal representatives.[25]

Another reason why directors have been described as trustees is the peculiar nature of their office. "The directors are persons selected to manage the affairs of the company for the benefit of the shareholders. It is an office of trust, which if they undertake, it is their duty to perform fully and entirely."[26] Some of their duties to the company are of the same nature as those of a trustee. For example, they, like trustees, occupy a fiduciary position. Moreover, almost all the powers of directors are powers in trust.[27] The power to make calls,[28] to forfeit shares,[29] to issue further capital,[30] the general powers of management[31] and the power to accept or refuse a transfer of shares, are all powers in trust which have to be exercised in good faith for the benefit of the company as a whole.

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23 LINDLEY LJ in *Lands Allotment Co, Re*, [1894] 1 Ch 616 at 631. *See* also *Sharpe, Re*, [1892] 1 Ch 154: [1891-4] All ER Rep Ext 1974, where directors were held liable to replace capital which was spent by them in paying interest *ultra vires* the company. Some other examples are: *Great Luxembourg Rly Co* v *Sir William Magnay (No 2)*, (1858) 25 Beav 586; *Rose* v *Humbles*, [1970] 1 WLR 1061. *See also* SIR GEORGE JESSEL *Forest of Dean, Coal Mining Co, Re*, (1878) 10 Ch D 450: 40 LT 287 and Lord SELBORNE in *G. E. Rly Co* v *Turner*, (1872) 8 Ch App 149, 152, where his Lordship said: "The directors are mere agents or trustees of the company; trustees of the company's money or property; agents in transactions which they enter into on behalf of the company." *See* also *Selangor United Rubber Estates* v *Cradock (No 3)*, [1968] 2 All ER 1073: [1968] 1 WLR 1555. Where the directors have been held trustees of the money standing to the credit of the company's bank account which they operate.

24 [1966] 1 Comp LJ 107.

25 *See*, the judgment of P. CHANDRA REDDY CJ at 130-132, *ibid*, where he discusses all the English authorities on the subject. *See* also *Ekambaram* v *Venkatachalapathi Mills*, [1967] 1 Comp LJ 133: (1967) 37 Comp Cas 693 AP, where for certain loans granted in contravention of S. 86-D(1) of the Act of 1913 and which remained unpaid, the legal representatives of a deceased director were held liable. "Such cause of action *prima facie* survives the death of such a person liable." The Court considered: *Peerdan Juharmal Bank, Re*, AIR 1958 Mad 583: (1958) 28 Comp Cas 546; *Sankaram Nambiar* v *Kottayam Bank*, AIR 1946 Mad 304.

26 ROMILLY MR in *York & North Midland Rly Co* v *Hudson*, (1853) 61 Beav 485: 22 LJ Ch 529.

27 *See*, for example, Berle, *Corporate Powers as Powers in Trust*, 44 Harv LR, 1949 where the learned writer enlists the powers which have been held as powers in trust.

28 *Alexander* v *Automatic Telephone Co*, [1900] 2 Ch 56: [1900-03] All ER Rep Ext 1755.

29 *Esparto Trading Co, Re*, (1879) 12 Ch D 191.

30 *Nanalal Zaver* v *Bombay Life Assurance Co*, AIR 1950 SC 172: (1950) 20 Comp Cas 179.

31 *Marshall's Valve Gear Co Ltd* v *Manning, Wardley & Co Ltd*, [1909] 1 Ch 267: 100 LT 65.

Yet directors are not trustees in the real sense of the word. There is nothing in common between a director and "a trustee of a will or of a marriage settlement".[32] Moreover, a trustee is the legal owner of the trust property and contracts in his own name. A director, on the other hand, is a paid agent or officer of the company and contracts for the company.[33] The real truth of the matter is that "directors are commercial men managing a trading concern for the benefit of themselves and of all the shareholders in it".[34]

For whom trustees?.—Directors are trustees of the company and not of individual shareholders. This principle was laid down in 1902 in *Percival* v *Wright*,[35] and still holds ground as a basic proposition.[36] In that case:

> Negotiations for the sale of a company's undertaking were on foot and without disclosing this the directors purchased shares from the plaintiff-shareholders. The selling shareholders had written to the company's secretary asking him if he knew anyone willing to purchase their shares. Three directors offered to buy the shares at a price assessed by an independent valuer but they did not disclose that they were in the process of negotiating the sale of the company at a price per share considerably higher than the amount offered to the shareholders. The negotiations proved to be abortive, but the plaintiffs claimed that the non-disclosure was a breach of the fiduciary duty entitling them to repudiate the sale.

But the court held that there was no such fiduciary duty towards individual shareholders and, therefore, the directors were not bound to disclose negotiations which ultimately proved abortive. The court also pointed out that a premature disclosure of this kind might well be against the best interests of the company.

The principle of the case was reiterated in *Peskin* v *Anderson*.[37] Ordinarily the directors are not agents or trustees of members or shareholders and owe no fiduciary duties to them.

This decision remained unchallenged in common law jurisdictions until the New Zealand decision in *Coleman* v *Myers*.[38]

> The case involved a struggle for control of a privately held family company. The company had substantial assets, like cash reserves, valuable lands and buildings. The assets were undervalued in the books of account.

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32 ROMER J in *City Equitable Fire Insurance Co, Re*, [1925] Ch 407: [1924] All ER Rep 485: 133 LT 520.

33 JAMES LJ in *Smith* v *Anderson*, (1880) 15 Ch D 247 at 275.

34 JESSEL MR *Forest of Dean Coal Mining Co, Re*, (1878) 10 Ch D 450 at 451-452: 40 LT 287. Their position is that of constructive trustees. *See* an excellent study by D. W. Fox, *Constructive Trusts in a Company Setting*, 1986 JBL 23.

35 [1902] 2 Ch 421, cited with approval by the Madras High Court in *Ramaswamy Iyer* v *Brahamayya & Co*, [1966] 1 Comp LJ 107.

36 *See*, Louis Loss, *The Fiduciary concept as applied to Trading by Corporate "Insiders" in the U. S.*, (1970) 30 Mod LR 34 at 40-41, where the learned writer says that although abandoned or escaped by importing special circumstances, the *Percival* concept still represents "majority rule".

37 [2000] 2 BCLC 1.

38 [1977] 2 NZLR 225.

They showed the share value to be at $4.10 on a going concern basis. If accounts were taken of the true asset backing of the shares, they were worth $7.75. The dominant majority shareholder formed another company which made a takeover offer at $4.80 per share. The reluctant minority shareholders were given notices of compulsory acquisition of shares. They eventually agreed. They had no access to inside information on the true value of the assets. No information was given to them. When they discovered the true facts they sought setting aside of the sale because of the breach of fiduciary duty.

MAHON J, said that the case could not be distinguished from *Percival* v *Wright* but that, in fact, *Percival* v *Wright* was incorrectly decided and, in the circumstances of the two cases, where directors were buying shares in their own company, a fiduciary duty was owed to shareholders. The Court of Appeal were, however, content to distinguish *Percival* v *Wright* on the special facts of the case. It held that the court will not impose a fiduciary duty automatically upon directors when they enter into transactions with the company's shareholders. Because of the special circumstances of this case, the court did impose a fiduciary duty. The circumstances were:

> Face-to-face negotiations in which the members relied upon the directors to disclose all material information; the directors had a high degree of inside knowledge; and the directors actively promoted the scheme and advised the shareholders to accept.[39]

The decision in *Percival* v *Wright* left scope for the rule that when negotiations reach a certain stage of maturity a disclosure of the director's profits to the selling shareholders would be necessary, otherwise the directors would be failing in their fiduciary obligation towards them.[40] The principle found application in *Allen* v *Hyatt*.[41]

> The directors of a company represented to the shareholders that their consent was necessary in order to effect an amalgamation and induced the shareholders to give them the option to purchase their shares. They exercised the option, carried out the amalgamation and made a profit.

It was held that the directors were trustees of this profit for the benefit of the shareholders. They cannot always act under the impression that they owe no duty to individual shareholders. No doubt the duty of the directors is primarily one to the company itself. But the facts of the present case showed that the directors had held themselves out to the individual shareholders as acting for them. Now, of course, there is a statutory obligation to disclose any profit of this

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39 For other cases on the subject see *Clement* v *Walker*, (1983) 1 NZCLC 98, 636, here the shareholder in question was also a director of the company with professional experience and had access to all the information contained in the company's records and *Cottam* v *GUS Properties Ltd*, (1995) 7 NZCLC 260, 821, where the duty was violated.

40 *See*, Robert H Mundheim, *The Texas Gulf Sulphur Complaint*, 1966 JBL 284 which discusses the duty of a corporate insider to disclose information materially enhancing the value of corporate stock before purchasing it.

41 (1914) 30 TLR 444. A decision of the Privy Council on appeal from Ontario.

kind to the shareholders along with the offer by which their shares are proposed to be acquired.[42]

In situations like this where the directors act as agents for the shareholders, the latter would be liable to the purchasers of their shares for any fraudulent misrepresentation made by the directors in the course of negotiations.[43]

Trustees of institution.—The role of the corporation in the modern society is something different from what it was in the previous century. "The modern company should function not simply as an economic machine designed to churn out profits for its shareholders, but rather as an institution which owes social responsibilities to a wide circle of interests."[44] The Supreme Court has already conferred its recognition upon the "social character" of a company. In *Charanjit Lal* v *Union of India*,[45] MUKHERJEE J observed: "A corporation which is engaged in the production of a commodity vitally essential to the community, has a social character of its own and it must not be regarded as the concern primarily or only of those who invest money in it." Accordingly, the directors become "the administrators of a community system".[46] A business executive once declared: "I am a trustee of the institution and not merely an attorney of the investor."[47] If this position comes to be accepted, the corporation law would become "in substance a branch of the law of trusts".[48] Whether this is so or not, it is widely recognised that the directors have to consider the interests of labour, consumers, the general public and the State.[49] Public responsibility of a company means to take account of outside interests affected by corporate operations. To the extent the directors are bound to consult outside interests, they become the trustees of such interests.[50]

Directors as organs of corporate body

"There was a time when corporations played a very minor part in our business affairs, but now they play the chief part, and most men are the servants of corporations."[51] "There is scarcely any business pursued requiring the ex-

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42 Sections 319-321 of the Companies Act, 1956. *See also* under Duties of Directors, *infra*.

43 It has been so held by the House of Lords in *Briess* v *Woolley*, 1954 AC 333: [1954] 1 All ER 909. *See also* Merrick Dodd, Jr, *For Whom are Corporate Managers Trustees*, (1932) 45 Harv LR 1145, and Duty of Good Faith, *infra*.

44 R. C. Beuthin, *The Range of a Company's Interests*, (1969) 86 SALJ 155, 146. The concept of the company as a social institution is developed in the following works: George Goyder, THE FUTURE OF PRIVATE ENTERPRISE, (1951) and THE RESPONSIBLE COMPANY, (1961); Peter F. Drucker, THE CONCEPTION OF THE CORPORATION; D. L. Mazumdar, TOWARDS A PHILOSOPHY OF THE MODERN CORPORATION, Asia (1967).

45 AIR 1951 SC 41 at 59: 1950 SCR 869: (1951) 21 Comp Cas 33.

46 Joseph L. Weiner, *The Berle-Dodd Dialogue of the Concept of the Corporation*, (1964) 64 Col LR 1458.

47 Cited in the above article.

48 *Id. See also* Carlos L. Israels, *Are Corporate Powers still held in Trust*, (1964) 64 Col LR 1446.

49 *See*, Lord DENNING at the 14th Legal Convention of the Law Council of Australia, cited in (1967) 41 Aust LJ 363-64, and Schmitthoff in 1966 JBL 112-13.

50 *See*, Eugene W. Rostow, *To Whom and For What Ends is the Corporate Management Responsible*, Mason. THE CORPORATION IN MODERN SOCIETY, (1959) 46, and W. H. Ferry, *Irresponsibilities in Metro Corporate America* in Andrews Hacker. THE CORPORATION TAKE-OVER, (1964) 108.

51 Woodrow Wilson, THE NEW FREEDOM, 24 (1967, Jaico).

penditure of large capital, or the union of large numbers that is not carried on by corporations. It is not too much to say that the wealth and business of the country are to a great extent controlled by them."[52] This gives the company and its executive an enormous power to affect the lives of labourers and consumers and shareholders.[53] Every position of power implies responsibility.[54] But it often became difficult to hold a company to its responsibilities in view of the artificial nature of its personality. There was a time when a company could not be held responsible for any wrong involving mental element. But today the range of corporate responsibility almost corresponds with that of an individual[55], as "the offending corporation cannot escape from the consequences which would follow in the case of an individual by saying that they are a corporation".[56]

This transformation has been brought about under the influence of the organic theory of corporate life, "a theory which treats certain officials as organs of the company, for whose action the company is to be held liable just as a natural person is for the action of his limbs".[57] Thus "the modern directors are something more than mere agents or trustees. The board is also correctly recognised to be a primary organ of the company."[58] As NEVILLE J put it in ***Bath*** v *Standard Land Co*:[59]

> The Board of directors are the brain and the only brain of the company, which is the body and the company can and does act only through them.

"When the brain functions the corporation is said to function."[60] Similarly, GREER LJ said in *Fanton* v *Denville*[61] that "a general manager of the business is regarded as the *alter ego* of the company, and it would be responsible for his

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52 FIELD J in *Pacel* v *Virginia*, 3 Wall (75 US) 168, 181-182; borrowed from Jackson, WISDOM OF THE SUPREME COURT, at 80. This statement is true of every modern democratic society.

53 Dodd, reviewing Dimock & Hyde, BUREAUCRACY AND TRUSTEESHIP IN LARGE CORPORATIONS, (1942) 9 Uni Ch L Rev 538.

54 *Id.* Cited by Joseph L Weiner, *The Berle-Dodd Dialogue of the Concept of the Corporation*, (1964) 64 Col LR 1458. *See also* Adolf A. Berle, *Modern Functions of the Corporate System*, 62 Col LR 433 (1962) and Henry G. Manne, *The Higher Criticism of the Modern Corporation*, 62 Col LR 399.

55 C. R. N. Winn, *Criminal Liability of Corporations*, (1929) 3 Camb LJ 398. The company would be liable in civil respects where the criminal conduct of those working for the company is either within the range of their authority or in the course of their employment, *Javali (MV)* v *Mahajan Borewell & Co*, (1998) 91 Comp Cas 708 SC.

56 BOWEN LJ in *R.* v *Tyler*, [1891] 2 QB 588, 594. Cited by HALLET J in *D. P. P.* v *Kent & Sussex Contractors Ltd*, [1944] KB 146: [1944] 1 All ER 119. A company can be punished by way of fine and not imprisonment. *Oswal Vanaspati and Allied Industries* v *State of UP*, (1992) 75 Comp Cas 770 All: *Maniam Transports* v *S. Krishna Moorthy*, [1993] 1 Comp LJ 153 Mad. Where imprisonment is the only punishment prescribed under an Act, a company cannot be prosecuted. *P. V. Pai* v *R. L. Rinawma*, (1993) 77 Comp Cas 179 Kar; *Delhi Municipality* v *J. B. Bottling Co*, (1975) Cri LJ 1148 Del. A company can be held liable for statutory violations like an individual, but it cannot be imprisoned. *M.V. Javali* v *Mahajan Borewell & Co*, (1997) 8 SCC 72: 1997 SCC (Cri) 1239: (1998) 91 Comp Cas 708 SC.

57 TALUKDAR J in *Gopal Khaitan* v *State*, AIR 1969 Cal 132 at 138: (1969) 39 Comp Cas 150.

58 R. C. Beuthin, *The Range of a Company's Interests*, (1969) 86 SALJ 155, 156.

59 [1910] 2 Ch 408, 416.

60 *State Trading Corpn of India Ltd* v *CTO*, AIR 1963 SC 1811 at 1832: (1964) 4 SCR 99: (1963) 33 Comp Cas 1057.

61 [1932] 2 KB 309 at 329.

personal negligence". Likewise, a company was held liable for giving a false warranty without having reason to believe that it was true.[62] The decision of the House of Lords in *Lennard's Carrying Co* v *Asiatic Petroleum Co*[63] gave a further fillip to this development:

> The facts were that the Merchant Shipping Act of 1874 provided that a shipowner would not be liable to make good a loss of or damage to the goods happening without "his actual fault". The shipowner in this case was an incorporated company and the loss had taken place due to the negligence of a managing director. The company was sued for the loss and its chief defence was that the company, being an artificial person, was incapable of committing "actual fault".

Rejecting this contention, Lord HALDANE in his well-known passage said:[64] "A corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its acting and directing will must, consequently, be sought in the person of somebody who for some purpose may be called an agent, but who is really the directing mind and the will of the corporation. That person may be under the direction of shareholders in general meeting; that person may be the board of directors itself. (His) fault is the fault of somebody who is not merely a servant or agent for whose action the company is liable upon the footing *respondeat superior*, but somebody for whom the company is liable because his action is the very action of the company itself."

The company's intention to occupy a premises for its own business requisite under the Tenancy Acts to evict a tenant, can be known by referring to the directors' conduct irrespective of any formalities.[65] DENNING LJ explained the organic character of the company's life in the following words:[66]

> A company may in many ways be likened to a human body. It has a brain and a nerve centre which controls what it does. It has also hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work, and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind or will of the company and control what it does. The state of mind of

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62 *Chuter* v *Freeth & Pocock Ltd*, [1911] 2 KB 832.

63 1915 AC 705: [1914-15] All ER Rep 280: 113 LT 195.

64 *Id.* at 713-714. Reaffirmed by the House of Lords in *Tesco Supermarkets Ltd* v *Nattrass*, 1972 AC 153: [1971] 2 WLR 1166: [1971] 2 All ER 127.

65 *H. L. Bolton (Engg) Co Ltd* v *T. J. Graham & Sons*, [1957] 1 QB 159: [1956] 3 WLR 804: [1956] 3 All ER 624 CA. For the liability of a company to be evicted, see *V. G. Paneerdas* v *Swadeshmitran*, [1986] 2 Comp LJ 267 Mad. A director can be held personally liable for the offence of cheating by issuing a cheque if he knew of inadequate funds and also intended to cheat. *Rachna Flour Mills (P) Ltd* v *Lal Chand Bhangadiya*, (1987) 62 Comp Cas 15 AP.

66 *Id.* See also *C. Evans & Sons Ltd* v *Specitebrand Ltd*, [1985] 2 All ER 415 CA, a director and his company held liable for infringement of copyright which the director authorised, directed and procured. *Attorney-General Ref No 2 of 1982*, [1984] 2 All ER 216, whether directors depriving the company of its property in connivance with shareholders can be prosecuted for theft.

these managers is the state of mind of the company and is treated by the law as such.[67]

"But the courts have not attempted to define the persons whose acts or intentions are to be considered the acts or intentions of the company."[68] It has, however, been suggested that it would include the company's governing body, directors, managing director[69] or general manager or other persons having authority from the board of directors to conduct the company's business.[70] For certain purposes even the secretary has been recognised as an essential organ. For example, in *Panorama Development (Guildford)* v *Fidelis Furnishing Fabrics*,[71] a company was held liable for the hire of taxis engaged by the secretary for his personal purposes while operating from the office of the company. Commenting upon the growing importance of the secretary, Lord DENNING MR said:

> A modern secretary is not a mere clerk but an officer of the company with extensive duties and responsibilities and has authority to sign contracts connected with the administrative side of a company's affairs and has ostensible authority to enter into a wide range of contracts. In that respect his position has altered very materially since the 19th century.[72]

Personal Liability of Working Organ

When a tort or some other wrong happens to occur in the working processes of a company, the question would be whether the responsibility for it is to be attributed to the company or it should be borne by the director alone. The applicable principle has been thus stated:

> "The authorities . . . clearly show that a director of a company is not automatically to be identified with his company for the purpose of the law of tort, however small the company may be and however powerful his control over its affairs. Commercial enterprise and adventure is not to be

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67 *See also* Lord PARKER in *Daimler Co Ltd* v *Continental Tyre & Rubber Co Ltd*, [1916] 2 AC 307 at 235: [1916-17] All ER Rep 191 and DU PARQ LJ in *Triplex Safety Glass* v *Lancegae Safety Glass*, [1939] 2 KB 395, 408: [1939] 2 All ER 613.

68 TALBOT J in *Wheeler* v *New Merton Board Mills*, [1933] 2 KB 669.

69 *Ashok Kumar* v *Shingal Land and Finance P Ltd*, (1995) 82 Comp Cas 430 Delhi, managing director disposing of land of a colonising company under his authority under the articles to act on behalf of the company, held company bound.

70 *See*, the judgements of SCRUTTON and LAWRENCE LJJ in *Rudd* v *Elder Dempster & Co*, [1933] 1 KB 566 at 576 and 594; *Moore* v *I. Bresler Ltd*, [1944] 2 All ER 515; *Tesco Supermarkets Ltd* v *Nattrass*, (1972) 2 All ER 127 HL where it was held that a branch manager of a shop was not sufficiently senior for the purpose that his default should be regarded as that of the company. He was not the *alter ego* of the company. Such an *ego* would be found amongst directors, managers, secretary or other officers of the company or someone to whom they delegated control and management with full discretionary powers in reference to some part of the company's business. Branch managers have not been regarded as the brain and the mind of the company. The deception practised on a branch manager was not the same thing as deception of the company, *R* v *Rozeik*, (1996) 1 BCLC 380 CA.

71 [1971] 3 WLR 440; [1971] 3 All ER 16; (1971) 2 QB 711 CA.

72 Noted (1971) 87 LQR 457. Another influence of the organic theory is shown by *Bognor Regis Urban District Council* v *Campion*, [1972] 2 WLR 983; [1972] 2 All ER 61, where it has been held that a corporation not only has a right to sue for libel affecting its property, but also for one affecting its personal reputation.

discouraged by subjecting a director to such onerous potential liabilities. In every case where it is sought to make him liable for his company's torts, it is necessary to examine with care what part he played personally in regard to the act or acts complained of."[73]

In a *New Zealand* case[74] the director of a one-man company gave advice, through the company, to a client for spraying of an insecticide around fruit trees. The advice was so negligent that fruit trees perished alongwith their parasites. The court did not consider the circumstances to be such as to hoist personal liability on the director. He had made it clear that he was trading through the company and the company was the legal contracting party to be charged with liability. As compared with this, in *Fairline Shipping Corpn* v *Adamson*[75] the director became personally liable for loss of perishable goods from the storage provided by his one-man company. The liability hinged on a letter written by the managing director to the plaintiffs on his own note paper rather than that of the company, an act which the court thought displayed an assumption of personal duty of care. In *Williams* v *Natural Life Health Foods Ltd*,[76] a health food shop was established under a franchise agreement. The franchiser company provided income projections estimates from the shop on which the plaintiff company relied in accepting the franchise. These projections proved inaccurate and after 18 months the plaintiff's business closed with substantial losses. The franchiser company came to be wound up. The plaintiffs sued the promoter-director of the company who had provided the estimate. The Court of Appeal held that in this case the director had acted in a capacity outside that of a mere director and had assumed a personal responsibility to the plaintiffs which was additional to that of the company.[77]

Liability for Bouncing of Cheques

The company would be liable to be prosecuted for the bouncing of a cheque if it was issued under the authority of the company. A complaint which alleged that the cheque was issued by a director who was in charge of and responsible for the day to day administration of the affairs of the company, was not liable to be quashed.[78]

APPOINTMENT OF DIRECTORS

The success of a company depends, to a very large extent, upon the competence and integrity of its directors. It is, therefore, necessary that management of companies should be in proper hands.[79] The appointment of

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73 *Per* SLADE LJ in *C. Evans & Sons Ltd* v *Spriteboard Ltd*, (1985) BCLC 105 at 110.

74 *Trevor Ivory* v *Anderson*, (1992) 2 NZ LR 517.

75 [1974] 2 All ER 967: [1975] QB 180.

76 [1997] 1 BCLC 131.

77 See notes by Jennifer Payne, *Personal Liability of Directors*, 1998 JBL and *The Attribution of Tortious Liability between director and company*, 1998 JBL 153.

78 *Unico Trading and Chit Funds (India) (P) Ltd* v *Zahoor Hasan*, (1991) 71 Comp Cas 270 Kant; *Voltas Ltd* v *Hiralal Agarwalla*, (1991) 71 Comp Cas 273 Cal. The prosecution is under S. 138 of the Negotiable Instruments Act, 1881.

79 *See*, the judgment of YOUNG J in *Indian States Bank Ltd* v *Kunwar Sardar Singh*, AIR 1934 All 855.

directors is accordingly strictly regulated by the Act. There are now special provisions for preventing management by undesirable persons.

One evil which has been abolished by the Act is that of a company or a firm acting as a director of another company. Now, according to Section 253, only an individual can be the director of a company. No company or firm or association can be appointed as a director.[80]

First directors [S. 254]

The first directors of a company are to be appointed by the subscribers of the memorandum. They are generally listed in the articles of the company. If they do not appoint any, all the subscribers who are individuals become directors. The very fact of incorporation makes them the first directors of the company. The first directors, howsoever appointed,[81] hold office only up to the date of the first annual general meeting of the company and the subsequent directors must be appointed in accordance with the provisions of Section 255.

Appointment at general meeting [S. 255]

Annual rotation.—"Election of directors is the primary managerial function of stockholders in business corporations, and one that needed careful regulation in their interest."[82] According to Section 255, directors must be appointed by the company in general meetings. In the case of a public company and its subsidiary private company, of the total number of directors, only one-third can be given permanent appointment. The office of the rest of them must be liable to determination by rotation. The articles can provide for all the directors to be rotational. The effect of sub-sections (1) and (2) is that the rotational directors have to be appointed at general meetings except where the Act provides otherwise and other directors of a public and all the directors of a private company which is not subsidiary of a public company have also to be appointed at general meetings subject only to the regulations in the company's articles.

"The provision is designed to eradicate the mischief caused by self-perpetuating managements."[83] At an annual meeting only one-third of such directors shall go out.[84] In the first place those directors will retire who have been longest in office since their last appointment. As between persons who

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80 S. 204 prohibits appointment of firms etc., to any place of profit under the company. *See* the New Zealand case of *Commercial Management Ltd* v *ROC*, [1987] NZLR 744 where it is pointed out that the partners of a firm cannot be collectively appointed as directors. It would be "quite foreign to the concept of the office of directors which calls for individual judgment and responsibility".

81 Such directors have to file with the company their consent to act as a director but they do not have to file their consent with the Registrar. [S. 264].

82 Cadman, THE CORPORATION IN NEW JERSEY, 302, (1949).

83 *Oriental Metal Pressing Works Ltd* v *Bashkar Kashinath Thakoor*, (1961) 31 Comp Cas 143: AIR 1961 SC 573: (1960) 63 Bom LR 505. A company not for profit or which prohibits payment of dividend to members may have in its articles its own provisions on the matter [S. 263-A].

84 S. 256(1). If their number is not three or a multiple of three, then the number nearest to one-third shall retire.

became directors on the same day, retirement is to be determined either by mutual agreement, or, in default, by lot.[85]

It has been held by the Delhi High Court[86] that directors cannot prolong their tenure by not holding a meeting in time. They would automatically retire from office on the expiry of the maximum permissible period within which a meeting ought to have been held. If no *de jure* directors are left in office to call an annual general meeting, the Company Law Board may call a meeting to appoint directors, which will not be an annual meeting, nor conduct the business of such meeting, for the court did not have the power to call an annual meeting. Now both the powers, namely, the power of calling the annual general meeting and that of calling the extraordinary general meeting are vested in the Company Law Board.

Where a director to be rotated out is also holding the office of managing director, the latter office will also go with the former, but expiry of the term of, or removal from managing directorship, does not entail the cessation of his office as a director.[87]

Reappointment (deemed reappointment) **[S. 256]**.—The vacancies thus created should be filled up at the same meeting. But the general meeting may also resolve that the vacancies shall not be filled up. If it has done neither, the meeting shall be deemed to have been adjourned for a week. If at the reassembled meeting also no fresh appointment is made, nor there is a resolution against appointment, the retiring directors shall be deemed to have been reappointed, except in the following cases:[88]

1. Where the appointment of a particular director was put to vote, but the resolution was lost.
2. Where the retiring director has, in writing addressed to the company or its board, expressed his unwillingness to continue.

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85 S. 256(2). This may give rise to serious disputes. *See*, for example, *All India Tea & Trading Co* v *Upendra Narain Sinha*, 42 CWN 774 and *Kailash Chandra Dutt* v *Jogesh Chandra Majumdar*, AIR 1928 Cal 868: 32 CWN 1084, where it was held that "so long as the general meeting is not held in which new directors are to be elected, the directors elected at the previous general meeting would continue to be in office". The Madras High Court in *Ananthalakshmi Ammal* v *IT & I Ltd*, AIR 1953 Mad 467 and the Bombay High Court in *Colaba Land & Mills Co* v *Vasant Investment Corporation*, [1962] 2 Comp LJ 89 have held that the directors retire at a time when the meeting ought to have been held. But cf. *Pasari Flour Mills* v *Kesho Dev*, AIR 1961 MP 340: 1961 Jab LJ 299; *see* also *Karus* v *Lloyd Property Ltd*, 1965 VR 232 (Aust.). The controversy is still going on. A later decision is *Shrimati Jain* v *Delhi Flour Mills Co Ltd*, (1974) 44 Comp Cas 228. The effect of the provisions and of preponderance of authorities is that their office stands vacated on the last day by which the meeting ought to have been held.

86 *B. R. Kundra* v *Motion Pictures Assn*, (1976) 46 Comp Cas 339 Del.

87 *Swapan Das Gupta* v *Navin Chand Suchanti*, (1988) 64 Comp Cas 562: [1988] 3 Comp LJ 76 Cal.

88 *B. R. Kundra* v *Motion Pictures Assn*, (1976) 46 Comp Cas 339 Del. Clause (*b*) of sub-s. (4); *Lalchand Mangraj* v *Shreeram Mills Ltd*, (1968) 38 Comp Cas 606 Bom. Following this case it was held in *Euro India Investments Ltd* v *Cement Corpn of Gujarat Ltd*, (1993) 76 Comp Cas 691 Guj, that a director, whose reappointment was deferred to the adjourned meeting, but no such meeting was held, nor the matter was put to vote and lost, was deemed to have been reappointed. Directors so reappointed have not to file with the Registrar their consent to act as director. [S. 264]

3. Where he is unqualified or has incurred a disqualification.
4. Where a special or ordinary resolution is necessary for his appointment by virtue of any of the provisions of the Act.[89]
5. A motion to appoint two or more persons as directors by a single resolution, if passed without unanimous consent, being void under Section 363(2), it shall not have the effect of reappointing rotated out directors.

***Fresh appointment* [S. 257].**—If it is proposed to appoint a new director in place of a retiring one the procedure prescribed by Section 257 must be followed. A notice in writing for his appointment should be left at the office of the company at least fourteen days before the date of the meeting along with a deposit of Rs 500 which shall be refunded to such person or member, if the candidate gets elected as a director.[90] Notice may be given by the proposed director himself or by anyone intending to propose him. The company is required to inform the members at least seven days before the meeting about the candidature.[91]

Appointment by nomination

Section 255(2) leaves scope for appointments to be made in accordance with the company's articles without being routed through the company's general meeting. An agreement among the shareholders may be imbibed in the articles to the effect that every holder of 10% shares shall have the right to nominate a

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89 It is also necessary that the meeting must be a validly constituted meeting. *Cardamom Marketing Co* v *N. Krishna Iyer*, (1982) 52 Comp Cas 299 Ker.

90 S. 257(1). Relying upon the section and the decision in *Horbury Bridge Coal, Iron & Waggon Co, Re*, (1879) 11 Ch D 109: 40 LT 353, the Nagpur High Court has held in *Berar Trading Co* v *Gajanan Gopal Rao Dixit*, (1972) 42 Comp Cas 48 Bom that the candidature for directorship need not be seconded and if the Chairman rules it out on this ground that would invalidate all subsequent proceedings. *Oriental Benefit & Deposit Society Ltd* v *Bharat Kumar K. Shah*, (2001) 103 Comp Cas 947 Mad, the section does not prescribe any particular time of the last day for filing of nomination.

91 S. 257(1-D). The information may be given to the members either by personal notices or by publication in two local newspapers of which one must be in English and the other in the regional language. Sub-section (1-A). Where only two directors were retiring under annual rotation, but the company received notices from three persons for appointment and the company informed the members that appointing one more director would increase the number of directors, this was a sufficient compliance with the requirements of the Act. The appointment was valid because the increase was within the maximum stated in the articles. *S. Pazhamalai* v *Aruna Sugars Ltd*, (1984) 55 Comp Cas 500 Mad. It is not necessary for proposing a candidate by a special notice that the requirements of S.188 relating to circulation of members' resolution be complied with. *Gopal Vyas* v *Sinclair Hotels & Transportation Ltd*, AIR 1990 Cal 45: [1990] 1 Comp LJ 388: (1990) 68 Comp Cas 518 distinguishing *Pedley* v *Inland Waterways Assn Ltd*, [1977] 1 All ER 209: 1976 JBL 349. The ruling in *Gopal Vyas* case has been followed in *Karnataka Bank Ltd* v *A. B. Datar*, (1994) 79 Comp Cas 417: (1993) 2 Kar LJ 230 and *Prakash Road Lines Ltd* v *Vijay Kumar & Narang*, (1993) 4 Kar LJ 561: (1995) 83 Comp Cas 569 Kant. On receiving a notice the company becomes bound to inform the members. It has no discretion in the matter. *See* the first cited case above.

Namita Gupta v *Cachar Native Joint Stock Co Ltd*, (1999) 98 Comp Cas 655 CLB, non-compliance with the requirements of procedure renders the appointment void. In this case, the members were not informed.

Section 257 does not apply to a private company which is not a subsidiary of a public company. *Sreerama Vilas Press and Publications (P) Ltd, Re*, (1992) 73 Comp Cas 275 Ker; *K. Meenakshi Amma* v *Sree Rama Vilas Press and Publications Ltd*, (1992) 73 Comp Cas 285 Ker.

director on the board.[92] Lending institutions also insist on putting upon the company's board of directors some of their nominees for watching their interest. The phenomenon of nominee directors is now a part of the corporate scenario.

Appointment by voting on individual basis [S. 263]

The appointment of every director is required to be made by voting at the general meeting. The candidates cannot be put to vote en bloc. Rather each candidate has to be voted on individually.[93] Wishes of shareholders in relation to each proposed director should be obtained. If two or more persons are appointed directors by a single resolution, the same is void and non-existent in the eyes of law.[94] But if the meeting has unanimously so resolved, more than one person may be elected by a single resolution.[95] A person who has been appointed as a director for the first time is required to submit within thirty days of his appointment a written consent to act as a director to the Registrar of Companies.[96]

Where the candidates are greater in number than the posts, the first appointment will go to the top scorer and further in the descending order from among those in whose favour the number of votes cast are more than those cast against them.[97]

Appointment by Special Resolution [S. 261] (*deleted* by 1969 amendment)

Appointment by proportional representation [S. 265]

It is apparent from the above provisions that the basic method adopted by the Act for the appointment of directors is election by simple majority. All the directors of a company can, therefore, be appointed by a simple majority of shareholders and a substantial minority cannot succeed in placing even a single director on the board. "Section 265 was, therefore, enacted by the Legislature so that the minority may have an opportunity of placing their representative on the board."[98] This section enables a company to provide in its articles the system of voting by proportional representation for the appointment of directors. This system of voting is devised to make minority votes effective. It is thus explained by BALLETINE in his book on CORPORATIONS:

> "Cumulative voting is the privilege, where several directors are to be voted for at the same time, of casting votes of the whole number of shares

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92 *Bharat Bhushan* v *H. B. Portfolio Leasing Ltd* (1992) 74 Comp Cas 20 Del.

93 S. 263(1). S. 263-A exempts from these provisions a company which does not carry on business for profit or which prohibits the payment of dividend to its members.

94 *Raghunath Swarup Mathur* v *Raghuraj Bahadur (Dr)*, [1966] 2 Comp LJ 100: (1967) 37 Comp Cas 802 All. But that is not a punishable offence.

95 There should first be an agreement to that effect at the meeting without any vote being given against it.

96 S. 264.

97 *B. Sivaraman* v *Egmore Benefit Society Ltd*, (1992) 75 Comp Cas 198 Mad. A company not for profit or which prohibits payment of dividend to members may have different provisions on the matter in its articles [S. 263-A].

98 For a remarkable account of the importance of this system *see* Justice P. N. BHAGWATI'S, *Rights of Minority Shareholders*, published in *Current Problems of Corporate Law Management and Practice* of the Indian Law Institute, New Delhi.

held, multiplied by the number of directors to be elected, for the candidate, for distributing the votes among part of the vacancies to be filled."[1]

"Cumulative voting is a voting procedure which permits a substantial minority of stockholders to elect one or more directors. A group owning one-seventh of the shares can always elect one-seventh of the directors."[2] Under this system each shareholder's vote is more important than under straight voting. It also facilitates the removal of an inefficient management. "Thus in some cases in the United States companies were salvaged by a single director placed on the board by cumulative voting and who brought out correct information."[3]

Casual vacancies [S. 262]

A casual vacancy occurs when the office of a director is vacated before the expiry of his term. Such a vacancy may be filled in accordance with the procedure prescribed by the articles. In the absence of any such clause in the articles, power is given to the directors to fill the vacancy at a board meeting. Any person so appointed holds office until the expiry of the period for which the outgoing director would have held office.

Additional directors [S. 260]

Additional directors can be appointed by the board if there is a power to that effect in the articles, provided that the total number of directors shall not exceed the maximum fixed by the articles. Where the strength of directors fell below the legal minimum, the appointment of an additional director by the remaining directors was held to be valid.[4] Such additional directors shall hold office only up to the date of the next annual general meeting.[5] They are exempted by Section 264 from the requirement of filing consent to act as director.

Appointment by Board

While the general power to appoint directors is vested in the general meeting of shareholders, there are at least two cases when the board can also appoint new directors. Firstly, articles may empower the directors to appoint additional directors subject, of course, to the maximum number fixed therein.[6] And, secondly, the Act itself by Section 262 authorises the directors to fill casual vacancies.

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1 Para 177 (1946 Edn).

2 John G. Sobieski, *In Support of Cumulative Voting*, 1960 JBL 316.

3 Ved Prakash Juneja, *Proportional Representation on Boards of Companies*, [1969] 2 Comp LJ 29.

4 *Shailesh Harilal Shah* v *Matushree Textiles Ltd*, AIR 1994 Bom 20. This power of the directors is not to be affected by the provisions of Ss. 255, 258 or 259. The effect seems to be that the requirement approval of Central Govt. under S. 259 for increasing the number of directors would not be applicable.

5 Where the AGM was stayed or deferred at the orders of the CLB, the nominee director remained in office till the stay was vacated and the meeting actually held, *Ador-Samia Ltd* v *Indocan Engg Systems Ltd*, (2000) 100 Comp Cas 370 CLB.

6 S. 260.

This may occasionally result in a conflict between the general meeting and the directorate. This kind of situation developed in *Viswanathan* v *Tiffins B A & P Ltd.*[7]

> A clause in the articles of a company authorised the directors to fill casual vacancies and also to increase the number of directors within the maximum number fixed in the articles. Some casual vacancies occurred but they were promptly filled at a general meeting of the shareholders. This was challenged on the ground that once the power to appoint was delegated to the board, it could not have been exercised at a general meeting.

After an extensive review of English authorities, VENKATRAMA IYER J upheld the appointment and said: "The principles can be summed up thus: A company has inherent power to take all steps to ensure its proper working and that, of course, includes the power to appoint directors. It can delegate this power to the board and such delegation will be binding upon it, but if there is no legally constituted board which could function or if there is a board that is unable or unwilling to function then the authority delegated to the board lapses and the members can exercise the right inherent in them of appointing directors."

The court found that at the time of the general meeting there was no director validly in office and, therefore, the members had the right to elect.[8]

A similar appointment was upheld by the Privy Council in *Ram Kissendas* v *Satya Charan.*[9] But their Lordships added:

> The articles may, however, be so expressed as to delegate the power of appointing new directors to the board to the exclusion of the general meeting.

It follows, therefore, that the question turns upon the construction of the language used in the articles.

Appointment by Central Government [S. 408]

The Central Government has the power under Section 408 to appoint directors for the purpose of prevention of oppression and mismanagement. This power comes into play when a petition has been made to the National Company Law Tribunal for prevention of oppression and mismanagement.

Appointment by National Company Law Tribunal [S. 402]

The National Company Law Tribunal has the power to appoint directors for prevention of oppression and mismanagement.

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7 AIR 1953 Mad 520: [1953] 1 MLJ 346: (1953) 23 Comp Cas 79.

8 The authorities reviewed by the learned Judge were: *Blair Open Hearth Furnace Co Ltd* v *Reigart*, (1913) 108 LT 665, which was considered to be of doubtful validity; *Worcester Corsetry Ltd* v *Witting*, [1936] Ch 640 CA; *Ram Kissendas* v *Satya Charan*, AIR 1950 PC 81; *Isle of Wight Rly Co* v *Tahourdin*, (1883) 25 Ch D 320: 50 LT 132; *Barron* v *Potter*, [1914] 1 Ch 895: 110 LT 929.

9 AIR 1950 PC 81. *See* also *Ananthalakshmi Ammal* v *IT & I Ltd*, AIR 1953 Mad 467 and *Srinivasan* v *Subramania*, AIR 1932 Mad 100: 136 IC 193, where the power of appointment vested in the shareholders, having been usurped by the directors, the appointments were held to be void.

Right to increase number of directors [Ss. 258-259]

A company may increase the number of its directors by passing an ordinary resolution at a general meeting. But the total number of directors must not exceed the limits fixed by the company's articles. However, an increase shall not have any effect unless approved by the Central Government and shall be void so far as it is disapproved. But in the following cases, the sanction of the Central Government is not necessary:

1. In the case of a company in existence on July 21, 1951, for an increase which was within the permissible maximum under its articles as in force on that date.
2. In the case of other companies an increase which is within the permissible maximum under the articles of a company as first registered.
3. Where the permissible maximum is twelve or less and the proposed increase does not make the total number of directors more than twelve.[10]

An agreement between groups of shareholders not to increase the number of directors and capital of the company and also not to do anything disturbing the existing pattern of management was held to be not binding on the company so as to prevent it from doing any of those things.[11]

Qualifications of directors

Share qualification [S. 270]

The articles of a company may provide that a certain number of shares will have to be held by each director. Such shares are called qualification shares. Within two months of appointment of a director, he must obtain the required number. No person can be compelled to obtain qualification shares before his appointment as director or within a period shorter than two months of his appointment.[12] The value of qualification shares cannot exceed five thousand rupees except when the nominal value of a single share exceeds that amount. Holding of share warrants does not serve the purpose of the Act. Only shares must be held. A director who fails to acquire his qualification shares within the prescribed period suffers in two ways: firstly, his office falls vacant[13] and, secondly, he becomes liable to a penalty if he continues to act as a director.[14]

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10 Not applicable to a private company unless it is a subsidiary of a public company. Increasing the number of directors beyond 12 would require Central Government approval, *Vinod Kumar Mittal* v *Kaveri Lime Industries Ltd*, [2000] 2 Comp LJ 354 CLB. An increase without such approval would be ineffective, *Registrar of Companies* v *Bharat Produce Co Ltd*, (1980) 50 Comp Cas 250.

11 *Rolta India (P) Ltd* v *Venire Industries Ltd*, (2000) 100 Comp Cas 19.

12 S. 270(2). Though the section does not provide as to the time from which the period of two months is to be taken from the time that the director in question should come to know of his appointment as such.

13 *Coal Products* v *R. A. Jalan*, [1968] 1 Comp LJ 311: (1969) 39 Comp Cas 223 Cal. *See* also *Zamir Ahmad* v *D.R. Banaji*, AIR 1958 Bom 198: (1957) 27 Comp Cas 634: 59 Bom LR 591, where it was held that when the office falls vacant by reason of failure to acquire qualification shares, the director's name cannot be placed on the list of contributories.

14 Extending up to 500 rupees per day (S. 272). Section 273 saves private companies which are not subsidiaries of public companies from the operation of Ss. 270 and 272.

The director must hold the shares in his own right.[15] He must not take them as a present from the promoters. If he does so, he will hold such shares in trust for the company.[16] Joint holding and holding by the firm in which he is a partner have been held to be sufficient.[17]

Shareholders may, however, insist on some other qualification. It was observed in *S. V. S. Nidhi* v *Daivasigamani*:[18]

> [T]hat to be a director the holding of shares is not a necessary *sine qua non*. The shareholders may well desire to have other qualifications. The matter is left entirely to the discretion and judgment of the shareholders. Hence a special resolution providing for the holding of a fixed deposit of one thousand rupees as an additional qualification for a director is *intra vires* and legal.

Disqualifications [S. 274]

Section 274 lays down the minimum eligibility requirements. A person is not capable of being appointed a director in the following cases:

(*a*) Where he is of unsound mind, provided that the fact has been certified by a court of competent jurisdiction and the finding is in force;

(*b*) Where he is an undischarged insolvent;[19]

(*c*) Where he has applied to be adjudicated as an insolvent;

(*d*) Where he has been sentenced to at least six months of imprisonment for an offence involving moral turpitude and five years have not elapsed from the date of the expiry of the sentence;[20]

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15 *Boschoek Proprietary Co Ltd* v *Fuke*, [1906] 1 Ch 148: 94 LT 398 and *Sutton* v *English & Colonial Produce Co*, [1902] 2 Ch 502: 87 LT 458.

16 *Canadian Oil Works Corpn, Re*, (1875) 10 Ch App 593: 33 LT 466.

17 *Spencer* v *Kennedy*, [1926] Ch 125: [1925] All ER Rep 135; *Grundy* v *Briggs*, [1910] 1 Ch 444: 101 LT 901.

18 AIR 1951 Mad 520: (1951) 21 Comp Cas 85. See also *Navnitlal Chabildas* v *Scindia Steam Navigation Co Ltd*, AIR 1927 Bom 609: 105 IC 541. The Act, however, does not prescribe any share qualification. See *The People's Bank of Northern India, Re*, AIR 1933 Lah 51. This is, however, subject to the requirements of S. 270 which requires that the amount should not exceed Rs 5000 and those of S. 274 which provides that a public company cannot add any other disqualifications. A qualification in terms of deposit etc., may become necessary where the company is without share capital.

19 *Jayesh Ramniklal Doshi* v *Carbon Corpn Ltd*, (1993) 96 Comp Cas 748 Bom. On appeal to the Supreme Court, *Mukul Harkisondass Dalal* v *Jayesh*, 1994 Mah LJ 259 Bom. The Supreme Court discharged the proceedings itself and the director remained qualified for his post.

20 This may be waived by the Central Government in favour of any person by notification in the Official Gazette [sub-section (2)]. Leave can be granted to a person about whom there was no evidence to show that he was misusing the names or assets of the company. *Lightening Electrical Contractors Ltd, Re*, (1996) 2 BCLC 302 Ch D. The period of *de facto* disqualification during the pendency of the proceedings is a relevant consideration for granting leave to a disqualified person. *Secy of State for Trade and Industry* v *Arif*, (1997) 1 BCLC 34 Ch D. Where such conviction is under appeal and there is a prayer for suspending the sentence for the purposes of this disqualification, the court should consider the possible effect of the director continuing in office upon the interests of the company and its shareholders. *Rama Narang* v *Ramesh Narang*, (1995) 2 SCC 513: (1995) 83 Comp Cas 194: (1995) 16 Corpt LA 247 SC. The meaning of the expression "moral turpitude" was traced by the Kerala High Court in *Joy* v *State of Kerala*, (1991) 72 Comp Cas 57. K. T. THOMAS J said: "The expression "moral delinquency" or "moral turpitude" has not been defined. All offences do not

(*e*) Where he has not paid for six months any call on his shares;[21]

(*f*) Where he has been disqualified under Section 203 of the Act for the purpose of preventing fraudulent persons from managing companies.

(*g*) Where such person is already a director of a public company,---

(A) which has not filed the annual accounts and annual returns for any continuous three financial years. (commencing on and after the first day of April, 1999); or

(B) has failed to repay its deposit or interest on it on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more. (The person so disqualified shall not be eligible for appointment as director of any other public company for five years from the date of the specified types of failure).

Provision for Additional Disqualifications

A private company which is not a subsidiary of a public company may add to the above further disqualifications.[22] It has been held by the Supreme Court[23] that this is an indirect way of saying that a public company and its subsidiary private companies cannot increase the disqualifications or add any other qualification, such as, for example, that the candidate should be a graduate.

The restriction on providing for additional disqualifications has been held to be not applicable to a Stock Exchange Public Company. Such a company can increase the grounds of disqualification for the membership of its governing council.[24]

Number of companies [Ss. 275 and 276]

A person cannot hold office of a director in more than 15 companies at the same time.[25] Facts are the only basis on which a director can properly exercise his judgment in the affairs of the company. No man can have the detailed knowledge of the facts of many enterprises. Where a director already holding office in 15 companies is appointed, the appointment shall not take effect and

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necessarily involve moral turpitude, e.g., violation of traffic rules, or non-compliance with certain statutory requirements such as filing of returns. Though the expression is vague, it is generally taken to mean a conduct contrary to justice, honesty, modesty or good morals. It implies depravity and wickedness of character. In BOUVIER'S LAW DICTIONARY it is described as an act of baseness or depravity in private or social duties which a man owes to his fellowmen or to the society in general, contrary to the accepted and customary rule of right and duty between man and man. The offence must be of such a type as would bring the offender into disrepute among the right thinking members of the society."

21 May also be waived. *Id. Ramesh Narang* v *Rama Narang*, (1995) 2 Bom CR 7 Bom. the power of removing disqualification on conviction can be exercised in respect of a director but not a managing director.

22 S. 274(3).

23 *Cricket Club of India* v *Madhav L. Apte*, (1975) 45 Comp Cas 574 Bom.

24 *Ketan Harkishan Marvadi* v *Saurashtra Kutch Stock Exchange Ltd*, (2002) 109 Comp Cas 269 (Guj).

25 S. 275.

shall become void unless within fifteen days he vacates his office in some companies so as to bring down the number to twenty.[26]

Vacation of office by directors [S. 283]

The office of a director is vacated when he incurs any of the disqualifications mentioned in S. 274 and also on the following additional grounds:

(*a*) he fails to obtain within the time specified in sub-section (1) of Section 270, or at any time thereafter ceases to hold, the share qualification, if any, required of him by the articles of the company;

(*b*) he is found to be of unsound mind by a court of competent jurisdiction;

(*c*) he applies to be adjudicated an insolvent;

(*d*) he is adjudged an insolvent;

(*e*) he is convicted by a court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months;]

(*f*) he fails to pay any call in respect of shares of the company held by him, whether alone or jointly with others, within six months from the last date fixed for the payment of the call [unless the Central Government has, by notification in the Official Gazette, removed the disqualification incurred by such failure;]

(*g*) where he absents himself from three consecutive meetings of the Board or from all meetings of the Board for a period of three months, whichever is longer, without leave of absence from the Board,[27] Three

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26 In computing the number for this purpose the following companies shall be excluded: (1) a private company which is neither a subsidiary nor a holding company of a public company; (2) an unlimited company; (3) an association not carrying on business for profit and which prohibits the payment of dividend to its members; (4) a company in which such a person is only an alternate director and will act only in the absence or incapacity of a director. S. 278. *See also* S. 279 which provides a penalty of Rs 50,000 in respect of each company after the first twenty companies. Section 277 is on similar choice on the commencement of the Companies (Amendment) Act, 2000.

27 See *Devi Talkies (P) Ltd* v *V. R. Partha Sarthi*, (1982) 52 Comp Cas 242 Mad, where the director proved that of the three alleged meetings two were never held and the other was notified late, but even so the court did not reinstate him as he was not re-elected at a subsequent meeting. Though a director may question the fact of a meeting or the fact of notice to him, he is not entitled to an opportunity of being heard before the section is permitted to operate. *Shekhar Mehra* v *Kilpest (P) Ltd*, [1986] 3 Comp LJ 234 MP. The matter is within the jurisdiction of ordinary civil courts and, therefore, the court can examine on evidence whether the requirements for vacation of office have been made out or not, *Radhakrishnan* v *Thirumani Asphalts and Felts (P) Ltd*, (1997) 27 Comp LA 78: (1997) 91 Comp Cas 31 Mad. Notice of meeting given at a time when the director was known to be abroad and, therefore, unable to attend and there was also no proof of despatch, no automatic vacation, *T. M. Paul (Dr)* v *City Hospitals Ltd*, [2000] 2 Comp LJ 84: (1999) 97 Comp Cas 216 Ker DB; *Atmaram Modi* v *ECL Agrotech*, (1999) 34 CLA 14 CLB, meeting not properly convened; *Puneet Goel* v *Khelgaon Resorts Ltd*, (2000) 38 CLA 259, CLB, also no proof of notices. *S. T. Ganapathi Mudaliar* v *S. G. Pandurangan*, (1999) 96 Comp Cas 919 CLB, notice sent at an address where the director was not residing, failure to attend meeting did not constitute a ground for automatic vacation. *Kamal K. Dutta (Dr)* v *Ruby General Hospital Ltd*, (2000) 36 CLA 214, 231 CLB, notice at local address, when the director was abroad, served no purpose.

months start running from the date of the first meeting that the director did not attend.[28]

(*h*) Where he takes a loan from the company in contravention of Section 275;

(*i*) Where he makes a contract with the company in contravention of Section 299, that is, without disclosing his interest in the contract;[29]

(*j*) He becomes disqualified by an order of the court under Section 203, [To restrain fraudulent persons];

(*k*) He is removed in pursuance of Section 284;[30]

(*l*) If he was appointed *ex officio*, he ceases to hold that office in the company.

The provision as to disqualification by non-attendance of meetings was held to be not attracted where four meetings were held within a period of less than three months.[31]

A director is obliged at the pain of penalty to leave office when he incurs any of the above disqualifications.[32]

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28 *Ajit Singh* v *DSS Enterprises P Ltd*, (2002) 109 Comp Cas 597 CLB.

29 The matter of the appointment of a director, his qualification and disqualification, vacation of office, etc., are matters of the jurisdiction of ordinary civil courts. *Avanthi Explosives (P) Ltd* v *Principal Subordinate Judge*, (1987) 62 Comp Cas 301 AP. *Suryakant Gupta* v *Rajaram Corn Products (Punjab) Ltd*, (2002) 108 Comp Cas 133 CLB, in the case of a closely held company the dealings of the company with a firm in which the director was interested was known to all the directors. The failure to formally disclose his interest did not invalidate the resolution.

30 Vacation of office consequent upon removal of a director from office, if disputed, is a matter within the jurisdiction of ordinary civil courts and not that of company courts. See *Vithalrao Narayana Raw Patil* v *Maharashtra State Seeds Corpn Ltd*, (1990) 68 Comp Cas 608 Bom. All matters relating to appointment, disqualification, vacation of office, removal of directors are matters for the jurisdiction of civil courts and not those of company courts. See *Panipat Woollen and General Mills* v *Kaushik*, (1969) 39 Comp Cas 249 P&H, followed in *Prakasam* v *Sree Narayana Dharma Paripalna Yogam*, (1980) 50 Comp Cas 611 Ker; *Avanti Explosives (P) Ltd* v *Coromandal Pharmaceuticals Ltd*, (1997) 89 Comp Cas 270 AP. There is no provision in Companies Act which gives exclusive jurisdiction in all company matters to company courts, *Myalarapu Ramkrishna Rao* v *Mothey Krishna Rao*, (1947) 17 Comp Cas 63 Mad; *Marturi Umamaheshwara Rao* v *Pendayala Venkatarayudu*, (1970) 40 Comp Cas 751: AIR 1970 AP 225; *Marikar Motors* v *Ravikumar*, (1982) 52 Comp Cas 362 Ker; suits for refund of subscription money, *Vatsa Industries Ltd* v *Shankarlal Saraf*, (1996) 87 Comp Cas 918 and relating to forfeiture of shares; *Tej Prakash S. Dangi* v *Coromandal Pharmaceuticals Ltd*, (1997) 89 Comp Cas 270 AP, have been held to be matters of civil court jurisdiction.

31 *Puneet Goel* v *Three ACES Services Ltd*, (2002) 109 Comp Cas 863 CLB. *Ajit Singh* v *DSS Enterprises P Ltd*, (2002) 109 Comp Cas 597 CLB, in the case of a private company leave of absence is normally granted without any written or oral application. Three months start running from the date of the first meeting that the director did not attend.

32 Sub-section (2-A) of S. 283 provides that if a person functions as a director when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified in the several clauses of sub-section (1), he shall be punishable with fine which may extend to five thousand rupees for each day on which he so functions as a director. Where there is no provision in the articles regarding resignation, a director's resignation takes effect from the date of submission. Formality of acceptance by the board is not necessary. He will not be liable for any default happening afterwards, such as failure to file accounts. *T. Murari* v *State*, (1976) 46 Comp Cas 616 Mad. For a study of the liability of such directors *see* L. S. Sealy, DISQUALIFICATION AND PERSONAL LIABILITY OF DIRECTORS, (1987). *K. Venkat Rao* v *Rockwool India Ltd*, (2002) 108 Comp Cas 494 AP, factual matters fall within the jurisdiction of the company court.

Where the vacation of office is due to adjudication as insolvent or conviction for an offence or an order of disqualification, it will not take effect for thirty days. If an appeal is preferred against the order within thirty days, it will not take effect until the expiry of seven days from the disposal of the appeal. If a further appeal is preferred, the order will become effective after the disposal of the appeal. [S. 283(2)].

Automatic Operation

The tenor of the section and the penalty provision which becomes effective from the date of disqualification show that the operation of the section is automatic. The office becomes vacated from the date of disqualification. No formalities, no show-cause notice, no hearing and no decision are necessary. All that is necessary is that there should be proof of the happening of the disqualifying event.[33]

Removal of directors

1. *Removal by shareholders* [S. 284]

Section 284 provides that "a company may, by ordinary resolution, remove a director before the expiration of his period of office". Section 184 of the English Companies Act, after providing the same, adds "notwithstanding anything in its [company's] articles or any agreement between it and him". But despite the absence of these words from the Indian provision, the same effect would follow as any provision in the company's articles or in any agreement between a director and the company by which the director is rendered irremovable by an ordinary resolution would be void, being contrary to the Act. The section is intended to do away with arrangements under which directors were either irremovable or removable only by extraordinary resolutions. "The field over which [the section] operates is thus extensive".[34] But it admits of the following exceptions:

1. It does not apply to the case of a director appointed by the Central Government in pursuance of Section 408. [S. 284(1)].
2. It does not, in the case of a private company, authorise the removal of a director holding office for life on April 1, 1952. [proviso].
3. It does not apply to the case of a company which has adopted the system of electing two-thirds of its directors by the principle of proportional representation. [proviso].[35]

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33 *Bharat Bhushan* v *H. B. Portfolio Leasing Ltd*, (1992) 74 Comp Cas 20 Del. If the company's records show despatch of board meeting notices, it would create a presumption under S. 53(2) of proper service. Under S. 264, directors have to file their consent to act as such with the company. Not applicable to directors reappointed after retirement by rotation and those who apply for candidature under S. 257. Directors have also to file within 30 days of appointment a consent letter with the Registrar. Not applicable to reappointment, alternate and additional directors and those named in the articles as first directors. The vacation of office is a matter for civil court jurisdiction and not company court, *K. Radhakrishnan* v *Thirumani Asphalts & Pelts (P) Ltd*, (1998) 91 Comp Cas 31 (Mad).

34 Any restriction upon the power of removal would be void. See *Tarlok Chand Khanna* v *Raj Kumar Kapoor*, (1983) 54 Comp Cas 12 Delhi.

35 The section also does not apply to nominated directors and those of a Government company. The

A special notice of a resolution to remove a director is required, that is, notice of the intention to move the resolution should be given to the company not less than fourteen days before the meeting.[36] This is to enable the company to inform the members beforchand. As soon as the company receives the notice, it must furnish a copy of it to the director concerned who will have the right to make a representation against the resolution and to be heard at the general meeting. If the director submits a representation and requests the company to circulate it among the members, the company should, if there is time enough to do so, send a copy of the representation to every member of the company to whom notice of the meeting is sent. If this is not possible, the representation may be read out to the members at the meeting.[37]

Where a meeting is requisitioned by the shareholders for the very purpose of removing a director, the Supreme Court laid down that it is not necessary for the requisitionists to state the reasons on which they wish to proceed against the director.[38] Earlier the Bombay High Court[39] had expressed the opinion that a

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matter of appointment and removal is in the realm of contract and therefore cannot be challenged under writ jurisdiction. *Parrel Putado* v *State of Goa*, (1994) 80 Comp Cas 859 Bom.

36 This privilege of members to propose by special notice the appointment or removal of a director cannot be subjected to the requirement of S.188 relating to circulation of members' resolutions. *Gopal Vyas* v *Sinclair Hotels and Transportation Ltd*, AIR 1990 Cal 45: [1990] 1 Comp LJ 388: (1990) 68 Comp Cas 516. Followed in *Karnataka Bank Ltd* v *A. B. Dattar*, (1994) 79 Comp Cas 417: (1993) 2 Kar LJ 230: *Prakash Road Lines Ltd* v *Vijay Kumar Narang*, (1993) 4 Kar LJ 561: (1995) 83 Comp Cas 569 Kant and in *Ernakulam Financiers & Kurries (P) Ltd* v *Joseph Chandy*, (1998) 93 Comp Cas 275 CLB, the company was not entitled to a declaration that the requirements of circulation of a members' resolution should be satisfied. Also to the effect that the requirement of circulation of members' resolution has not to be satisfied is *Karedla Suryanarayana* v *Shri Ramdas Motor Transport Co (P) Ltd*, (1998) 28 Corpt LA 233 CLB: (1999) 98 Comp Cas 518 CLB. Contrary rulings are *Pedley* v *Inland Waterways Assn*, (1977) 1 All ER 209 Ch D; *Amar Nath Malhotra* v *MCS Ltd*, (1993)) 76 Comp Cas 469 Del. A resolution passed without special notice would be invalid irrespective of the fact whether the meeting was valid or not. *Queens Kuries and Loans (P) Ltd* v *Sheena Jose*, (1993) 76 Comp Cas 821 Ker.

37 S. 284(2) to (4). The meeting should be a valid meeting in all its aspects. *M. G. Mohanraj* v *Mylapore Hindu Permanent Fund Ltd*, [1990] 1 Comp Cas 87 Mad: [1990] 1 Comp LJ 73 Mad. A resolution without affording the opportunity of making a representation would be null and void. Where there is no evidence of the posting of a letter to the director sought to be removed, it is a denial of opportunity, *Bhankerpur Simbhaoli Beverages (P) Ltd* v *P. R. Pandya*, (1995) 17 Corpt LA 170 P&H: (1996) 86 Comp Cas 842. The proviso to sub-s (4) provides that the representation need not be circulated nor read at the meeting where, on application to the Central Government, the latter is satisfied that the rights conferred by the section are being abused for giving needless publicity to defamatory matter. The director may be ordered to pay the costs of the application even if he is not a party to it, see for a discussion on the point, *Jarvis* v *Price Waterhouse Coopers*, [2000] 2 BCLC 368 Ch D. The same considerations apply to the representation of an auditor.

38 *LIC* v *Escorts Ltd*, (1986) 1 SCC 264: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC. Section 284 cannot be used for calling a meeting for a declaration that election of directors at a previous meeting was not valid. *B. Sivaraman* v *Egmore Benefit Society Ltd*, (1992) 75 Comp Cas 198 Mad. Where for the removal of two directors of a banking company a letter was written by the company to the Reserve Bank recommending removal on stated grounds, it was held that a copy of the same letter should have been attached with the notice to the directors concerned, without which the notice was not valid, *B. G. Somayaji* v *Karnataka Bank Ltd*, (1995) 83 Comp Cas 649 Kant. The stay order on the ground of incomplete notice was vacated by the Supreme Court on the condition that a letter containing necessary information be circulated before the meeting, *P. Rajan Rao* v *B. G. Somayaji*, (1995) 83 Comp Cas 662 SC.

39 *Escorts Ltd* v *UOI*, (1985) 57 Comp Cas 241: [1984] 3 Comp LJ 387, *overruled* by the

notice of removal which does not mention the grounds would be against the meaning and intent of the Companies Act because it would defeat the director's statutory right of representation in the sense that it would be impossible to write a representation without proper information. This proposition was not accepted by the Supreme Court. CHINNAPPA REDDY J[40] cited an observation of COTTON LJ:[41]

> Then there is a second object, "To remove, (if deemed necessary or expedient) any of the present directors, and to elect directors to fill any vacancy in the board." The learned judge below thought that too indefinite, but in my opinion a notice to remove "any of the present directors" would justify a resolution for removing all who are directors at the present time; "any" would involve "all". I think a notice in that form is quite sufficient for all practical purposes.

The Court also cited a passage from the speech of FRY LJ:

> The second objection was, that a requisition to call a meeting "to remove (if deemed necessary or expedient) any of the present directors" is too vague. I think that it is not. It appears to me that there is a reasonably sufficient particularity in that statement. It is said that each director does not know whether he is attacked or not. The answer is that all the directors know that they are laid open to attack. I think that any other form of requisition would have been embarrassing, because it is obvious that the meeting might think fit to remove a director or allow him to remain, according to his behaviour and demeanour at the meeting with regard to the proposal made at it.

The Court also pointed out that the company cannot go behind the apparent exercise of a shareholder's statutory right of requisitioning a meeting. The company was accordingly not allowed to say that the LIC in requisitioning the meeting had gone beyond its constitutional competence. That aspect is for the State to take care of.[42] The Company Law Board (now Tribunal) restrained the company from putting the resolution before the meeting where it found that the member sending the notice was not honestly motivated. He had made it a practice of sending such notices to all companies wherein he was a member.[43]

The vacancy thus created may be filled at the same meeting, provided special notice of the proposed appointment was also given. The director so appointed would hold office for the period for which the director removed

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Supreme Court, *ibid.*

40 Overruling *Escorts Ltd* v *UOI*, (1985) 57 Comp Cas 241: [1984] 3 Comp LJ 387.

41 (1986) 1 SCC 264 at 340.

42 The court cannot prevent shareholders from exercising their power. It can only examine whether the procedure prescribed by the Act has been followed or not, *Khetan Industries (P) Ltd* v *Manju Ravindra Prasad*, (1995) 16 Corpt LA 169: AIR 1995 Bom 43, nor entertain a suit for removal of a director.

43 *Dabur India Ltd* v *Anil Kumar Poddar*, (2002) 108 Comp Cas 293 CLB. *House Development Finance Corpn* v *Sureshchandra V. Parekh*, (2002) 112 Comp Cas 650 CLB, another case in which the company was restrained from considering the resolution because the member concerned had made it a practice to send such notices year after year.

would have been in office. If the vacancy is not filled at the meeting, it may be filled by the board as a casual vacancy, provided that the director removed should not be reappointed.[44]

The section, however, does not deprive the person removed of any compensation or damages payable to him on the termination of his appointment.[45]

The powers of management are generally vested in the directors and the shareholders do not, ordinarily, have the right to interfere in the matter. But if they are not agreeable with the policy of a particular director, they can use their power of removal and thus have a greater voice in the administration of the company.[46]

The section applies to private companies as well. But they can evade its operation in the manner shown by the decision of the House of Lords in *Bushell* v *Faith*.[47]

> A small private company was composed of three persons, *C*, *K* and *G*, each holding 100 shares of £1 each. *C* and *G* were directors. Clause 9 of the articles of association provided that when it was proposed to remove a director he would, on a poll, have the right to three votes per share. *C* and *K*, being dissatisfied with *G* as a director, proposed to remove him. He demanded a poll, at which he cast 300 votes for his 100 shares and thus defeated the motion.

The trial judge held that the clause which gave a shareholder treble voting power was invalid as it would make a "mockery" of Section 184. The Court of Appeal, as upheld by a majority of the House of Lords, reversed this decision. The majority found that the clause was consistent with the Act. Lord DONOVAN pointed out that Parliament, being fully aware of the phenomenon of articles of association carrying "weighted votes" made no provision against it and left to companies and their shareholders liberty to allocate voting rights as they pleased.

The decision has been criticised. It has been described as one that defeats "the clear intention of the legislature"; that "contravenes the spirit, if not letter, of Section 184"; that "sanctions evasion of the Companies Act".[48] Its merit, however, has not been ignored. "In this particular field it may be highly desirable that 'partners' should be safeguarded in directorships, whether by means of special

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44 Sub-sections (5) and (6).

45 S. 280(7)(*a*). Though if the removal is in accordance with the articles or terms of service, no compensation may be payable. *Read* v *Astoria Garage (Streathan) Ltd*, [1952] Ch 637 CA: [1952] 2 All ER 292.

46 Where the directors do not call a meeting on requisition, the requisitioning shareholders can themselves call it. In their notice of meeting the requirements of S. 273 as to explanatory statement is not applicable. The court did not restrain the meeting and also held that S. 284 is not applicable to the removal of a managing director from his managership as distinguished from his directorship. *S. Varadrajan* v *Venkateswara Solvent Extraction (P) Ltd*. (1994) 80 Comp Cas 693 Mad.

47 [1970] 1 All ER 53: [1970] 2 WLR 272: (1970) 86 LQR 155.

48 Clive M. Schmitthoff, *IIL Sanction Evasion of the Companies Act*, (1970) JBL 1. *See also* D. Prentice, *Removal of Directors from Office*, (1969) 32 Mod LR 693 and *Bushell* v *Faith*, [1970] 1 All ER 53: [1970] 2 WLR 272: (1970) 86 LQR 155; Bernard J. Cartoon, *The Removal of Company Directors*, (1980) JBL 17 where the decision has been supported.

voting rights or by means of shareholders' voting agreements".[49] In a South African case[50] two shareholders of a company contracted between themselves not to vote on a resolution removing the third from his office of director. They were restrained from voting against the terms of their agreement. Now another remedy that would be available to a director of a small private company who has been successfully removed from office is to apply for winding up on the just and equitable ground. In the words of Lord WILBERFORCE:[51]

> The just and equitable provision nevertheless comes to his assistance if he can point to, and prove, some underlying obligation of his fellow members in good faith, or confidence, that so long as the business continues he shall be entitled to management participation, an obligation so basic that, if broken, the conclusion must be that the association must be dissolved.

In a two-member-director company the attempt of the majority shareholder to remove the minority shareholder (49%) from his office as director was frustrated by the latter by not attending the meeting. The court (under the [Indian] Companies Act, CLB) ordered a meeting to be called and held to consider the motion and that the meeting would be valid even if only one member attended. The quorum provision cannot be used so as to veto the power. The decision highlights the importance of the majority's statutory right to remove a director.[52]

The procedure prescribed by this section is not applicable where a relief sought under Section 402 contemplates en bloc removal of all the directors.[53]

2. *Removal by Central Government* [S. 388-B to 388-E]

A director may also be removed at the initiative of the Central Government. A special Chapter of the Companies Act enables the Central Government to remove managerial personnel from office on the recommendation of the National Company Law Tribunal. The Government has the power to make a reference to the Tribunal against any managerial personnel. The power can be exercised where, in the opinion of the Central Government, there are circumstances suggesting:

(*a*) that any managerial personnel is or has been guilty of fraud, misfeasance, persistent negligence or default in carrying out his legal obligations or functions or breach of trust; or

(*b*) that the business of the company has not been conducted in accordance with sound business principles or prudent commercial practices; or

(*c*) that the company has been managed by the person concerned in such manner which has caused or is likely to cause serious injury to the interest of the trade, industry or business to which the company belongs; or

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49 R. C. Beuthin, *A Director firmly in the Saddle*, (1969) SALJ 489; noted, *Removal of Directors*, (1970) 75 CAL WN 5 Journal.

50 *Stewart v Schwab*, (1956) 4 SA 791; noted (1970) 86 LQR 155.

51 *Westbourne Galleries Ltd, Re*, (1973) AC 360, 380; [1972] 2 All ER 492.

52 *Opera Photography Ltd, Re*, 1989 BCLC 763 Ch D.

53 *Shoe Specialities Ltd v Standard Distilleries and Breweries (P) Ltd*, (1997) 90 Comp Cas 1 Mad.

(*d*) that the person concerned has conducted the business with intent to defraud creditors or members or any person or for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

The reference is made by stating a case against the person with a request that the Tribunal may inquire into the case and record its decision whether he is a fit or proper person to hold the office of a director or other managerial office.[54] The person against whom a case is presented is joined as a respondent to the application. The application should contain a concise statement of the circumstances and materials necessary for the purpose of the inquiry. The Tribunal has the power to direct by an interim order that the respondent shall not discharge the duties of his office until further orders.[55] The Tribunal may appoint a suitable person in his place and he shall be deemed to be a public servant.

At the conclusion of the inquiry the Tribunal has to record its decision.[56] If the decision is against the respondent, the Central Government may by order remove him from office.[57] But, before making its order, the Government has to give him a reasonable opportunity to show cause against the same.[58] But he cannot raise any matter which has already been decided by the Tribunal. The person removed is disabled from holding a managerial office for five years, unless the period is remitted.[59] No compensation is payable to him.[60] The company may, with the previous approval of the Central Government, appoint another person to the office.[61]

The nature and scope of the power and its constitutional validity have been examined by the Calcutta High Court in *Alak Prakash Jain* v *Union of India*.[62] Looking at the charges levelled against the director concerned as substantiated by reports from reliable quarters, the court said:

> It seems to us that in the facts of this case, it cannot be said that there was no material to justify the opinion which the Central Government formed. The charges are sufficiently grave and serious, namely, fraud, misappropriation, manipulation of accounts, diversion of the company's funds, illegal declaration of dividends and unlawful payment of travelling expenses. Full particulars with dates and amounts involved have been furnished.

The court further held that the power of the Central Government is not of discriminatory nature, for the word "may" couples power with duty and,

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54 See *S. P. Jain* v *UOI*, [1966] 1 Comp LJ 42 Bom.
55 S. 388-C(1).
56 S. 388-D.
57 S. 388-E.
58 S. 388-E(2).
59 S. 388-E(3).
60 S. 388-E(4).
61 S. 388-E(5).
62 (1973) 43 Comp Cas 68 Cal. Before the amendment of 1988, a reference under the section had to be made to a High Court. Now this jurisdiction is vested in the Company Law Board.

therefore, when the circumstances justify a reference, the Central Government has no choice but to make a reference; that the delegation of the power to the Company Law Board (now Tribunal) is not invalid as the board functions subject to the control of the Central Government[63] and that the resignation by the director either before or after the reference does not make it infructuous. The power is not merely to remove from an existing office but is also to restrain future conduct.

3. *Removal by National Company Law Tribunal* [S. 402]

When, on an application to the Tribunal for prevention of oppression or mismanagement, the Tribunal finds that a relief ought to be granted, it may terminate or set aside any agreement of the company with a director or managing director or other managerial personnel. When the appointment of a director is so terminated he cannot, except with the leave of the Tribunal, serve any company in a managerial capacity for a period of five years.[64] Neither can he sue the company for damages or compensation for loss of office.[65]

Resignation

In a case before the Madras High Court,[66] of the two directors of a company, one died and the other wanted to resign. There was no provision in the company's articles about resignation. Nor is there anything in the Companies Act as to whether, and by what procedure, a director can resign. The Act, however, indirectly recognises resignation by the provisions in Section 318 one of which is that no director is entitled to compensation if he resigns his office. If there is a provision in the articles, resignation will take effect in accordance with such provision and, if there is no provision, resignation will take effect in accordance with its terms. Notice may be written or oral. The court accordingly held that the resignation was effective even when no other director was in office, but added that no resignation can avail a director to evade his obligations by severing his connection with the company.

Once a director has given a notice of resignation of his office, he is not entitled to withdraw that notice, but, if it is withdrawn, it must be by the consent of the company properly exercised by their managers who are the directors of the company.[67]

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63 S. 10-F(6).

64 S. 407(1)(*b*).

65 S. 407(1)(*a*). Sub-section (2) contains penalty provisions. Disputes about appointment, removal, qualifications, etc., are matters within the jurisdiction of ordinary civil courts and not that of company courts. *Prakash Road Lines Ltd* v *Vijay Kumar Narang*, (1993) 4 Kar LJ 561: (1995) 83 Comp Cas 569 Kant.

66 *S. S. Lakshmana Pillai* v *ROC*, (1977) 47 Comp Cas 652 Mad.

67 *Glossop* v *Glossop*, [1907] 2 Ch 370: 97 LT 372. The notice of resignation must be addressed to the company. A letter addressed to a third party has no effect. *Registrar of Companies* v *Orissa Paper Products Ltd*, (1988) 63 Comp Cas 460 Ori. A person appointed to the post of managing director of a Govt. company too has a right to resign though he is appointed by the President to hold office during the pleasure of the President. *Prasanta Chandra Sen* v *UOI*, (1990) 67 Comp Cas 87 Cal.

POWERS OF DIRECTORS

General powers vested in Board [S. 291]

Section 291 declares that "subject to the provisions of the Act, the board of directors of a company shall be entitled to exercise all such powers and to do all such acts and things as the company is authorised to exercise and do".[68] The effect of this section is that subject to the restrictions contained in the Act, and in the memorandum and articles of the company, the powers of directors are co-extensive with those of the company itself. Once elected and in control, the directors have almost total power over the operations of the company, until they are removed. The share market crash highlighted the problem inherent in directors' autonomy over all company affairs. There is no restriction on the appointment of directors. There are, however, two important limitations upon their powers. Firstly, the board is not competent to do what the Act, memorandum and articles require to be done by the shareholders in general meeting and, secondly, in the exercise of their powers the directors are subject to the provisions of the Act, memorandum and articles and other regulations not inconsistent therewith, made by the company in general meeting. "Individual directors have such powers only as are vested in them by the memorandum and articles. It is true that ordinarily the courts do not unsuit a person on account of technicalities. But the question of authority to institute a suit on behalf of a company is not a technical matter. It has far reaching effects. It often affects policy and finances of the company. Thus unless the power to institute a suit is specifically conferred on a particular director, he has no authority to institute a suit on behalf of the company... such power can be conferred by the board of directors only by passing a resolution in that regard."[69]

"The Act thus tries to demarcate the area of proper management control and proper shareholder control."[70] But however precise the demarcation may be, there will always be a scope for clash between the two basic organs of the

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68 A director, therefore, cannot be deprived of his right by the other directors. *Pulbrook* v *Richmond Consolidated Mining Co*, (1878) 9 Ch D 610. The Board of directors have the power to regulate the working hours of the company's employees, *Metalurgical & Engg Consultants (India) Ltd* v *Mecon Executive Assn*, (1998) 28 Corpt LA 381 MP.

69 *Al-Amin Seatrans (P) Ltd* v *Owners and Party interested in Vessel M V Loyal Bird*, (1995) 17 Corpt LA 204 Cal, per BABOO LAL JAIN J who unsuited the managing director in his attempt to get possession of a ship because he had no authority of the board of directors to sue. Where the directors by their resolution authorised a particular director and he delegated the power to an officer of the company, an appeal filed by that officer was held to be competent because it was not necessary that for every piece of work a board resolution should be passed. *Hindustan Petroleum Corpn Ltd* v *Sardar Chand*, (1991) 71 Comp Cas 257 P&H. The courts do not interfere in decisions of corporate bodies made through responsible organs, *U. P. Financial Corpn* v *Naini Oxygen & Acetylene Gas Ltd*, (1995) 2 SCC 754: (1995) 17 Corpt LA 219, the court did not interfere in the decision of a corporation to enforce recovery by disposing of the unit of the borrower and did not accept the argument that more loans should have been provided to keep the unit afloat. *BOC India Ltd* v *Zinc Products & Co (P) Ltd*, (1996) 86 Comp Cas 358 Pat, winding up petition on behalf of company filed by person not authorised, incompetent.

70 *See*, Henry G. Manne, *The Higher Criticism of the Modern Corporation*, (1962) 62 Col LR 399, 408.

company, namely, shareholders and directors, as to their respective powers. A prototype of the clash which they are likely to pick up is *Automatic Self-Cleansing Filter Syndicate Co Ltd* v *Cuninghame*.[71]

> A company had power under its memorandum of association to sell its undertaking to another company having similar objects. By its articles the general management and control of the company were vested in the directors subject to such regulations as might from time to time be made by extraordinary resolution. Particularly important was the provision in the articles by which directors were empowered to sell or otherwise deal with the property of the company on such terms as they thought fit. The shareholders passed a simple resolution for the sale of the company's assets on certain terms and required the directors to carry the sale into effect.

On the director's refusal to do so it was contended by the shareholders that it was a mere question of principal and agent. The shareholders are the principal, and directors, the agents, and it would be an absurd thing if an agent should act like a dictator and manage the principal. But it was held that "directors are agents not of a majority of the shareholders, but of the company, of the whole entity made up of all the shareholders. And if the whole entity of shareholders has entrusted the directors with a particular power a simple majority could not interfere in exercise of it."

In a subsequent case, FARWELL LJ observed:[72] "Even a resolution of a numerical majority at a general meeting cannot impose its will upon the directors when the articles have confided to them the control of the company's affairs." In another leading case[73] GREER LJ explained the principle in the following words:

> A company is an entity distinct alike from its shareholders and directors. Some of its powers may, according to articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose action they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of the shareholders.

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71 [1906] 2 Ch 34: 94 LT 651. Followed in India in *M. P. & V. Works* v *M. Murarka*, AIR 1961 Cal 251: (1961) 31 Comp Cas 301, which refers to a large number of decided cases on the point: *A. P. Pothen* v *Hindustan Trading Corpn*, AIR 1968 Ker 149: (1967) 37 Comp Cas 266: *Suburban Bank (P) Ltd* v *Thariath*, AIR 1968 Ker 206: (1968) 38 Comp Cas 13: [1967] 2 Comp LJ 182 Ker, where the members were not allowed to interfere in the directors' discretion.

72 *Gramophone & Typewriter Ltd* v *Stanley*, [1908] 2 KB 89: 99 LT 39. *See* also *Salmon* v *Quin & Axtens Ltd*, [1909] 1 Ch 311: 100 LT 161.

73 *John Shaw & Sons (Salford) Ltd* v *Peter Shaw & John Shaw*, [1935] 2 KB 113: [1935] All ER Rep 456 CA.

This principle was followed in *Scott* v *Scott*[74] and applied to the case even of a private company. The court observed:

> Under the articles of this private company the management of the business and the declaration of the interim dividends were both assigned to the directors. That being so, they were not subject to any control in that respect by the shareholders in general meeting. It is true that if the company in general meeting disapproved of the management or the declaration of an interim dividend, they could remove the directors, but the general meeting could not, as the articles stood, directly interfere by resolution with the management or the declaration of an interim dividend. The division of authority is important even in the case of what may be called family companies and having regard to the liability of directors as occupying a fiduciary position, it is necessary that it should be strictly observed.

Thus the relationship of the board of directors "with the general meeting is more of federation than one of subordinate and superior".[75]

These principles have been generally followed by the courts in India. For example, in a case before the Kerala High Court,[76] by the articles of a banking company, the power of management was vested in the directors. The shareholders by a resolution pressed the directors to forego a debt. The court held that the directors were entitled to enforce the payment of the debt.[77]

Shareholders' intervention in exceptional cases

"But the fact should not be overlooked that the company is an institution owned and controlled by its shareholders. According to the legal theory the shareholder is the ultimate and final authority within the corporate enterprise."[78] The inherent, residuary and ultimate powers of a company lie with the general meeting of shareholders.[79] Thus the shareholders can interfere in management

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74 [1943] 1 All ER 582. For an Indian authority see *Srinivasan* v *Subramania*, AIR 1932 Mad 100: 136 IC 193, where the directors were not allowed to exercise a power expressly vested in the shareholders. Followed in *Pothen* v *Hindustan Trading Corpn.* [1966] 2 Comp LJ 252: AIR 1968 Ker 149: (1967) 37 Comp Cas 266. *See* also *Murarka Paint and Varnish Works* v *M. Murarka*, (1960) 65 CWN 32: AIR 1961 Cal 251: (1961) 31 Comp Cas 301, which refers to a large number of decided cases on the point.

75 R. C. Beuthin, *The Range of a Company's Interests*, (1969) 86 SALJ 155, 156.

76 *Suburban Bank Ltd* v *Thariath*, AIR 1968 Ker 206: (1968) 38 Comp Cas 13: [1967] 2 Comp LJ 182 Ker.

77 The directors of a company cannot be restrained from exercising their managerial powers in general, though they can be restrained in reference to some particular act. *Rajapalayam Industrial and Commercial Syndicate Ltd* v *K. A. Vairaprakasam*, [1989] 2 Comp LJ 236: AIR 1989 Mad 13. Unauthorised legal proceedings cannot be ratified. *Breckland Group Holdings Ltd* v *London and Suffolk Properties Ltd*, 1989 BCLC 100 Ch D. A solicitor was not permitted to recover his fee for conducting such proceedings. *Fletcheritunt (Bristol) Ltd, Re*, 1989 BCLC 108 Ch D. The courts may have to face practical difficulties in attempting to review the merits of the board's decision. "The courts have not been slow to acknowledge that their skill is not that of the businessman, and that the so-called business judgment doctrine acknowledges that it is both unfair to review, with the benefit of hindsight, the board's decision, and that the court is ill-placed to judge entrepreneurship." Ross Grantham, *The Content of the Director's Loyalty*, (1993) JBL 149.

78 J. A. C. Hetherington, *Corporate Responsibility*, (1969) Stan LR 248, 251.

79 *See*, M. A. Pickering, *Shareholders' Voting Rights & Company Control*, (1965) 81 LQR 248.

by replacing the existing management with a new one which would be more responsive to their and the company's interests. This aspect of the relationship between the directorate and shareholders has been highlighted in the decision of the Supreme Court in *LIC* v *Escorts Ltd.*[80] CHINNAPPA REDDY J cited a passage from the speech of COTTON LJ.[81]

> It is a very strong thing indeed to prevent shareholders from holding a meeting of the company, when such a meeting is the only way in which they can interfere if the majority of them think that the course taken by the director, in a matter *intra vires* of the directors, is not for the benefit of the company.

In the case before the Supreme Court, public financial institutions, including LIC were holding a majority of shares in the company. They requisitioned a meeting to remove nine directors. No reasons were stated. But the background was that the directors had refused to register certain transfers and had engaged the company in a calamitous litigation against the Government and also in a litigation to stay the requisitioned meeting and all this without consulting the principal block of majority shareholders who had so much at stake in the company. The Bombay High Court granted the stay.[82] The Supreme Court vacated it. The shareholders had a right to meet and decide whether the destinies of the company were safe in the hands of the present management. The company had no right to say that the public financial institutions were going beyond their powers in trying to interfere in management, they being constitutionally only investing institutions. They have a right to be vigilant in safeguarding their investment and putting it in the hands of a management which can assure safety and security. In this respect they exercise their elementary right as shareholders. They do not thereby directly undertake to manage the company.

In the following exceptional situations the general meeting is competent to act even in a matter delegated to the board.

1. *Mala fide*

In the words of FAZL ALI J of the Supreme Court:[83] "[O]rdinarily the directors of a company are the only persons who can conduct litigation in the name of the company, but when they are themselves the wrong-doers, and have acted *mala fide*... and their personal interest is in conflict with their duty in such a way that they cannot or will not take steps to seek redress for the wrong done to the company, the majority of the shareholders [may take steps to redress the wrong]." "The duty of supervision on the part of this court will thus be confined to the honesty, integrity and fairness with which the deliberation has been

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80 (1986) 1 SCC 264 at 340-341: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC.

81 *Isle of Wight Rly Co* v *Tahourdin*, (1883) 25 Ch D 320: 50 LT 132.

82 *Escorts Ltd* v *UOI*, (1985) 57 Comp Cas 241: [1984] 3 Comp LJ 387. The court also relied upon *Inderwick* v *Snell*, 42 ER 83 and *Bentley Stevens* v *Jones*, [1974] 2 All ER 653 also involving removal of directors.

83 *Satya Charan* v *Rameshwar Prasad Bajoria*, AIR 1950 FC 133: 20 Comp Cas 39: 1949 FCR 673: 1950 SCR 394.

conducted, and will not be extended to the accuracy of the conclusion arrived at."[84] *Marshall's Valve Gear Co Ltd* v *Manning Wardley & Co Ltd*[85] is a case of this kind.

> *A* and three other persons were the four directors of *M Co* and they held substantially the whole of the subscribed capital of the company. *A* was the majority shareholder, but held less than three-fourth. Another company, known as *N Co*, was committing an infringement of *M Co's* trade mark and the other three directors were interested in that company. With the result that at a meeting of the board they declined to sanction any proceeding against *N Co*. *A*, at a general meeting of the shareholders, resolved and commenced an action to restrain the alleged infringement. The other directors applied for striking down the name of the company on the ground that as the articles had left the powers of management with the board, the shareholders could not interfere by a simple resolution.

It was held that the majority of the shareholders had the right to control the action of the directors in the matter. NEVILLE J explained the reason thus:

> Now it is obvious that in the position in which they (directors) have placed themselves on this question their duty and their interest are in direct conflict. On the one hand, it is their duty as directors to protect the interest of the original patent which is the property of the company; on the other hand, their personal interests are clearly to maintain the validity of the patent which belongs to them. And, therefore, the majority shareholders are entitled to decide whether or not an action in the name of the company shall proceed.

2. *Board incompetent*

Secondly, majority of the shareholders may exercise a power vested in the board when the directors have, for some valid reason, become incompetent to act. One situation would be when all the directors are interested in a transaction of the company. Another illustration is *Viswanathan* v *Tiffins B. A. & P. Ltd*,[86] where the power to fill casual vacancies was delegated to the board, but the appointments made by shareholders in general meeting were held to be valid as at the material time no director was validly in office. Where the circumstances were such that a valid board could not be constituted, it was held that the majority shareholders could act to protect the interests of the company and they could conduct the company's defence in a suit pending against it.[87]

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84 *Beloved Wilke's Charity, Re*, (1851) 3 Mac & G 440.

85 [1909] 1 Ch 267: 100 LT 65.

86 AIR 1963 Mad 520: [1953] 1 MLJ 346: (1953) 23 Comp Cas 79, the full facts and judgment of the case have been discussed above in connection with appointment of directors. Where the board of directors is validly constituted and whether its meeting should be stayed is a matter for the ordinary civil court and not a company court. *Maharaja Exports* v *Apparels Exports Promotion Council*, (1986) 60 Comp Cas 353.

87 *Glucoseries (P) Ltd* v *Deb Kanta Roy*, (2000) 38 CLA 39 Cal.

3. *Deadlock*

A third occasion for shareholders to intervene would be when the directors are unwilling to act, or, on account of a deadlock, unable to act. The leading case in line is *Barron* v *Potter*.[88]

> There were only two directors on the board of a company and the one refused to act with the other. There was no provision in the articles enabling the general meeting of the shareholders to increase or reduce the number of directors.

It was held that as there was a deadlock in the administration resulting from the fact that the directors were unwilling to act and exercise their powers, the company had the inherent power to take necessary steps to ensure the working of the company and to appoint additional directors for the purpose.

4. *Residuary powers*

The residuary powers of a company reside in the general meeting of shareholders.[89] Thus it has been held that "where a power to allot shares is conferred by the articles of a company on its directors and they act in excess of that power a residuary inherent power remains in the company to validate the allotment by an ordinary resolution in general meeting".[90]

STATUTORY PROVISIONS: RESTRICTIONS ON POWERS

Powers exercisable by resolution at board meetings [S. 292]

The Act also makes a careful effort to lay down the manner in which certain powers of the company are to be exercised. Section 292 provides that following powers of the company can be exercised only by means of resolutions passed at meetings of the board: The power (1) to make calls; (2) to authorise buy-back referred to in the first proviso to clause (*b*) of Section 77-A(2); (3) to issue debentures; (4) to borrow money; (5) to invest the funds of the company; and (6) to make loans.

The board may by a resolution delegate the power to borrow money to any committee of directors or other principal officers of the company.[91] The resolution should specify the amount up to which moneys may be borrowed by the delegate.[92] Similarly, the power to make investments may be delegated. The resolution should once again specify the extent and nature of investment.[93] In the same way the power to make loans is delegable, but the resolution should specify the total amount up to which loans may be made, the purposes of the loans and the maximum that can be made for a particular purpose.[94] The

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88 [1914] 1 Ch 895: 110 LT 929. See also *Foster* v *Foster*, [1916] 1 Ch 532; [1916-17] All ER Rep 856.

89 G. D. Goldberg, *Article 80 of Table A of the [English] Companies Act*, 33 Mod LR 177.

90 *Bamford* v *Bamford*, [1968] 3 WLR 317: [1968] 2 All ER 655. Judgment of PLOWMAN J affirmed on appeal on different grounds, [1969] 2 WLR 1107: [1969] 1 All ER 969.

91 S. 292 (proviso).

92 S. 292 (2).

93 S. 292 (3).

94 S. 292 (4).

shareholders in general meeting may place any restrictions on, or otherwise regulate, the exercise of the above powers.[95] Delegation must be by a specific resolution of the board. In a case where a hire purchase agreement was entered into by directors without authorisation, the agreement was held to be not enforceable against the company. Entries in the company's ledger were not sufficient by themselves to fasten liability on the company.[96]

Powers exercisable with general meeting approval [S. 293]

Further, Section 293 imposes important restrictions on the powers of the board of directors of a public company or any subsidiary of a public company. Following powers can be exercised by the board only with the consent of the company in general meeting:

1. sale or lease of the company's undertaking;[97]
2. extension of the time for payment of a debt due by a director;
3. investment of compensation received on compulsory acquisition in securities other than trust securities;
4. borrowing of money beyond the paid-up capital of the company. This, however, does not include temporary loans obtained from the company's bankers in the ordinary course of business;[98]
5. contributions to any charitable or other funds beyond fifty thousand rupees in one financial year or five per cent of the average net profits during the preceding three financial years, whichever is greater.

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95 S. 292(5).

96 *Ambala Bus Syndicate (P) Ltd* v *Roop Nagar Credit & Instrument Co (P) Ltd*, (1997) 88 Comp Cas 821 (P&H).

97 The sale of one out of the three vessels of the company which was not in use was held to be not a sale of the company's undertaking so as to require shareholders' resolution. The sale was also found to be necessary for raising funds for the company's business. Shareholders were not allowed to question it. *P. S. Offshore Inter Land Services P Ltd* v *Bombay Offshore Suppliers Ltd*, (1992) 75 Comp Cas 589 Bom. A closed or out of function unit of a company may be an undertaking. *Pramod Kumar Mittal* v *Andhra Steel Corpn Ltd*, (1985) 58 Comp Cas 772 Cal; *R C Cooper* v *UOI*, (1970) 1 SCC 248: (1970) 3 SCR 530: (1970) 40 Comp Cas 325, "In reality the undertaking is a complete and complex weft and the various types of business and assets are threads which cannot be taken apart from the weft"; *Yallamma Cotton, Woollen and Silk Mills Co, Re*, (1970) 40 Comp Cas 466; *International Cotton Corporation (P) Ltd* v *Bank of Maharashtra*, (1970) 40 Comp Cas 1154. Undertaking means a substantial part of assets. Leasing of the use of premises (slaughter house) during periods of non-use by the company, not a lease of undertaking, *Allana Cold Storage Ltd* v *Goa Meat Complex Ltd*, (1997) 10 Comp Cas 50 Bom: [1997] 4 Comp LJ 225 : (1998) 29 Corpt LA 45. The court said that an agreement of sale etc. would mean a complete and exclusive transfer whereby the transferee gets the right to hold, possess and control the assets. *Mohta Alloys & Steel Works* v *Mohta Finance and Lease Co Ltd*, (1997) 89 Comp Cas 227, no formality was considered necessary to execute a lease on behalf of the company where authority was given by the board under its powers conferred by the articles. *Shoe Specialities Ltd* v *Tracstar Investment Ltd*, (1997) 88 Comp Cas 471 Mad, investment of the company's money in shares was not regarded as a sale of undertaking or even a substantial part of it. *Cochin Malabar Estates & Industries Ltd* v *P. V. Abdul Khader*, (2003) 114 Comp Cas 777 Ker, a single shareholder holding 0.02% shares was not allowed to question the wisdom of disposing of the company's assets under a directors' resolution as confirmed by the company in general meeting.

98 *See*, Explanation II. Any resolution passed by the company in general meeting allowing borrowing beyond this limit or making contributions beyond the specified limit should specify the total amount. *(Explanation I)*.

If the directors have in breach of the above restrictions sold or leased the undertaking of the company, the title of the purchaser or lessee will not be affected, provided he acted in good faith and with due care and caution. Thus the purchaser must see that the transaction is executed in accordance with the company's articles, because otherwise it would be ineffective to pass any title to him.[1] This restriction does not apply to the case of a company whose ordinary business is to sell or lease property. Where[2] borrowing has been effected exceeding the amount of the paid-up share capital, the lender may not be able to enforce the loan against the company, unless he can prove that he advanced the loan in good faith and without knowledge that the limit had been exceeded.[3]

The consent of the general meeting may be expressed by means of a formal resolution or informally through conduct as it happened, for example, in *Joint Receivers and Managers of Niltan Carson Ltd* v *Hawthorne*.[4] The hotel premises of the company were handed over to a director of the company under a lease granted by the managing director without the approval of the shareholders. The lessee director had acted with complete honesty and openness and with the agreement of practically all the shareholders who desired that she should run the community home independently of the company. The transaction was held to be not voidable without showing that there was no proper consideration.

Audit Committee [S. 292-A]

A public company with share capital of not less than five crores of rupees is required to constitute a committee of the Board of directors to be known as the Audit Committee. Its membership is not to be of less than three directors and such number of other directors as the Board may determine. Two-thirds of them must be directors other than the managing or wholetime directors. The committee has to act in accordance with the terms of reference to be specified by the Board in writing. The members of the committee have to elect a chairman from amongst themselves.

The auditors, the internal auditors, if any, and the director-in-charge of finance shall attend and participate in meetings of the Audit Committee but shall not have the right to vote. The committee should have discussions with auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review half-yearly and annual financial statements before they are submitted to the Board and also ensure compliance of the internal control systems.

The Audit Committee would enjoy authority to investigate into any matter relating to the terms specified in the section or referred to it by the Board. The committee shall have for this purpose full access to information contained in the records of the company. It may also take external professional advice, if necessary. The recommendations of the committee on any matter relating to financial management, including the audit report shall be binding on the Board.

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1 For a suitable illustration see *U. Ba Din* v *Janki Devi*, AIR 1938 Rang 447.
2 S. 293(2)(*b*).
3 S. 293(5). *See also* sub-section (4).
4 1988 BCLC 298 QBD. *See* also *Brady* v *Brady*, [1988] 2 All ER 617 HL.

If the Board does not accept the recommendations of the committee, it shall record its reasons for the same and communicate them to the shareholders.

The chairman of the committee has to attend the annual general meetings of the company to provide any clarifications on matters relating to audit.[5]

Board's sanction when directors interested [S. 297]

Section 297 further restricts the powers of individual directors. Whenever a company has to deal for the sale, purchase or supply of any material or services or for underwriting any shares or debentures with any director or his relative, or with a firm in which such a director or relative is a partner or any other partner in such a firm or with a private company of which such a director is a member or a director, the consent of the board of directors must be obtained.[6] Such an approval of the board is, however, not necessary in the following cases:

1. Where the contract is for cash at the prevailing market prices.
2. Where the contract relates to goods in which the company or the other party trades or does business, but not exceeding the value of five thousand rupees in any year.
3. The transactions of a banking or insurance company.

Such contracts may, however, be made in any emergency and beyond the value of five thousand rupees, provided approval of the board is obtained within three months. If the approval is not obtained or is refused, the contract will be voidable at the option of the board.[7]

The amendment of 1974 has extended this restriction to contracts for underwriting the subscription of any shares or debentures of the company.[8] The amendment further provides that in the case of a company having paid-up share capital of rupees one crore or more, contracts of the above kind should not be entered into except with the previous approval of the Central Government.

Power to make political contributions [S. 293-A]

Before the Companies (Amendment) Act, 1985 (35 of 1985) companies were not permitted to make contributions for political purposes. Now this ban has been lifted, except in the case of Government companies and companies which have been in existence for less than three years. Rest of the companies have been permitted to contribute money to any political party or to any person for political purposes. The amount should not exceed 5 per cent of the

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5 Sub-s. (11) provides that if a default is made in complying with the provisions of the section, every officer who is in default shall be punishable with imprisonment for a term which may extend to one year, or with fine extending to Rs 50,000 or both.

6 A contract of this kind was not permitted to be avoided after the expiry of its term. The contract also otherwise complied with the provisions. The court pointed out that the mere presence of a director at the meeting where the matter of his interest was being considered would not amount to fraud or undue influence. *Mehta Teja Singh & Co* v *Globe Motors Ltd*, (1983) 54 Comp Cas 883 Delhi.

7 S. 297(3), (4), (5) and (6). *Dintex Dyechem Ltd Re*, (2001) 104 Comp Cas 735 CLB, failure to take approval of the Central Government for purchase/sale of goods of negligible amount through partnership firms in which some of the directors were interested, the offence against the company and directors was compounded on payment of compounding fee of Rs 75,000.

8 S. 297(1)(*b*).

company's net profits during the three immediately preceding financial years. Contribution should be sanctioned by a resolution of the company's board of directors and that will be sufficient authorisation for all-round validity. Donation given to enable a party to win public support would also be a contribution so also those for publication of a souvenir, brochure, tract, pamphlet or the like.[9] The amount contributed must appear in annual accounts. Defaulting company will be punishable with three times the amount and defaulting officers with fine and imprisonment extending up to three years.

DUTIES OF DIRECTORS

Corporate executives are today possessed of "immense power which must be regulated not only for the public good, but also for the protection of those whose investments are involved."[10] Directorships will always be susceptible to abuse. "Some directors will always be faithless to their trust. They can capitalise their strategic position in the company to serve their own interest."[11] The law, therefore, continues to struggle against their wiles and imposes upon them certain duties which, when properly enforced, will, without driving away from the field competent men, materially reduce the chances of abuse.[12]

Fiduciary obligation

Liability for breach of trust.—Traditionally the duties of directors were non-statutory. They were fashioned out essentially from the common law as developed through the cases. But now company legislation of some countries has made a departure from this tradition. The Nigerian Act contains the following provision on the point:[13]

> "A director of a company stands in a fiduciary relationship towards the company and shall observe the utmost good faith towards the company in any transaction with it or on its behalf."

The first and the most obvious obligation of persons in fiduciary position is to act with honesty. "Greatest good faith is expected in the discharge of their duties."[14] Good faith requires that all their endeavours must be directed to the benefit of the company. Thus where a director of a company, being also the

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9 This restriction is not violated where contribution has been made as the cost of advertisement appearing in a party's souvenir. *Graphite India Ltd* v *Dalpat Rai Mehta*, (1978) 48 Comp Cas 683 Cal. But if the consideration is unreal or illusory or a mere pretence for a contribution, different result should follow. J Parkinson, *Political Donations and Companies*, 5 BLR 200. Section 293-B empowers directors and other persons to make contributions to National Defence Fund etc.

10 William C. Douglas, *Directors who do not Direct*, (1934) 47 Harv LR 1305, 1307.

11 *Id.*, 1317.

12 For a systematic account of the duties of directors *see* D. N. Hossie, *The Civil Liability of the Directors of a Corporation*, (1952) 30 Can BR 908, and for a broader view of directors' fiduciary, common law and statutory duties in general as well as their enforcement, covering duties to shareholders and creditors as well as to the company, *see* Robert R. Pennington, DIRECTORS' PERSONAL LIABILITY (1987).

13 The Companies and Allied Matters Act, 1990, S. 279.

14 *See*, PATEL in *Bank of Poona* v *Narayandas*, AIR 1961 Bom 252 at 253: (1961) 31 Comp Cas 364. *See* also *Turner Morrison & Co* v *Shalimar Tar Products*, (1980) 50 Comp Cas 296 Cal, general statement of duty of good faith.

member of another company, earned bonuses from the other company by providing some business facility of his company, he was held liable to account for such profits, although the company had itself lost nothing and also could not have earned the bonus.[15] Where a director was aware of the fact that the company's property was being sold for £350,000 when its real value stood at £650,000, this was a breach of the fiduciary duty and since the recipient of the property was aware of this fact, he became a constructive trustee towards the company for his undeserved gain.[16]

Directors' personal profits.—In *Hirsche* v *Simons*,[17] on the eve of issuing a prospectus for additional capital, the assets of the company were revalued by a leading firm of surveyors and revised values were quoted. This brought about an increase in the market price of the company's shares. The directors sold some of their existing shares and obtained the benefit of the market situation. They were held by the House of Lords to be not accountable for this profit. Directors exercising their powers in a normal way are not accountable if the sensitive market is incidentally influenced creating opportunities of beneficial disposal of existing shares. In *Albion Steel and Wire Co* v *Martin*,[18] a director sold certain goods to his company out of his personal stock but at the market price of the day, but even so he did make a profit because he had obtained the stock earlier at lower rates. He was required by the court to account for his profit.

Business opportunities.—Similarly, a director should not exploit to his own use the corporate opportunities. "The doctrine of corporate opportunity has been described as an act of a director or controlling shareholder in diverting from the benefit of the corporation any enterprise or transaction in which reasonable persons would agree that the corporation had some expectancy or interest."[19] In *Cook* v *Deeks*[20], for example, the directors of a company diverted a contract opportunity of the company to themselves and by their votes as holders of three-fourths majority resolved that the company had no interest in the contract. It was

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15 *Boston Deep Sea Fishing & Ice Co* v *Ansell*, (1888) 39 Ch D 339: [1886-90] All ER Rep 65. A good account of such cases is to be seen in D. W. Fox, *Constructive Trusts in a Company Setting*, 1986 JBL 23.

16 *Aviling Barford Ltd* v *Perion Ltd*, 1989 BCLC 626 Ch D; *International Sales and Agencies Ltd* v *Marcus*, [1982] 3 All ER 551, liability for giving away the company's property to an outsider without consideration and without shareholders' consent. This is on the basis of the principle that a person who receives money or property from the hands of a person knowing that the disposal was in breach of trust, would become a constructive trustee. The court applied the principle of the case in *Belmont Finance Corpn* v *Williams Furniture Ltd*, (1980) 1 All ER 393 CA. Before a person can be held liable as a constructive trustee it has to be shown that he is guilty of something amounting to dishonesty or want of probity. *Eagle Trust Plc* v *SBC Securities Ltd*, 1991 BCLC 438 Ch D; *Agip (Africa) Ltd* v *Jackson*, 1990 Ch 265: (1989) 3 WLR 1367. Another case in which the recipient became liable because he had knowledge that he was receiving the shareholders' money is *Houghton* v *Fayers*, [2000] 1 BCLC 511 CA. *Saurashtra Cement & Chemical Industries Ltd* v *Esma Industries P Ltd*, (2001) 103 Comp Cas 1041 (Guj), the main object of the proposal to purchase shares in another company was to fulfil the personal obligation of directors, the proposal was restrained.

17 1894 AC 654.

18 (1875) 1 Ch D 580.

19 Jan Houwink, *The American Close Corporation and its Dutch Equivalent*, (1958) BL 250.

20 [1916] 1 AC 554: [1916-17] All ER Rep 285.

held that the benefits of the contract belonged in equity to the company and the directors could not validly use their voting power to vest it in themselves. Their Lordships observed:

> It is quite right to point out the importance of avoiding the establishment of rules as to directors' duties which would impose upon them burdens so heavy and responsibilities so great that men of good position would hesitate to accept the office. But, on the other hand, men who assume complete control of a company's business must remember that they are not at liberty to sacrifice the interests, which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent.[21]

On the same principle, where a director is instructed to purchase some property for the company, and he purchases the same for himself and then sells it to the company at a profit, he is clearly liable to account for the profit so made. As he was under an obligation to acquire the property for the company, the same belonged in equity to the company from the moment he purchased it and he could not have made a profit on its resale. Supposing now that he is not under any such direction to purchase for the company, but purchases some property on his own account which is subsequently sold to the company at a profit. Is the company entitled to this profit also? This was precisely the question in *Burland v Earle*,[22] which the Judicial Committee answered in the negative. "It is one thing if a director sells a property to the company which in equity as well as at law is his own. It would be quite another thing if the director had originally acquired the property which he sold to the company under circumstances which made it in equity the property of the company."

> One Burland was a director of the plaintiff company. He was also a shareholder and creditor of another company known as Burland Lithographic Company, which was being wound up. At a public sale by the liquidator, Burland purchased all the assets of the company in four lots. The price paid by him for lot 1 was £21,564 and he shortly afterwards sold it to the plaintiff company for £60,000. In these circumstances he was ordered by the lower court to pay to the company the sum of £38,436, being the amount of the profit made by him on the resale.

Their Lordships of the Judicial Committee of the Privy Council set aside this decision and observed: "There is no evidence whatever of any commission or mandate to Burland to purchase on behalf of the company, or that he was in any sense a trustee for the company for the purchased property. It may be that he had an intention in his own mind to resell it to the company, but it was an intention which he was at liberty to carry out or abandon at his own will."

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21 Other illustrative cases on the right of a company to recover such secret commissions are: *Grant v Gold Exploration & Development Syndicate Ltd*, [1900] 1 QB 233; *Salford v Lever*, [1891] 1 QB 168 is a case on agency. No duty is breached by merely being a director in a rival company, *London and Mashonaland Exploration Co v New Mashonaland Exploration Co, Re*, 1891 WN 185.

22 1902 AC 83; [1900-3] All ER Rep Ext 1452.

A similar case is *Thomas Marshall (Exports) Ltd* v *Guinle*.[23] A company was importing foreign goods for resale in U.K. Its managing director formed a new import company and solicited orders on its behalf from the U.K. buyers. He imported goods from those very firms with whom he had established contact while acting for the company. He was restrained from this course of conduct. It was a breach of service contract and also of the fiduciary duty. In *Fine Industrial Commodities Ltd* v *Powling*,[24] the demand for the company's product had fallen. The director in question knew of an alternative product for which there was a demand and he was also aware of the modification of the company's plant and machinery which was necessary for that purpose. But, instead of doing that, he created a new company and obtained a patent of the new product in the name of his new company. He was held accountable for his profits. His knowledge of the product in demand and of the fact that the company's plant and machinery could be modified for that purpose was considered by the court to be the company's knowledge. Another parallel case is *Cranleigh Precision Engineering Ltd* v *Bryant*.[25] Here a director after resigning from directorship, formed a company with another person and embarked upon manufacturing a product which embodied his own earlier invention made by him while working for the company. He and his company were restrained from doing so. In *Heyting* v *Dupont*.[26] the company was not able to undertake a product which required a patent in a specialised sector of engineering, because it lacked resources. Both the directors formed their different companies for that product and both sued each other for mutual restraint on behalf of the original company. Their actions were dismissed.

When director may make personal use of company's opportunity.—There are, however, some cases when a director may profit by a corporate opportunity without incurring the liability to account for it. "Where the corporation is insolvent and defunct, its officers are free to act for themselves, since such condition is ascertainable and not easily feigned. Similarly, if the undertaking would be *ultra vires* for the corporation, that fact, being capable of exact determination by the court, should be a complete defence. Where the opportunity is outside the scope of corporate business, or where the corporation has shown no interest in the property, an officer may buy for himself."[27]

Similarly, where a new venture is offered to a company and its directors *bona fide* come to the conclusion that it is not an investment that the company ought to make, the individual directors who subsequently buy the same do not violate any duty to the company even though they have consulted the company's geologist.[28] These are facts of the Canadian case of *Peso Silver Mines Ltd* v

23 1979 Ch 227.
24 (1954) 71 RPC 253.
25 [1964] 3 All ER 289.
26 [1964] 2 All ER 273: [1964] 1 WLR 843.
27 *Peso Silver Mines Ltd* v *Cropper*. (1966) 58 DLR (2d) 1.
28 *Ibid*. For a learned comment on this case *see* Stanley M. Beck, *Saga of Peso Silver Mines: Corporate Opportunity Revisited*, (1971) 44 Can BR 80.

Cropper[29]. If *Regal (Hastings) Ltd* v *Gulliver*[30] is reviewed in this background, it would seem to be an abnormally strict decision. But the English courts are in no mood to relax their standards.[31]

Position on cessation of directorship.—The decision in *Industrial Development Consultants Ltd* v *Cooley*,[32] is a reaffirmation of the belief in the *Regal* standard of honesty.

> The managing director of a company tried to get from the Gas Board a Government contract for the company. But the Gas Board plainly told him that the Government would not allow the contract to the company, but was willing to deal with him personally. He resigned from the company, under the pretence of ill-health and then promptly obtained the contract for himself. Having earned a handsome profit, he had to face an action from the company to account for it.

The court held that the managing director had acted in breach of his duty and, therefore, must account. In the *Peso Silver Mines* case the directors had in good faith rejected the opportunity to acquire adjacent mines and then some directors used the opportunity. Here the company greatly desired the contract and employed Cooley only in a bid to obtain it.[33] But the fact remains that it was the Government, not Cooley, who was to blame for what had happened. The moral of the decision is that either Cooley should have refrained from the contract or executed it at his personal risk and responsibility, but all the time for the benefit of the company.[34]

In *Cranleigh Precision Engg Ltd* v *Bryant*[35] in the course of his work in designing the company's products, a director discovered the existence of a patent which hindered the company from adding a refinement to its product, so as to make them readily marketable. He resigned his directorship and then purchased that patent from its owner. He formed a new company to manufacture

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29 *Ibid.* *See* further *New Zealand Netherlands Society "Oranje" Inc* v *Kays*, [1973] 2 All ER 1222, where the Judicial Committee look the view that there may be circumstances in which a person in a fiduciary position vis-a-vis the company may hold that position only in respect of a part of his duties.

30 [1942] 1 All ER 378, *see* infra at p 229.

31 This despite criticism. *See*, for example, C. D. Baker, *Disclosure of Director's Interests in Contracts*, 1975 JBL 181 and John Birds, *The Permissible Scope of Articles excluding the Duties of Company Directors*, (1976) 39 Mod LR 394. Both consider the validity of Article 84 of Table A of the English Act which came into being in response to the decision in *Regal (Hastings)* case and permits reduction of the fiduciary obligation.

32 [1972] 1 WLR 443: [1972] 2 All ER 162.

33 For an appreciation of this decision *see* 1973 LQR 187 and J. G. Collier, *Directors' Duties*, [1972-A] Camb LJ 222; (1973) 35 Mod LR 655.

34 For another similar authority see *Canadian Aero Service Ltd* v *O' Malley*, (1973) 40 DLR (3d) 371, Supreme Court of Canada, where it was held that it is breach of duty on the part of directors to resign their office and to appropriate a chance to their new company which came before the company while they were still in office. *See* further, *Gilbert* case, (1870) 5 Ch App 559, where the payment of a call was postponed only to enable a director to transfer his shares for avoiding liability and he was nevertheless held liable. For the wisdom of a rule which equates the position of an honest director with that of the dishonest, *see* N. A. Bastin, *The Honest Director and Secret Profits*, 1978 New LJ 527.

35 1964 All ER 289.

the product with the addition of the patented improvement. He had to account to the company for the profits of his new company.[36]

Fiduciary obligation does not cease with resignation, but on the company exercising its right on full information to accept the resignation or to terminate his services if it so wishes.[37] Where the termination is due to operation of law, the director ceases to hold office immediately and his fiduciary duties terminate forthwith.[38] However, even in such a situation the duty to maintain confidential information survives. The duty of confidence as to business secrets terminates only when the company releases him from the obligation or when the secret information is published or becomes generally known, that is to say, it is converted by the owner into a matter of public knowledge.[39]

Competition by directors

In a decision on the point, the judicial opinion was that there is no breach of duty if a director competes with his company or holds some interest in a rival company or is a director in a competing company.[40] But accountability will chase a director if he uses the company's assets for the benefit of a rival concern and this includes its business connection, goodwill, trade assets and the list of customers.[41] If a company has invested resources in providing some training to a director or special skills, he may be restrained from using such skills for the benefit of a rival concern.[42] A director can also be restrained by the terms of his appointment from

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36 This is in contrast to *Nordick Insulin Laboratorium* v *Gorgate Products Ltd*, 1953 Ch 430, in which an agent had made a profit after the termination of his agency and he was held not liable.

37 *Thomas Marshall (Exports) Ltd* v *Guinle*, 1979 Ch 227.

38 *Reid* v *Explosives Co*, (1887) 19 QBD 264; *Measures Bros Ltd* v *Measures*, [1910] 2 Ch 248.

39 *Morison* v *Moat*, (1851) 9 Hare 241; *Merry Weather* v *Moore*, [1892] 2 Ch 518; *Robb* v *Green*, [1895] 2 QB 315; *Franchi* v *Franchi*, [1967] RPC 149. A breach of this duty is illustrated by a plethora of cases involving directors leaving a company and setting up a business in competition. *SSC & Lintas New Zealand Ltd* v *Murphy*, (1981) 1 NZ CLC 98, 348 where the managing director of an advertising agency left taking staff and clients, is one example, *Independent Broadcasting Company Ltd* v *Rob McKay (Media) Ltd*, (1991) 5 NZ CLC 67, 527 where a radio broadcasting executive and director successfully tendered for a broadcasting frequency, and then left the company to operate a new radio station is another. The director's former company was successful in obtaining an interim injunction. Thorp J discussed the corporate opportunity doctrine in the judgment, which requires that "if the corporation has a present interest in the opportunity, then the fiduciary must present it to the corporation prior to exploiting it himself". For a further discussion of the scope of the prohibition on the misuse of confidential information by directors, see Harris, "Fiduciary Duties of Directors under the Companies Act, 1993" [1994] NZLJ 242 at 242-243.

40 *London and Mashonaland Exploration Co* v *New Mashonaland Exploration Co*, 1891 WN 185.

41 *Bell* v *Lever Bros Ltd*, 1932 AC 161; *Soltman Engg Co Ltd* v *Campbell Engg Co Ltd*, 1948 PRC 203; *Horsal Ltd* v *Gaitland*, 1984 BCLC 549.

42 *Hivac Ltd* v *Park Scientific Investments Ltd*, 1946 Ch 169; (1948) 18 Comp Cas 16 CA. The position is thus stated in Charlesworth and Cain, COMPANY LAW, 406 (13th Edn 1987): "Under the general law, apart from the case where a director has a service agreement with the company which requires him to serve only the company, there is authority to the effect that he may become a director of a rival company, i.e. in this way he may compete with the first company, provided that he does not disclose to the second company any confidential information obtained by him as a director of the first company, and that what he may do for a rival company, he may do for himself or a rival firm. . . . He must not subordinate the interests of the first company to those of the second. . ." Citing *London and Mashonaland Exploration*

competing with the company or from joining any other concern as a director whatever be its business. A wholetime director has by virtue of the very nature of employment to restrain himself from joining any other company. He can be sued for breach of his contract with the company[43], though not for an account of his profits elsewhere.[44] If his personal influence weakens the company's ability to offer competition to his other concern and thereby suffers loss of business, he will be liable for the company's set back.[45] He will also be liable if he prevents the company's expansion into an area already occupied by the rival concern.[46] The courts have been somewhat liberal in this respect because they recognise, particularly in the case of part-time directors, that too strict an interpretation of directions' duties of loyalty as part of their fiduciary duties could result in a stifling of enterprise and a bottling up of management talent.

Trading in corporate control

A learned writer says:[47] "A director who acquires property while in office will, however, be liable to account for his profit upon resale if two elements are present. He must have acquired property only by reason of the fact that he was a director and in the course of the exercise of the office of director." *Regal (Hastings) Ltd* v *Gulliver*[48] carries the principle to the farthest limit.

> The plaintiff company were the owners of a cinema in Hastings. Its directors were anxious to acquire two other cinemas in Hastings and then to sell the whole property of the company as a going concern. For the purpose of acquiring the new cinemas they formed a subsidiary company with a capital of £5000 divided into shares of £1 each. They were offered a lease of the two cinemas, but the landlord required a guarantee of the rent by the directors unless the paid-up capital of the subsidiary company was £5000. The original intention was that the plaintiff company should hold all the shares in the subsidiary, but it was unable to provide for more than 2000 shares. The matter was, therefore, rearranged: 2000 shares were allotted to the plaintiff company; 500 shares were taken by each of the three directors, 500 by the solicitor of the company and the remaining 500 were allotted to certain persons found by the chairman of directors. And thus a capital of £5000 was raised. The two cinemas were taken and all the shares in the plaintiff company and the subsidiary company were sold. The 3000 shares

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Co v *New Mashonaland Exploration Co*, 1891 WN 165; *Bell* v *Lever Bros Ltd*, 1932 AC 161, 165. *Also see* Gower's PRINCIPLES OF MODERN COMPANY LAW, 588 (4th Edn).

43 *Sequois Vacuum Systems Inc* v *Stranky*, (1964) 229 Cap App 2d 281.

44 *Whitwood Chemical Co Ltd* v *Hardman*, [1891] 2 Ch 416.

45 *Singer* v *Carlisle*, (1941) 26 NYS 2d 320.

46 *Rosenblum* v *Judson Engg Corpn*, (1954) 99 NH 267.

47 D. N. Hossie, *The Civil Liability of the Directors of a Corporation*, (1952) 30 Can BR 908. Following articles on the subject of corporate control may be consulted: Hill, *Sale of Controlling Shares*, 70 Harv LR 936 (1951); Berle, *Control in Corporate Law*, 58 Col LR 1212 (1958); *Liability of Directors for Taking Corporate Opportunities, using Corporate Facilities or Engaging in a Competing Business*, (1939) 39 Col LR 219; William D. Andrews, *The Stockholders' Right to Equal Opportunity in the Sale of Shares*, (1965) 78 Harv 505. Hornstein, *The Future of Corporate Control*, 63 Harv LR 476: *See also* Louis Loss, SECURITIES REGULATION, (1951).

48 [1942] 1 All ER 378: [1967] 2 AC 134.

allotted to the directors, the solicitor and the chairman were sold at a profit of £2-16s-1d. per share. The action was brought by the plaintiff company to recover this profit.

It was held that in the circumstances the directors, other than the chairman, were in a fiduciary relation to the company and liable, therefore, to repay to it the profit they had made on the shares. The solicitor was not in a fiduciary relationship and was not liable. They acquired these shares only by reason of the fact that they were the directors of the *Regal* and in the course of their execution of that office. Lord MACMILLAN added:[49] "The plaintiff company has to establish two things: first, that what the directors did was so related to the affairs of the company that it can properly be said to have been done in the course of their management and in the utilisation of their opportunities and special knowledge as directors and, secondly, that what they did resulted in a profit to themselves."

The real ground for the decision seems to be that the opportunity to take 5000 shares was the corporate opportunity.[50] The directors, however, took the shares in good faith because the company was financially unable to make use of the opportunity. But if they were permitted to retain the profit, there would be temptation to induce such inability on the part of the company and to profit by it. The liability of the directors to account, therefore, seems to be just and clear. But to hand over this profit to the purchaser shareholders would be to give them the benefit of an undeserved reduction in price which they had willingly paid up. Recovery, therefore, should have been in favour of the old shareholders who had really suffered. This course was preferred in the American case of *Commonwealth Title Insurance & Trust Co* v *Seltzer*.[51]

> Directors of a corporation had agreed to sell to a prospective purchaser the assets of the corporation indirectly by selling all the stock at a stated price. The directors then bought up the whole of the stock from the shareholders at a lower figure and completed the sale. They were held liable to return the profit thus realised not to the corporation but to the old shareholders whose stock was bought. "The payment to the corporation would in substance be a return of a part of the purchase price to the buyer who, of course, had no claim to such a windfall."

Still another duty of controlling shareholders is not to make money for themselves from selling their controlling block of shares. According to Berle and Means: "Control power is itself an asset which may not be traded or disposed of without regard to the interest of the corporation or the totality of shareholders."[52] If the price received by the directors for the controlling block of

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49 *Id.* at 391-392.

50 The full implications of the decision have been discussed by Gower, THE PRINCIPLES OF MODERN COMPANY LAW, 535-537 (3rd Edn, 1969.) *See* also *Lindgren* v *L & P Estates Co Ltd*, [1968] 2 WLR 562; [1968] 1 All ER 917; noted (1968) JBL 152; *Parker* v *Mckenna*, (1874) 10 Ch App 96; 31 LT 739.

51 227 Pa 410; 76 Atl 77, (1910); discussed in a note on *Fiduciary Duty of Directors not to compete with the Corporation*, (1941) 54 Harv LR 1190.

52 THE MODERN CORPORATION AND PRIVATE PROPERTY, (1932) 244. This statement is quoted

shareholders is greater than the prevailing market price of their shares, the real consideration for the inflated price is the "control" which the purchaser has acquired. The minority shareholders should, therefore, be entitled to a *pro rata* distribution of the price which is attributable to the right of control.[53] But this broad general principle does not yet seem to have been adopted by the courts.[54] On the contrary, it has been frequently pointed out that "shares" are the private property of the shareholder and he may sell them for any price or in any manner he pleases, even if his shares carry the right to control the company.[55] Yet two inroads upon this principle have already been made.

In the first place, any profit obtained through breach of a fiduciary obligation, such as, sale of office or interception of corporate opportunities, has to be shared with the minority shareholders. *Perlman* v *Feldmann*[56] is the well known illustration.

> During the period when steel was in short supply, a small steel company was offered by a syndicate of steel users an interest-free loan for the expansion of its plants in return for commitment for future deliveries. Instead of accepting this offer, the directors sold to the syndicate their controlling block of shares at a price approximately twice their market value and allowed the purchasers to assume control, who then withdrew the offer of free loan.

In an action brought by minority stockholders the court granted *pro rata* recovery in their favour. The directors had tried to make profit from "the ability to allocate steel in the time of short supply", which was a corporate asset.

Secondly, the sellers of the controlling block would be liable if they have "negligently or fraudulently" passed the "control" to a person who would loot the assets of the company.[57] Such purchasers are often tempted by large liquid assets which they afterwards utilise in paying off short-term loans taken to finance the take-over bid.[58] In such cases it is not necessary that the seller should have actual knowledge of the purchaser's design to loot. It will be enough to make him liable that there were circumstances putting him on inquiry, for

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in William C. Warren, *Adolf A. Berle*, (1964) 64 Col LR 1377. For reasons why corporate control is a valuable asset *see* Henry G. Manne, *Some Theoretical Aspects of Share Voting*, 1964 Col LR 1427. "A controlling block of shares is worth more than a non-controlling block". *See* Leonard J. Connolly, *Perlman* v *Feldmann & the Sale of Control*, (1971) BL 1259.

53 See *Individual Pro Rata Recovery in Stockholder's Derivative Suit*, (1956) 69 Harv LR 1314.

54 *See* Anthony John Boyle, *The Sale of Controlling Shares*, (1964) 13 ICLQ 185 at 189, where the learned writer also considers the academic criticism of the view.

55 *Gerdes* v *Reynolds*, 28 NYS 2nd 622. For a consideration of this and other cases on the subject *see* a note in (1955) 68 Harv LR 1275.

56 (1955) 349 US 952: 219 F 2d 173, from where the facts have been collected.

57 *See* a note in (1955) 68 Harv LR 1275; *Also see* Hill, *Sale of Controlling Shares*, (1957) 70 Harv LR 986 and Janning, (1956) 44 California LR 1.

58 *See* Anthony John Boyle, *The Sale of Controlling Shares*, (1964) 13 ICLQ 185, 187, where the learned writer cites recommendations of the Jenkins Committee, paras 176 to 186 of the Report. Where the funds of a company were diverted to another company to enable the two sons of the managing director to acquire control over that company, the two sons were not allowed to be charged with conspiracy and criminal breach of trust because they were not even the directors of the company at that time, *Ashim K. Roy* v *Bipinbhai Vadilal Mehta*, (1998) 1 SCC 133: (1998) 91 Comp Cas 1: [1998] 1 Comp LJ 1 (SC).

example, the purchaser's previous history, excessive price offered, liquidity of the corporate assets, etc.[59]

Statutory provisions relating to sale of controlling shares.—Apart from these judicial developments the legislature have also tried to modify the inequitable result of *Regal (Hastings) Ltd* v *Gulliver*. Sections 319 to 321 of the Companies Act are designed to catch any extra payment that may be received by directors in connection with transfer of the undertaking or property or shares of a company. The right to control the management of a company is a valuable asset and it is desirable that if any price is obtained for the sale of this right, the same should be shared by the members in accordance with their rights. The control of a company may pass in several ways. The whole undertaking or property of the company may be sold.[60] In such a case the directors of the company have to retire from office as the purchasers will like to place their nominees on the board. The directors may receive some payment from the company by way of compensation for loss of office or from the transferee as a consideration for retirement. As long as the amount thus received is nothing more than a *bona fide* payment by way of damages for breach of contract or by way of pension in respect of past services, there is hardly anything objectionable in it. This right of directors is, indeed, expressly protected by sub-section (3) of Section 321. But what may happen is that under the cover of compensation for loss of office, they may manage to make money as an inducement to retire and to facilitate the transfer of control. Indeed, they may be getting the money as a price for the right of control. That is why Section 319 provides that any money received from the transferee in connection with the transfer of the company's property or undertaking must be disclosed to the members of the company and approved by the company in general meeting. Where this is not done, the amount shall be held by the directors in trust for the company.[61]

Another method of acquiring the control of a company is by purchasing its shares.[62] Shares may be purchased:

1. by making an offer to the general body of shareholders;
2. where the purchaser is a company, by inviting the company to become its subsidiary or a subsidiary of its holding company;
3. by making an offer with a view to obtaining the right to control the exercise of one-third of the total voting power;
4. by making any other offer which is conditional on acceptance to a given extent.

Here also those who acquire control will replace the existing management. The outgoing director may be induced on payment of money to facilitate the transfer of control, although outwardly the payment may have been made as compensation for retirement. If the transferee proposes to pay something to the

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59 *Id.*, 192.

60 For a discussion of the various modes of transfer of control and how side-payments are obtained by the majority sellers, *see* Henry G. Manne, *Some Theoretical Aspects of Share Voting*, 1964 Col LR 1427.

61 S. 319(2).

62 S. 320(1)

directors, the latter must take reasonable steps to inform the shareholders of the particulars of such payment along with any notice of the offer made for their shares.[63] Where this disclosure is not made to the selling shareholders, the directors may call a meeting of such shareholders and get the proposed payment approved before any transfer is made.[64] But where they do neither, they shall hold the amount in trust for the shareholders who have sold their shares.[65]

The scope of the words "compensation for loss of office" and "consideration for retirement" is considerably widened by Section 321 so that directors may not avoid their obligation to account by apparently separating the transfer of control from payment. This section provides that any payment made by the transferee in pursuance of any arrangement entered into as a part of the agreement for the transfer of shares, or within one year before or two years after the agreement, shall be deemed to have been received as "compensation for loss of office" or "consideration for retirement" and liable to be accounted for.[66] Similarly, if the price paid to a retiring director for his shares in the company is in excess of the price paid to other shareholders or any other valuable consideration has been given to him, it shall also be regarded as "compensation" or "consideration" and must be disclosed to the shareholders.[67]

These statutory provisions also modify the result of *Percival* v *Wright*.[68] In cases falling within the scope of the above sections, directors become trustees for those individual shareholders who have sold their shares for any profits made by the directors.

The scope of the disclosure obligation has been considerably widened in the United States. The interpretation of Rule 10B-5 of the Securities Exchange Regulations[69] creates a situation where "fiduciary obligations are no longer owed only to the current owners of the corporation, that is, the stockholders, but are also owed to outside non-stockholders. The insider owes a duty not only to refrain from stating falsehoods, or half-truths, but affirmatively to disclose all the material facts of the transaction."[70] The case of *Securities & Exchange Commission* v *Texas Gulf Sulphur Co*[71] has become well known in this connection.

The Texas Gulf Sulphur Co carried on certain drilling operations and discovered important mineral deposits. Before disclosing this fact to the

63 S. 320(2). *See also* sub-section (3) which imposes penalty for default.

64 S. 320(4).

65 *Ibid.* According to sub-section (5) if at a meeting called for the purpose of approving any payment a quorum is not present and the meeting having been adjourned, a quorum is again not present, the payment shall be deemed to have been approved.

66 S. 321(1).

67 S. 321(2).

68 [1902] 2 Ch 421.

69 Federal Securities Exchange Act, 1934.

70 *Scienter and Rule 10B-5*, (1969) Col LR 1057 to 1061. Also see *The National Securities* case; *The Supreme Court and Rule 10B-5*, (1969) Col LR 906. Israels and Loss, *Recent Developments in Securities Regulations*, (1963) 63 Col LR 856, William Henry Navin, *Insiders' Liability under Rule 10B-5 of the Illegal Purchase of Actively Traded Securities*, (1968) 78 Yale LJ 864.

71 401 F 2d 833 (2d Cir 1968). Considered in *Scienter and Rule 10B-5*, (1969) Col LR 1057.

public, the directors purchased the company's shares in the market and also acquired options to purchase further shares (calls). They also tipped their relatives and friends to purchase the company's shares. Ultimately, when the fact of discovery was made public, the prices of the company's shares soared up.

The SEC brought an action against the insiders to restrain them from purchasing shares unless a full disclosure of the facts was made and to offer restitution to those whose shares they and their "tippees" had purchased. They contended that they had no intent to defraud and had in good faith withheld the information because any disclosure of this kind would have materially affected the prices of adjoining areas thus defeating the company's chances of acquiring the land at reasonable prices. But even so they were held liable. It is no doubt primarily the function of the management to decide when an information is ripe for disclosure, but in the meantime they should not operate in the company's stock market.[72]

Misuse of corporate information.—Exploitation of unpublished and confidential information belonging to the company is a breach of duty and the company can ask the director in question to make good its loss, if any. Any knowledge or information generated by the company is the property of the company, commonly known as intellectual property. Turn over of business, profit margins, list of customers, future plans, any personal use of such knowledge is equivalent to misappropriation of property.[73] Use of such information can be restrained by means of an injunction.[74] Any gain made by the use of inside information has to be accounted for to the company.

At common law, equity imposes fiduciary duties on directors because of their position of power in, and their relationship of confidence to, the company. In the course of their office, directors often can and do, obtain access to confidential information relating to sensitive transactions of the company. Also, information is acquired in circumstances where the recipient is required to keep it confidential. It is part of each director's fiduciary duty not to misuse this information. Each director owes a duty to the company not to disclose or use confidential information without the company's consent.

SEBI (Insider Trading) Regulations, 1992.—The Securities and Exchange Board of India has formulated Regulations for preventing and punishing the use of price sensitive unpublished inside information in dealings with the company's securities.

Where the directors sold their shares before publishing half-yearly statements and the market went down after the publication because the accounts

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72 For criticism of this decision *see* Louis Loss, *The Fiduciary Concept as Applied to Trading by Corporate "Insiders" in the U. S.*, (1970) 33 Mod LR 34 and Henry G. Manne, ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES, (1968). For a view of all the possible aspects of directors' liability, *see* Robert R Pennington, DIRECTORS' PERSONAL LIABILITY (1987).

73 *Boardman* v *Phipps*, [1967] 2 AC 46; *Exchange Telegraph Co Ltd* v *Gregory & Co*, [1896] 1 QB 147; *Exchange Telegraph Co* v *Central News Ltd*, [1897] 2 Ch 48.

74 *Saltman Engg Co Ltd* v *Campbell Engg Co Ltd*, 1948 PRC 203; *Terrapin Ltd* v *Builders Supply Co (Hayes) Ltd*, [1960] RPC 128; *Morris Ltd* v *Gilman (BST) Ltd*, (1943) 60 RPC 20.

were not according to expectations, they were held liable to hand over profits to the company.[75] Purchase of company's shares by directors cheaply with the knowledge that soon they were due to issue an offer to buy from willing shareholders at a higher price out of the company's reserves, made them accountable.[76]

Apart from violations of the regulatory framework, directors' dealings in their own company shares are not illegal. It is considered desirable that directors of listed companies should hold the shares of their companies. As a part of remuneration package, directors are often given share options which enable them to acquire shares in their company, which they may afterwards sell. When directors decide to sell their shares however acquired or to buy more shares, their trading comes to be governed by the legislation on insider trading. They commit an offence if they trade on some specific non-public information about their companies' securities. "For instance, if the director has access to unpublished price sensitive information, such as information on future earnings' figures, security issues, assets disposal and purchases, etc., which if it were made public would have significant effect on the share prices, it is illegal for them to trade on the information. Consequently, directors can trade in the shares of their own company but the trading must not be based on any inside information."[77]

Outsiders dealing in inside information.—A dealer in a company's securities receiving inside information commits an offence under Section 1(3) and (4) of the Companies Securities (Insider Dealing) Act, 1985 (English) whether he procured that information from a primary insider by purpose or came by it without any positive action on his part.[78]

Directors' duty of care and skill

Liability for negligence

Fidelity alone is not enough. A director has to perform his functions with reasonable care. He has to attend with due diligence and caution the work assigned to him. The Nigerian Act contains a set of provisions on this aspect of directors' duties:

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75 *Diamond* v *Oreamuno*, (1969) 24 NY 2d 494.

76 *Brophy* v *City Service Co*, (1974) 31 Del Ch 341. Insider trading in violation of the law has been held to be an offence connected with the management of a company and is therefore, a ground for disqualification under the [English] Directors' Disqualification Act, 1986 and under S. 203 of the [Indian] Companies Act, 1956, *R* v *Goodman*, [1992] 2 All ER 789 CA.

77 David Hillier and Andrew Marshall, *The Timings of Directors' Trades in the United Kingdom and the Model Code*, 1998 JBL 454.

78 *Attorney-General's Ref No 1 of 1988*, [1989] 1 All ER 321 CA: [1989] 2 WLR 195; 1988 BCLC 193. The same would be the position where the information comes his way without any effort on his part. *Attorney-General's Ref No 1 of 1989*, [1989] 2 All ER 1 HL. For further study, *see* P.St. J. Smart, *Misuse of Confidential Information: The Company and Minority Shareholder's Remedies*, 1987 JBL 464. Tipees are liable to be prosecuted under S. 1(1) if they had knowledge that the information was still unpublished. *See* Charles Rickett and Ross Grantham, ESSAYS ON INSIDER TRADING AND SECURITIES REGULATION, (1997) on the desirability of such regulation and whether inside trading is really objectionable.

"A director shall act at all times in what he believes to be the best interests of the company as a whole so as to preserve the assets, further its business and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinarily skilful director would act in the circumstances."[79]

Another provision runs as follows:[80]

"Every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interests of the company and shall exercise that degree of care, diligence, and skill which a reasonably prudent director would exercise in comparable circumstances."

The New Zealand Companies Act, 1993 also provides that a director must exercise his powers for a proper purpose.

The courts have been very liberal in the matter of the expected standards of skill and care. An early example is *Overend Gurney & Co* v *Gibb*.[81] A company was formed to take over a private bank. Without investigating the value of the bank's assets and the extent of its liabilities and with knowledge that the bank was in a state of insolvency, the directors paid £50,000 for goodwill. Still holding them not liable, the House of Lords laid down that there should be violation of either the Act or the memorandum or the transaction was such that no man of ordinary prudence would have entered into. In another case of overvaluation of assets, acquitting the directors, the court said that in order to make them liable their negligence must be in a business sense culpable and gross.[82] Directors may not know the nature of the company's trade, because all that the law expects from them is that if they know they must use the knowledge for the company's benefit.[83] Accordingly directors were held guilty of negligence when they participated in a transaction without trying to know whether the transaction was really for the purposes of the company or whether they were authorised by the Board in that respect, and it was no defence for any director to show that he believed that he was bound to sign because the other directors wanted it or that he joined under protest or that even without his joining, the other directors were determined to carry out the transaction.[84] Directors were also held liable where they released the company's funds for paying a debt without trying to know whether anything was really due and for purchasing assets without knowing whether there was any real transfer of those assets.[85] Liability for negligence also followed where without any board resolution being properly passed a single member was allowed to manage a part

79 Section 279(1) of the Companies and Allied Matters Act, 1990.

80 Section 282, *ibid*.

81 (1872) LR 5 HL 480. *See* further *Prudential Assurance Co Ltd* v *Newman Industries Ltd (No 2)*, [1982] Ch 204, 221: [1980] 2 All ER 841: [1980] 3 WLR 543, no liability where assets reduced to less than liabilities.

82 *Lazunas Nitrate Co* v *Lagunas Syndicate*, [1899] 2 Ch 392.

83 *Brazilian Rubber Plantations and Estates Ltd, Re*, [1911] 1 Ch 425: 103 LT 697.

84 *Land Credit Co of Ireland* v *Lord Fermoy*, (1869) LR 3 Eq 7: (1850) 5 Ch App 763.

85 *Selangor United Rubber Estates* v *Cradock (No 3)*, [1968] 2 All ER 1073: [1968] 1 WLR 1555; *Joint Stock Discount Co* v *Brown*, (1869) 8 Eq 381; *Ramskill* v *Edwards*, (1885) 31 Ch D 100.

of the company's business and he misconducted himself.[86] A director would also be guilty of negligence where he discovers something wrong and, instead of informing the shareholders, rests content after pointing it out to the directors only.[87]

Beginning with ROMER J's formulation of directors' duties, a constant judicial effort has been maintained in putting some objectivity into the standards of skill and care expected from directors. "His duties will depend upon the nature of the company's business and the manner in which the work of the company is distributed between the directors and other officials of the company. In discharging these duties a director must exercise some degree of skill and diligence. But he does not owe to his company the duty to take all possible care or to act with best care. Indeed, he need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. It is, therefore, perhaps, another way of stating the same proposition that directors are not liable for mere errors of judgment."[88] This is a well-known observation of ROMER J in the celebrated case of *City Equitable Fire Insurance Company, Re*.[89]

> One *B* was a director of the City Equitable Fire Insurance Co. The company was ordered to be wound up. A searching investigation of the affairs of the company was then made and this investigation showed a shortage in the funds which the company should have been possessed of over £12,00,000. The collapse of the company was due to bad investments, bad debts and misappropriation. All the losses were due to *B's* instrumentality. He was accordingly convicted for his frauds.

But the question naturally arose as to whether during the period covered by *B's* nefarious activities the other directors were properly discharging their duties to the company? It was alleged that they were guilty of negligence in not detecting the frauds. But there was an exemption clause in the articles according to which the directors were liable only for gross negligence. The facts of the case did not disclose that degree of negligence and, therefore, the case of the official receiver against *B's* co-directors failed.

***Exclusion of liability now not allowed* [S. 201].**—"This acquittal (in *City Equitable* case) caused such ferment as to lead to legislation abolishing 'contracting out'."[90] Accordingly, the Act now does not allow liability for negligence to be excluded. Section 201 renders void any provision in the company's articles or in any agreement which excludes liability for negligence, default, misfeasance, breach of duty or breach of trust. The company is also not

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86 *City Equitable Ins Co, Re*, 1925 Ch 407.

87 *Joint Stock Discount Co* v *Brown*, (1869) 8 Eq 381; *Ramskill* v *Edwards*, (1885) 31 Ch D 100.

88 See *Brazilian Rubber Plantations & Estates Ltd, Re*, [1911] 1 Ch 425: 103 LT 697, directors not liable for ignorance of trade practices.

89 [1925] Ch 407: [1924] All ER Rep 485: 133 LT 520. *See* also *Union Bank of Allahabad, Re*, AIR 1925 All 519: 88 IC 785; *Govind* v *Rangnath*, 32 Bom LR 232; *Parke* v *Daily News Ltd*, [1961] 1 WLR 493: [1961] 1 All ER 695.

90 William O. Douglas, *Directors Who Do Not Direct*, (1934) 47 Harv LR 1305, 1320. *See also* Samuel, SHAREHOLDERS' MONEY, (1933) 125.

allowed to indemnify its officers against such liability. The only exception is that where an officer has been sued or prosecuted on any of the above charges and the judgment is in his favour or he has been acquitted, or relief has been granted to him under Section 633, the company may indemnify him against costs incurred in defence. An auditor has been held to be an officer of the company for the purposes of such indemnity.[91] But where an auditor is retained only to conduct and carry out an audit function, without appointment as an auditor, he would not be an officer.[92]

Though this provision came into being in reaction to the decision in the *City Equitable* case, its scope is not confined merely to contracting out of the consequences of negligence. Apart from negligence, it renders void any provision in the articles or in an agreement which exempts a director from liability for default, misfeasance, breach of duty or breach of trust.[93]

Standard and degree of care and skill.—Quite apart from this statutory development, the courts have also been trying to reconsider the standard of care expected of directors. ROMER J formulation is largely subjective, as a director has to use only such "skill as may reasonably be expected from a person of his knowledge and experience". The standard of care required of directors at common law has traditionally been light compared with their duties in other areas. Usually it took gross negligence for directors to be liable. But the current trend is towards objectivity.[94] In the words of Justice CARDOZO:

> The diligent director is the one who exhibits in the performance of his trust the same degree of care and prudence that men prompted by self-interest generally exercise on their own affairs.[95]

This standard demands reasonable business prudence from managers. To the same effect is the observation of BUCKLEY J in *Duomatic Ltd, Re.*[96] A director has to act "in the way in which a man of affairs dealing with his own affairs with reasonable care, and circumspection could reasonably be expected to act...." Applying this standard to the case before him, the learned Judge held that payment of £4000, without legal advice, as compensation to a director for retirement when, in fact, he was entitled to no compensation was, an act which could not be regarded as reasonable.[97]

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91 *Mutual Reinsurance Co Ltd* v *Post Marwick Mitchell & Co*, (1997) 1 BCLC 1 CA; *R* v *Shacter*, [1960] 1 All ER 61: (1960) 30 Comp Cas 334 CCA.

92 *Mutual Reinsurance Co Ltd* v *Post Marwick Mitchell & Co*, (1997) 1 BCLC 1 CA.

93 It has been maintained by some eminent authors that this provision still permits diminution of duty apart from exemption from liability. Duty itself may be modified, though liability for breach of duty cannot be excluded. *See* Gore-Browne, COMPANY LAW, 42nd Edn, 778 and Gower, 532 (3rd Edn) COMPANY LAW.

94 *See* M. J. Trebilock, *Liability of Directors for Negligence*, (1969) 32 Mod LR 409.

95 *People* v *Mancuso*, 255 GY 463, 469. Borrowed from Jackson, WISDOM OF THE SUPREME COURT, 82, (1962).

96 [1969] 2 WLR 114: [1969] 1 All ER 161: [1969] 2 Ch 365.

97 *See* 1967 JBL at 139-40. *See also* J. A. C. Hetherington, *Corporate Responsibility*, (1969) Stan LR 248 at 257; M. Feuer, PERSONAL LIABILITY OF CORPORATE OFFICERS AND DIRECTORS, (1961).

The directors of a company manufacturing car components were held liable because they failed to ensure that their company had established an efficient production system before commencing production and caused loss by paying wages, salaries and general overheads which were not matched by output.[1] Justice HAND said:

> I cannot agree with the language of *Hun* v *Carey*[2] that in effect a director gives an implied warranty of any special fitness for his position. Directors are not specialists like lawyers or doctors. They must have good sense: perhaps they must have an acquaintance with the affairs; but they need not, indeed, perhaps they should not, have a technical talent. They are the general advisers of the business, and if they have faithfully given such ability as they have to their charge, it would not be lawful to hold them liable.

Directors would decidedly be liable for omitting to do what they could have done in the circumstances. Where the president of an investment company improvidently invested in companies in which he was interested and caused loss, his fellow directors were held liable because they had left the investment of the company's funds to the president's unfettered discretion and exercised no supervision over him.[3] In another similar case, a money lending company had two chartered accountant directors. They left the matter of the negotiations for loans wholly to the discretion of the third professionally unqualified director without supervision and also for making loans without inquiring for what purpose the loans were made, what was the security, if any, and what were the terms of repayment. The company had suffered loss in the transactions. The directors were held liable.[4]

Where the senior executives of a company caused loss because of illegal price fixing agreements, the directors were held not liable when there was no evidence to show that they knew or had reason to believe that such things were being done or that they were negligent in their choice of senior executives.[5]

What seems now to be the leading case on directors' duty of care is the New South Wales Court of Appeal decision in *Daniels* v *Anderson*.[6] It was observed in this case that the old cases, with their notions of subjective tests and gross negligence have become outdated. "The idea that the shareholders were ultimately responsible for the unwise appointment of directors led to the duty of care, skill and diligence, which a director owed to a company being characterised as remarkably low."[7] The Court said:

> "We see no reason why the relationship of a director to a company should not, in accordance with the law as it has been developed since

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1 *Barnes* v *Andrews*, (1924) 298 F 614, USA.
2 (1880) 82 NY 65, USA, where it was stated that directors should possess at least ordinary knowledge and skill.
3 *Kavanangh* v *Common Wealth Trust Co*, (1918) 233 NY 103 USA.
4 *Dorchester Finance Co Ltd* v *Stebbings*, 1 Co Lawyers 38 USA.
5 *Graham* v *Allis Chalmers Mfg Co*, (1963) 41 Delhi Ch 78.
6 (1995) 16 ACSR 607.
7 *See* S. M. Watson, *Directors Duties in New Zealand*, 1998 JBL 495 at 502.

Hedley Byrne & Co v *Heller & Partners Ltd*[8] satisfy the proximity test. One must look to see whether there are reasons of policy for saying that a director does not owe a duty of care to the company."

The court further said:

"In our opinion, the responsibilities of directors require that they take reasonable steps to place themselves in a position to guide and monitor the management of the company. The courts have recognised that directors must be allowed to make business judgments and business decisions in the spirit of enterprise. Any entrepreneur will rely upon a variety of talents in deciding whether to invest in a business venture. These may include legitimate but ephemeral political insights, a feel for future economic trends, trust in the capacity of other human beings. Great risks may be taken in the hope of commensurate rewards. If such venture fails, how is the undertaking of it to be judged against the allegation of negligence by the entrepreneur? In our opinion, the concept of negligence which depends ultimately upon a general public sentiment of moral wrongdoing for which the offender must pay[9] can adopt to measure appropriately in the given case whether the acts or omission of an entrepreneur are negligent."

The practical difference that the developments have made between the old and new version of the duty has been spelt out to be this:

"The new duty is therefore in effect not greatly different from the Re Equitable standard. The major differences are first that the focus is on the level of responsibility taken on by directors rather than the director's actual level of expertise of experience, and secondly that it is likely that the courts will continue the line of applying a higher standard of care and attention to business by all directors. The standard required is that to be reasonably expected of someone occupying the office in question."[10]

The New Zealand Companies Act, 1993 imposes a new duty on directors, not to engage in reckless trading. This expression is defined in the Act as agreeing to cause or allowing conduct likely to create a substantial risk of serious loss to the company's creditors. The duty of directors in this respect has been thus explained:[11]

"The taking of business risks and allowing directors a wide discretion in matters in business judgment requires a sober assessment by directors as to the company's likely future income stream. Given current economic conditions, did the directors make reasonable assumption in their forecasts of future revenue? Creditors are likely to suffer serious losses if future outflows of cash exceed cash inflows for the same period. If there is no profit margin on goods being sold or services provided the company will reach a stage where the shareholders' risk capital has been exhausted and

8 1964 AC 465: [1963] 3 WLR 101: [1963] 2 All ER 575.

9 Citing *Donoghue* v *Stevenson*, 1932 AC 562 at 580.

10 S. M. Watson, *Directors' Duties in New Zealand*, 1998 JBL 495 at p. 504.

11 Ross M, *Directors' Liability and Company Insolvencies—the New Companies Act*, [1994] Commerce Clearing House, 98.

directors are instead using resources otherwise available to meet all creditor's claims. In those circumstances, the company should have stopped trading. To continue trading is to risk creditor's money."

Duty of non-executive director

It has been laid down that in the application of the standards of care and skill, no distinction can be made between executive and non-executive directors. On facts, the two non-executive directors were held guilty of negligence inasmuch as they signed blank cheques which enabled the executive director to act at pleasure in completing the cheques. They were held liable to compensate the company for its loss.[12] Summarising the present position of the duty of care and skill, the court crystallised it into the following three points: (1) There ought to be an exhibition of such a degree of skill as may reasonably be expected from a person with the particular director's knowledge and experience; (2) The director has to exercise in the performance of his duty such care as an ordinary man might be expected to do on his own behalf, and (3) All powers vested in directors must be exercised in good faith and in the interest of the company.

"When exercising powers or performing duties, directors are charged with exercising the care, diligence and skill that a reasonable director would exercise in the same circumstances. Despite arguments in its favour and some case law supporting the approach, the extra knowledge and abilities of professional executive directors do not mean there is a higher duty of care specifically imposed on them. Conversely, a director with a lesser level of skill and experience must, on the exercise of his or her power, still reach the level of the mythical reasonable director. Similarly, traditionally non-executive directors owed lower duties to the company at common law. But there were indications of changing attitudes in the courts. In *Morley*.[13] Mrs Morley, who took no active part in a company run by her husband, was still found to be liable to a third party. In *Deloitte Haskins & Sells* v *National Mutual Life Nominees Ltd*[14] the court did not accept that a lower standard of care should be imposed on a non-executive director than an executive director. The difference from the common law must be more academic than problematic since practically, in most cases, directors will take on responsibilities commensurate with their abilities. If they do not, it is perhaps reasonable they should face liability if they do not reach the requisite standard.[15]

Nominee directors

Where the directors failed to carry out directions of the court for arranging payment to the workers of the sick industrial company, the court said that the

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12 *Dorchester Finance Co Ltd* v *Stebbings*, 1 Co Lawyers 38, USA: 1989 BCLC 498 Ch D. *See* E. J. Jacobs, *Non-Executive Directors*, 1987 JBL 269.

13 *Morley* v *Statewide Tobacco Co Ltd*, (1990) 8 ACLC 933.

14 (1991) 5 NZ CLC 67, 418.

15 S. M. Watson, *Directors' Duties in New Zealand*, 1998 JBL 495 at 503. For another contribution on the subject see Jones, *Company Law in New Zealand* (Butterworth, 1993, 119-20).

nominee director representing the BIFR in the company's Board was not to be held liable for contempt of court.[16]

***Special statutory protection against liability* [S. 633]**

The Act, however, in Section 633, extends special protection against a liability that may have been incurred in good faith. Where it appears to the court that the director sued "has acted honestly and reasonably, and that having regard to all the circumstances of the case..., he ought fairly to be excused, the court may relieve him, either wholly or partly from his liability on such terms as it may think fit."[17] Thus three circumstances must be shown to exist. The position must be such that the person to be excused is shown to have acted firstly, honestly, secondly, reasonably, and thirdly having regard to all the circumstances he ought fairly to be excused.[18] A good illustration is *Claridge's Patent Ashphalt Co, Re*.[19]

> A company was formed for the production of certain compositions of cement for making roads. Owing to great increase in motor traffic there was a profitable future in making roads and it was proposed that the company should embark upon this new business. After consulting the company's solicitors, who advised that the scheme was not *ultra vires*, the directors applied the company's capital, but the new business proved a failure.

They were sued for misapplication of funds. But the court allowed relief. "They were acting for the benefit of the company and took the best advice." Similarly, in a case before the Orissa High Court.[20] where the annual general meeting of a company could not be held in time on account of the dissolution at the material time of the company's Board of directors by a court order, the court granted relief against liability for default. The Kerala High Court granted relief to a director who had not disclosed that his joint family was carrying on a contract with the company, the same having been entered into by his deceased father eighteen years ago and, he being not an active member of the family, did not know it.[21] Where a statement in the prospectus was that the company had 25 years of experience in its line of business, whereas the experience was that of the partnership which it had taken over and the

16 *Girni Kamgar Sangharsh Samiti* v *Matulaya Mills Ltd*, 2002 Cri LJ 253 (Bom).

17 S. 633(1); a proviso to which declares that in a criminal action for negligence, etc., the Court shall have no power to grant relief from any liability. The word "officer" as used in the section has been held to include an officer whose service has been terminated. *Amrit Lal Chum* v *Devoprasad*, (1988) 2 SCC 269. Relief is allowed only to officers of the company and not to the company itself, *Balwant Singh* v *ROC*, (1995) 2 Punj LR 563.

18 BUCKLEY J in *Duomatic Ltd, Re*, [1969] 1 All ER 161 at 171: [1969] 2 WLR 114: [1969] 2 Ch 365.

19 [1921] 1 Ch 543: 125 LT 255.

20 *S. L. Kapoor* v *ROC*, [1964] 1 Comp LJ 211 Ori; *C. S. Lognathan* v *Registrar*, [1964] 1 Comp LJ 211 Ori. *Tapan Kumar Chowdhury* v *ROC*, (2003) 114 Comp Cas 631 Cal, there was sufficient cause for failure to hold AGM and file statutory documents with Registrar, relief was granted to the petitioning director alone because for the defaults committed by the directors, the directors were individually responsible and liable for conviction, one director could not make the application in a representative capacity for all the directors.

21 *M. O. Varghese* v *Thomas Stephen & Co Ltd*, (1970) 40 Comp Cas 1131 Ker.

business was commenced a bit late than what was stated in the prospectus, the directors were held not guilty of misrepresentation. Relief against prosecution was granted.[22] Relief was granted against the consequences of delay in registering a transfer of shares because the directors had acted on the advice of competent legal advisers.[23] Relief was allowed to a managing director because the delay of 24 days in filing the cost audit report was due to labour problems in the company.[24]

The Calcutta High Court refused to grant relief in a case where there was a default in holding five successive meetings.[25] Relief was allowed where the directors could not hold AGMs and file annual returns, the failure being due to the takeover of the company by the Government and the matters being beyond their control.[26] Similarly, where the directors overdrew their remuneration in anticipation of its being voted to them in future, the court held that they could not be said to be acting reasonably and ought not to be excused,[27] or directors who knowingly accepted deposits beyond the statutory limits.[28] No relief was allowed to directors who had collected contributions under the Employees' State Insurance Act and the Provident Fund Act but did not pay the employees according as their claims became due.[29] Relief was not allowed where correct returns were not filed and the offence was *prima facie* made out.[30] Relief has been allowed under the section to persons who become directors only for the purpose of rendering some professional or technical services. Such directors may not be aware of what administrative directors have been doing.[31] Relief was allowed in anticipation to two Japanese directors who were not concerned with the day to day management of the company.[32] Part-time directors are not entitled to any special consideration, but they may be more readily relieved where no

22 *Progressive Aluminium Ltd* v *ROC*, (1997) 89 Comp Cas 147 AP: [1997] 4 Comp LJ 215.

23 *G. R. Desai* v *ROC*, (1999) 95 Comp Cas 138 AP; *Narsimha Janardan Ramath* v *ROC*, [1999] 2 Comp LJ 25 Bom.

24 *M Meyyappan* v *ROC*, (2002) 112 Comp Cas 450 Mad.

25 *Coal Marketing Co of India Ltd, Re*, [1967] 1 Comp LJ 237 Cal.

26 *Gautam Kanoria* v *Asstt ROC*, (2002) 108 Comp Cas 260 Bom.

27 *Duomatic Ltd, Re*, [1969] 1 All ER 161: [1969] 2 WLR 114. The Allahabad High Court has further pointed out in *G. D. Bhargava* v *ROC*, (1970) 40 Comp Cas 664: [1970] 2 Comp LJ 24, that relief under the section is not allowed where the offences are so serious as to attract the provisions of the Indian Penal Code relating to forgery or falsification.

28 *Jagjivan Ram Hiralal Doshi* v *ROC*, (1989) 65 Comp Cas 553 Bom: [1989] 2 Comp LJ 315.

29 *Jagannath Pd Jhalani* v *Regional Provident Fund Commr*, (1987) 62 Comp Cas 571 Delhi. Relief is not allowable for defaults under other Acts. It is confined to defaults under the Companies Act, *Harishchandra Maganlal* v *UOI*, (1991) 71 Comp Cas 69 Bom.

30 *Farouk Irani* v *BIFR*, (2002) 110 Comp Cas 64 Mad.

31 *Om Prakash Khaitan* v *Shree Keshariya Investment Ltd*, (1978) 48 Comp Cas 85 Delhi.

32 *Kerji Tamaiya, Re*, (1990) 68 Comp Cas 142 Bom. Anticipatory relief was also allowed to directors who apprehended prosecution for defaults in reference to annual accounts though the period of limitation for proceeding against them had expired, the offence being not of continuing nature. *K. K. Mehra* v *ROC*, (1991) 1 Comp Cas 669 Delhi.

evidence of their role in management is adduced.[33] The section was applied to relieve a marketing manager,[34] but not to debenture trustees.[35]

The totality of the circumstances have to be examined for considering whether relief is to be allowed or not. In this case, an *ex offico* chairman of a Government enterprise was also the chairman and managing director of a joint venture company. He was not to be exonerated of his duty to take care to see that the provisions of the Act were complied with. The Board had delegated substantial powers of management to another director. There was also a company secretary in the employ of the company. The court said that the chairman-cum-managing director deserved to be relieved of the alleged statutory violations. A director who was not on the Board at the time of violations was also to be relieved.[36]

The proviso to Section 633(1) declares that in a criminal proceeding under the section the court shall have no power to grant relief from any civil liability.

It has been held by the Court of Appeal in England that although the provision is expressed in wide language, in its context of company law and on its true construction the only proceeding for which relief can be claimed were proceedings against a director by, on behalf of, or for the benefit of his company for breach of his duty to the company as a director.[37]

Duty to attend board meetings

Negligence by non-attendance

Duties of directors are of intermittent nature to be performed at periodical board meetings. In other words, they are not bound to pay continuous attention to the affairs of the company. "They do not undertake to manage the

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33 *Jagjivan* (supra) followed in *Harishchandra Maganlal* v *UOI*, (1991) 71 Comp Cas 69 Bom: AIR 1990 Bom 34, 36: [1990] 1 Comp LJ 355 Bom. where the court added that "such other person" whom notice of the proceedings under the section had to be given would include shareholders of the company. *S. P. Punj* v *ROC*, (1991) 71 Comp Cas 509 Delhi, relief was granted where it was doubtful whether deposits had been taken in excess of limits and whether the accused directors were parties to the resolution for inviting further deposits. Relief was allowed to directors of the sick industrial company which was under reference to the Board for Industrial and Financial Re-construction (BIFR). One and a half year period of relief was extended for two years, *Oriental Power Cables Ltd* v *ROC*, (1995) 83 Comp Cas 447 Raj. There cannot be an automatic relief in favour of a director who was appointed for compliance of laws only in a specified respect, though the default did not relate to the specified matter. *Shiv Kumar Dalmia* v *Mangal Chand Hukum Chand*, (1996) 86 Comp Cas 366: [1996] 2 Comp LJ 219 MP.

34 *Ravinder Kumar Sangal* v *Auto Lamps Ltd*, (1984) 55 Comp Cas 742 Delhi.

35 *Central Bank Executor & Trustee Co Ltd* v *Magna Hard Temp Ltd*, (1997) 89 Comp Cas 40 AP.

36 *Madhavan Nambiar* v *ROC*, (2002) 108 Comp Cas 1 Mad.

37 *Customs and Excise Commrs* v *Hedon Alpha Ltd*, [1981] 2 All ER 697 CA. According to a circular of the Company Law Board, the Registrar should not file a criminal complaint to set at naught the application of a director for relief under S. 633. *P. S. Bedi* v *ROC*, (1986) 60 Comp Cas 1061 Delhi. The jurisdiction under the section is not a proper forum for determining the question whether there had been a default or not. *S. Pandit, Re*, (1990) 68 Comp Cas 129: [1990] 2 Comp LJ 170 Bom. Seizure of books was not a sufficient ground for excuse particularly when copies were supplied. Where proceedings have already been launched, relief can be claimed only from the court where the proceedings are pending, *Jyotindra Manhar Lal Vakil*, (1995) 16 Corpt LA 174 Bom.

company."[38] A director is not even bound to attend all the meetings of the board, although he is under an obligation to attend whenever in the circumstances he is reasonably able to do so. According to Section 283(*g*) the office of a director will be vacated if he absents himself from three consecutive meetings of the board, or from all meetings of the board for a consecutive period of three months, whichever is longer, without obtaining leave of absence from the board. Moreover, a director's habitual absence from board meetings may, taken in the light of other circumstances, become evidence of negligence on his part. In an early case in which liability was imposed for failure in this respect, the court said: "[I]f some persons are guilty of gross non-attendance, and leave the management entirely to others, they may be guilty by this means if breaches of trust are committed by others."[39]

Duty not to delegate

Liability for co-directors' defaults

Generally, a director has to perform his functions personally. He is bound by the maxim *delegatus non-potest delegare*. Shareholders have appointed him because of their faith in his skill, competence and integrity and they may not have the same faith in another person. The rule is, however, not inflexible. In the following two cases at least delegation is proper and valid. Firstly, a delegation of functions may be made to the extent to which it is authorised by the Act or articles of association of the company.[40] Secondly, there are certain duties which may, having regard to the exigencies of business, properly be left to some other officials. Directors must be able to entrust details of management to subordinates, or else business could not be carried on. A proper degree of delegation and division of responsibility by the Board is permissible but not a total abrogation of responsibility since this would undermine the collegiate or collective responsibility of the Board of directors which is of fundamental importance to corporate governance. A director might be in breach of duty if he left to others the matters for which the Board as a whole had to take responsibility.[41] These two exceptions permit a reasonable distribution of work among all the directors and other officials of the company. Now, if a co-director or other official to whom a function is so delegated commits a fraud and the

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38 ROMER J in *City Equitable Fire Insurance Co, Re*, [1925] 1 Ch 407; [1924] All ER Rep 485.

39 *Charitable Corpn* v *Sutton*, (1742) 26 ER 642. The general practice, however, is not to hold a director liable for things that transpire in his absence at a board meeting. See *Cullerne* v *London & Suburban General Permanent Building Society*, (1890) 25 QBD 485; 63 LT 511.

40 *See* S. 292 under "Statutory Provisions" *supra*. The directors, being in control of the company's affairs, they cannot get rid of their managerial responsibility by nominating a person as the occupier of the factory. *J. K. Industries* v *Chief Inspector of Factories*, (1996) 1 SCC 665; (1997) 88 Comp Cas 285 SC. This will not apply to the case of a Government company, the ultimate responsibility being that of the Government, special rules become necessary. *Indian Oil Corpn Ltd* v *Chief Inspector of Factories*, (1998) 94 Comp Cas 64; AIR 1998 SC 2456.

41 *Landhurst Leasing plc, Re*, [1999] 1 BCLC 286 Ch D.

company suffers a loss, to what extent are the other directors liable. This was the question before the House of Lords in the leading case of *Dovey* v *Cory*.[42]

> A banking company had suffered heavy loses on account of advances of money made to irresponsible persons and without security; and also on account of payment of dividends out of capital. These losses were due to the mechanism of the chairman and the manager who manipulated the accounts and showed a profit. At a meeting of the board, the defendant was ensured of the correctness of the accounts and, therefore, he gave his authority to the payment of a dividend which was obviously paid out of capital.

He was sued for the losses, but was held not liable. Lord HALSBURY observed:

> Each and all of the charges may be disposed of by the proposition that Mr Cory was not himself conscious of any one of these things being done. Was he under a duty to probe into and know these things? It cannot be expected of a director that he should be watching the inferior officers or verifying the calculations of auditors. Business of life could not go on if people could not trust those who are put in a position of trust for the express purpose of attending to the details of management. He could have been held liable only if he had some reasonable grounds to suspect the honesty of the other officials.[43]

This principle was followed by the Madras High Court in *D. Doss* v *C. P. Connell*.[44]

> An undischarged insolvent,[45] having been appointed advisory director of a banking company, misappropriated a part of the security money received from the employees of the company which was at his disposal.

The official liquidator could not succeed in his effort to charge his co-directors with the liability. The court said that the respondents had no reason whatsoever to suspect the integrity of the Chairman. "Insolvency does not necessarily mean that a man is a dishonest man."[46] In a subsequent decision, the same court added:[47]

> The ordinary directors of a company are entitled to presume in the absence of features arousing their suspicion that the affairs of the company are being properly conducted by the managing director and the managing committee, and unless any mismanagement or other act of misfeasance is

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42 1901 AC 477: [1895-9] All ER Rep 724. *See* R. K. Goel, *Delegation of Directors' Powers and Duties: A Comparative Analysis*, (1967) 18 ICLQ 152.

43 1901 AC 485. *See also* LINDLEY LJ in *National Bank of Wales Ltd, Re*, [1899] 2 Ch 629 at 673: [1895-9] All ER Rep 715; *Denham & Co, Re*, (1883) 25 Ch D 752: 50 LT 523. See also *Land Credit Co of Ireland* v *Lord Fermoy*, (1870) 5 Ch App 763, where a company's board had, in accordance with the company's constitution, quite properly delegated the making of a transaction to a sub-committee, which made illegal loans, the director who was not a member of the sub-committee and who had no reason to suspect the impropriety of the transaction was held not liable for the loss suffered by the company.

44 AIR 1938 Mad 124.

45 S. 202 now prevents an undischarged insolvent from holding any managerial office.

46 Quoting LINDLEY MR in *National Bank of Wales Ltd, Re*, [1899] 2 Ch 629 at 673: [1895-99] All ER Rep 715.

47 *Ganesan* v *Brahamayya & Co*, [1946] Comp LJ 262 Mad.

brought to the notice of the directors, they cannot be held liable in respect of the same.

On the same principle, directors were held not liable for misappropriation of stores by the stores manager,[48] or for failure to detect cashier's concealment of overdrafts,[49] or for payment of dividends on false accounts declared at a meeting where the director sought to be made liable was absent,[50] or for allowing, by one of the two directors, the company's premises to be used for gaming purposes without licence, the other director knowing nothing.[51]

"A director is also permitted to rely on professional or expert advice given by reliable competent employees, professional advisors and experts, and other directors. This is provided the reliance is in good faith, after proper inquiry when appropriate, and without knowledge that the reliance was unwarranted. A prudent director aware that he or she lacked expertise in a particular area could avoid potential liability under Section 137 by obtaining the advice of an expert. In common with other provisions in the Act, the best way a director can protect him or herself from later liability is to lay a 'paper trail' before entering into any transaction or carrying out any action."[52]

This, however, does not mean that directors can always throw up their hands and say, "we knew nothing and believed that everything was alright". Sometimes it is their duty to know. These words of Lord SIMONDS in *Morris* v *Kanssen*,[53] though spoken in a different context, were borrowed by NAIR, J of the Kerala High Court in deciding the typical case of *Palai Central Bank Ltd* v *Joseph Augusti*:[54]

> The accounts of a banking company in liquidation showed that taxes and dividends were paid for as many as twenty-two years (i.e. from 1936-1958) on profits not really earned, but made to appear firstly by fictitious entries, and subsequently by showing interest, which there was no prospect of ever realising, on the bad and irrecoverable advances. The length of time was by itself a sufficient proof of the deliberateness of the falsification.

The court rejected the directors' plea that they had relied on competent staff and auditors who always certified the accounts as true. Referring to the magnitude of the loss involved, which could not be easily explained, the court said:

> Not one of them has cared to disclose who were the persons in actual charge of these matters, what exactly were the duties imposed on them, and

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48 *Vijai Laxmi Sugar Mills, Re*, AIR 1963 All 55.

49 *Prefontaine* v *Grenier*, 1907 AC 101

50 *Nagendra Prabhu* v *Popular Bank*,: AIR 1970 Ker 120: (1969) 39 Comp Cas 685: ILR [1969] 1 Ker 340.

51 *Huckerby* v *Elliott*, [1970] 1 All ER 189. *The City Equitable* principles have been followed in the following Indian cases. *S. C. Mitra* v *Nawab Ali Khan*, AIR 1926 Oudh 153: 92 IC 50; *National Bank of Upper India* v *Dina Nath Sapru*, AIR 1926 Oudh 243: 95 IC 234; *Thinnappa Chettiar* v *Rajagopalan*, AIR 1944 Mad 536: [1944] 2 MLJ 45.

52 S. M. Watson, *Directors' Duties in New Zealand*, 1998 JBL 495 at p. 504.

53 1946 AC 459 at 476: [1946] 1 All ER 586: 174 LT 353.

54 [1966] 1 Comp LJ 360.

what scrutiny there was over their work in order to assure that it was properly done. At best the plea of the respondents can only amount to a plea of complete ignorance born of a complete inadvertence to their duties, as directors, a reckless indifference, or, otherwise put, a wilful shutting of their eyes.... The deliberate falsification of the books year after year could not have been the handiwork of the staff of the company; it could only have been at the specific instructions of those at the helm of affairs. In a company, the directors are at the helm of affairs, and although the rudder might be in the hands of the managing director, it is their duty to keep an eye on him and see that he steers a proper course.[55]

Similarly, "the position of a managing director or chairman of the board of directors is different. He cannot say that he signed the accounts without understanding the implication of its entries."[56]

Duty to disclose interest [Ss. 299-300]

Conflict of interests

Every agent occupies a fiduciary position towards his principal. As such it is his duty to see that his personal interest and his duty to his principal do not conflict. For the proper exercise of the functions of a director, it is essential that he be disinterested, that is, be free from any conflicting interest.[57] This conflict invariably arises when a director is personally interested in a transaction of the company. Naturally a man is likely to prefer his personal interest. This principle was established in the leading case, *Aberdeen Railway Ltd* v *Blaikie*.[58] There, Blaikie had a conflict of interest as director and chairman of the company and managing partner of a firm which supplied office furniture to the company. Despite the fact that the price the company paid for the furniture was fair, the company was entitled to set the contract aside. The judge said:

> "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 interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a 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 engagements 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."

Blaikie had an interest as a partner in the firm to sell as high as possible but an interest as director, of the company to purchase as low as possible. The

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55 [1966] 1 Comp LJ 381. The learned Judge then cited passages from the speech of Lord DAVEY in *Dovey* v *Cory*, 1901 AC 477: [1895-9] All ER Rep 724 and distinguished the case on the ground that there the defendant faced a searching examination which certified his innocence.

56 *Official Liquidator* v *Shri Krishna Prasad Singh*. [1969] 1 Comp LJ 325; *National Sugar Mills Ltd, Re*, (1978) 48 Comp Cas 339 Cal, where the managing director was held liable for misappropriations but not his co-directors.

57 Jackson, THE WISDOM OF THE SUPREME COURT, 417-18 (1962).

58 (1854) 1 Mcy 461.

fairness or otherwise of the price was irrelevant; what the court considered was the *possibility* of unfairness.[59]

The Act lays down a special procedure to be followed in such cases.

In the first place, a director who is interested in a transaction of the company is required to disclose his interest to the board.[60] The disclosure must be made at the first meeting of the board held after he has become so interested.[61] If he is a member of a company or of a firm with which the company has to deal he may give a general notice to the board of his interest in that concern. Such notice must be renewed after every year.[62]

Secondly, an interested director is not allowed to take part in the discussion by the board on the matter of his interest. Neither shall he vote nor shall his presence count for the purpose of quorum. If he does vote, his vote shall be void.[63]

As noted above, these provisions are based upon the sound principle that the company is entitled to the unbiased advice of every director upon matters which are brought before the board.

> It is possible, of course, that a person may be altruistic and in coming to an arrangement in which he is concerned he will give better terms to the other contracting party than if he had no interest at all, but persons of such disposition are not usually found among the directors of a company and it must be assumed that in the making of an arrangement a man will consider his own interest rather than the interest of the other contracting party.[64]

What constitutes "Interest".—This obviously raises the question as to what constitutes an "interest" within the mischief of the rule. "The interest to be disclosed is that which in a business sense might be regarded as influencing judgment; 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."[65] In short, the interest must be such which conflicts with the director's duties towards the company. Thus, for example, where the directors took part in and

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59 Under S. 139 of the New Zealand Companies Act, 1993, directors are deemed to be interested in the following circumstances:

If the director is a party to or will or may derive a material financial benefit from the transaction;

If the director has a material financial interest in another party to the transaction;

If the director is a director, officer or trustee of another party or person who will or may derive a material financial benefit from the transaction;

If the director is the parent, child or spouse of another party or person who will or may derive a material financial benefit from the contract;

If the director is otherwise directly or indirectly materially interested in the transaction.

60 Ss. 299-300. The object of these provisions is explained by CHAGLA CJ in *Walchandnagar Industries v Ratanchand*, AIR 1953 Bom 285.

61 S. 299(2)(*a*) and (*b*).

62 S. 299(3).

63 *Id.*, (*b*). *See also* sub-section (4) which imposes penalty for default; also sub-sections (5) and (6) which contain some exceptions.

64 *Alexander Timber Co, Re*, (1901) 70 LJ Ch 767 *See* also *Ramaswami Iyer v Madras Times Printing & Publishing Co*, AIR 1915 Mad 1179.

65 *Colmess Iron Co, Re*, 1951 SC 476 [Scotland]; 1951 SLT 344.

voted at a meeting of the board which granted debentures to two of them, the resolution was held to be bad.[66]

Only such interest comes within the mischief of the rule and has to be disclosed which is "personal" in the business sense of the word. Thus the appointment of a director as a chairman or as a managing director is not such an interest and the appointment will, therefore, be valid even if the director to be appointed was present at the meeting and voted.[67] But in *V Ramaswami Iyer* v *Madras Times Printing & Publishing Co*:[68]

> Under a company's articles two directors constituted a quorum for a meeting of the board. Two were present and they appointed one of themselves as managing director and co-editor of the paper run by the company. The appointments were held to be invalid as when the vote of the interested director was excluded there was no quorum to make the appointment in each case.

Where Board already aware.—Where the whole body of directors is already aware of the facts, a formal disclosure is not necessary. A very illustrative case is *Venkatachalapathy* v *Guntur Cotton, etc. Mills*.[69]

> A mortgage of Rs 1,23,354 was created over the mill property of a company. The loan was advanced by the wife of a director. Thus he was interested in the transaction. But he neither disclosed his interest, nor abstained from voting. In an action by the company to have the mortgage set aside, it was held that as the fact was already known to the directors there was no necessity of a formal disclosure.

It was also contended by the company that his voting on the matter vitiated the contract. The court was, however, of the opinion that mere voting by an interested director could not render the contract void or voidable unless, in the absence of that vote, there would have been no quorum qualified to contract.

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66 *North Eastern Insurance Co Ltd, Re*, [1919] 1 Ch 198: 120 LT 223. This may be compared with *Bank of Poona* v *Narayandas*, AIR 1961 Bom 252: (1961) 31 Comp Cas 364: 63 Bom LR 122, where a resolution allotting shares to a defaulting director in a meeting at which he was present and voted was held not void. *See* also *Public Prosecutor* v *T. P. Khaitan*, AIR 1957 Mad 4: (1957) 27 Comp Cas 717: [1956] 2 MLJ 590. *Mukkattukara Catholic Co Ltd* v *Thomas*, (1996) 2 Ker LT 173, the mechanical function of accepting or rejecting transfer of shares at board meetings does not create conflict of duty and interest.

67 See *Foster* v *Foster*, [1916] 1 Ch 532: [1916-17] All ER Rep 856 and *N. W. Transportation Co* v *Beatty*, (1887) 12 AC 589: 57 LT 426. In the case of *Public Prosecutor* v *T. P. Khaitan*, AIR 1957 Mad 4, it was held that a resolution by which a director was authorised to draw cheques on the company's bankers was not bad simply because the director so authorised had participated in the meeting of the board. *Shailesh Harilal Shah* v *Matushree Textiles Ltd*, AIR 1994 Bom 20, appointment of a director's brother as a director in the company was not viewed as a matter of personal interest so as to be vitiated by the director's presence and voting. Such appointment is neither a contract nor arrangement within the meaning of S. 299. The court cited *Madras Tube Co Ltd* v *Hari Kishon Somani*, [1985] 1 Comp LJ 195 Mad where the court in turn relied upon *Foster* v *Foster*, (1916) 1 Ch 532: [1916-17] All ER Rep 856.

68 AIR 1915 Mad 1179.

69 AIR 1929 Mad 353: 115 IC 486. Where the daughter of the chairman-cum-managing director was to be appointed as vice-president and the whole number of directors were already aware of this fact, its having been disclosed on an earlier occasion, non-disclosure at this occasion was held to be not a failure in duty, *A. Sivasailam* v *ROC*, (1995) 83 Comp Cas 141 CLB.

The mere fact that voting is an offence[70] punishable with fine does not *ipso facto* render the contract void or voidable. The court agreed with the company's argument that an interested director not declaring his interest would be liable to account for secret profit made by him in the transaction, but the present case revealed no such profits. The mortgage was found to be fair and in the interest of the company.

An English ruling on this point was handed down in *Lee Panavision Ltd* v *Lee Lighting Ltd.*[71] The court said that it would hesitate to find that the failure to formally disclose at a Board meeting an interest common to all members and, *ex hypothesi*, already known to all the members of the Board would be a breach of duty. This ruling was followed in *MacPherson* v *European Strategic Bureau Ltd.*[72] In this case, the fact of mutual interest was known to all the directors and, therefore, no importance was attached to the lack of a formal disclosure. But the Court of Appeal[73] did not approve the contract because there was the breach of a fiduciary duty in exercising powers of management for their own benefit rather than for the benefit of the company. The distribution of the company's assets was an attempt to effect an informal winding without making a provision for its creditors.

Effect upon transaction.—It has been pointed out by the Supreme Court that there is no ban on a contract in which a director is interested; only that it should be disclosed, *bona fide* and fair.[74] Even where the interest is not disclosed the transaction is only voidable against the interested director and not void.[75] If the company waives the irregularity and affirms the transaction, he becomes bound by it. He cannot insist on the irregularity.[76]

Accountability for profit from transaction.—The director in question is bound to hand over the benefits, if any, that he might have secured under the transaction and he cannot ask for set off for any claim that he may have against the company. This is the grand contribution of the decision of the House of Lords in *Guinness plc* v *Saunders.*[77] The plaintiff company launched a takeover bid for another company. *W* and two other directors formed a committee of the board for the purpose of conducting the bid. A company controlled by *W* submitted a bill for £ 5.2m by way of remuneration for services rendered in connection with the take-over. The calculation was in terms of a percentage linked with the amount involved in the take-over. *W* claimed that the payment was under an agreement with the company, but, in fact, it was only under an

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70 Sub-section (4) of S. 299 and sub-section (4) of S. 300 impose a penalty for the contravention of the provisions which may extend up to fifty thousand rupees. For a critical examination of these provisions *see* P. A. S. Rao, *Law Relating to Directors' Interest*, [1966] 2 Comp LJ 47.

71 [1992] BCLC 22 CA.

72 [1999] 2 BCLC 203 Ch D.

73 *Mac Pherson* v *European Strategic Bureau Ltd*, The Times, Sept 5, 2000 CA.

74 *P. Leslie & Co* v *V. O. Wapshare*, AIR 1969 SC 843: [1969] 2 Comp LJ 113: 39 Comp Cas 808: (1969) 3 SCR 203.

75 *Narayandas* v *Sangli Bank*, AIR 1966 SC 170: (1965) 35 Comp Cas 596: [1965] 2 Comp LJ 99.

76 *Ibid.* See also *Yuill* v *Greymouth, etc Rly Co*, [1904] 1 Ch 32, where a director was not allowed to avoid an allotment on the ground that he took part in it.

77 [1990] 1 All ER 652 HL: [1990] 2 WLR 324: the decision of the court of appeal is reported in 1988 BCLC 607: [1988] 2 All ER 940 CA: [1988] 4 BCC 377.

agreement with the committee of directors and the fact that he had become interested in the transaction by linking his remuneration with the takeover amount was also disclosed only to this committee. He was compelled to refund the whole amount to the company. The matter of his interest had to be disclosed at a meeting of the full board of directors duly convened and not merely to a sub-committee of directors. He thus held the money as a constructive trustee and was obliged to account for it irrespective of any cross-claim he might have by way of *quantum meruit* or equitable compensation for services rendered.

General consequences of default.—According to ISSAC J of the Kerala High Court[78] the consequences of default under the section are: (1) liability to be prosecuted under Section 299(4); (2) cessation of the office of directorship under Section 283(1)(*i*)[79]; (3) liability to be prosecuted under Section 283(2-A) for acting as director after incurring a disqualification; and (4) liability to refund remuneration. It is not possible for the court to relieve the director concerned under Section 633 from the cessation of directorship and its consequences.

Exception.—This procedure has not to be followed where the contract is between two companies and a director does not hold more than 2% [or two or more of them together hold not more than 2%] of the paid-up share capital of the company.[80]

Position and liability of nominee director

A nominee director is not supposed to be in charge of a company's affairs. He is not liable for the failures of the company to comply with the Companies Act and other regulatory laws. His duty is to watch the interest of the institution which nominated him. As a member of the Board the only expectation from him is that he should not do anything against the interest of the company. Where a complaint showed that a nominee director wilfully abetted the making of a false statement under the Income Tax Act, the court refused to quash the complaint against him. His position was to be considered on evidence.[81]

A nominee director suffers from an essential conflict of duty and interest. He owes his duty to the nominator but he is sitting in the board of the denominator. A holding company nominated a majority of the directors in the subsidiary company's board who remained docile and because of their inaction, the holding company suppressed the business of the subsidiary. Without exploring the possibilities of making the nominees liable for destroying the business of the subsidiary, the court allowed the alternative relief of compelling the holding company to refund the minority investment in the subsidiary taken at a value before the repressive policy began. The court observed that nominee directors cannot consider themselves as merely the watchdog of the nominator's interest. No problem arises so long as the interests of both the companies are in

78 *M. O. Varghese* v *Thomas Stephen & Co Ltd*, (1970) 40 Comp Cas 1131 Ker.

79 Punishment is by way of fine which may extend to five thousand rupees. *See* further, *Globe Motors Ltd* v *Mehta Teja Singh*, (1984) 55 Comp Cas 445 (Del). *K. S. Dhillon* v *Paragaon Utility Financiers*, (1988) 64 Comp Cas 19, 32 P&H, automatic vacation of office of director.

80 S. 299(6). For an account of liabilities of officers and directors of companies, *see* Dr V. Gauri Shanker, [1986] 3 Comp LJ 127 (Journal section).

81 *J. Sethuraman* v *IAC of IT*, (1992) 74 Comp Cas 815 Mad.

harmony. But when their interests are at a conflict, the nominees would be placed in an impossible position.[82]

In a subsequent case[83] the nominator company and its nominees were sued by those who lost their investment because of acting upon quarterly financial statements issued by the nominees on behalf of the denominator company, the statements being false. They were held not liable because shareholders or investors who appoint or nominate directors owe no duty to anybody about their conscientious functioning unless there is some impropriety in the conduct of the nominator. But the judges were agreed that nominee directors are in the same position as other directors and they owe the same duties.[84] The question of nominee directors was again dealt with in the New Zealand case of *Dairy Containers Ltd* v *NZI Bank Ltd*.[85] Three nominee directors of a New Zealand Dairy Board subsidiary stole large amounts of money for that subsidiary. The Court was critical of the Privy Council decision in *Kuwait Asia Bank*[86] but felt obliged to follow it and state that the Dairy Board was not liable for the acts of its nominee directors since it did not exercise direct control over Dairy Containers Ltd.

Tax Liability

Where the bank account of a director of a private company was frozen for recovering income tax dues of the company, it was held that it was for the director to show that the default on the part of the company was not attributable to any breach of duty on his part.[87] But apart from any provisions of the taxing statute, arrears of the tax amount are not to be recovered from any director personally.[88]

MEETINGS OF DIRECTORS

Directors of a company have to exercise most of their powers at periodical meetings of the board. It is, therefore, provided in Section 285 that "in the case of every company, a meeting of its board of directors shall be held at least once in every three months; and at least four such meetings shall be held in every year".[89]

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82 *Scottish Cooperative Wholesale Society* v *Meyer*, 1959 AC 324: [1958] 3 All ER 66. (1958) 3 WLR 404 HL.

83 *Kuwait Bank EC* v *National Mutual Life Nominees Ltd*, (1990) 3 WLR 297: [1990] 3 All ER 404 PC.

84 See *Selangor United Rubber Estates Ltd* v *Cradock (No 3)*, (1968) 1 WLR 1555 at 1613-1614: (1969) 39 Comp Cas 485.

85 (1995) 2 NZLR 30.

86 *Kuwait Asia Bank EC* v *National Mutual Life Nominees Ltd*, (1993) NZLR 513.

87 *Gurudas Hazra* v *P.K. Chowdhury*, (2002) 109 Comp Cas 109 Cal.

88 *Peter J R Prabhu* v *Asstt Commr of Commercial Taxes*, (2002) 109 Comp Cas 299 Kant. *Maddi Swarna* v *Commercial Tax Officer*, (2002) 109 Comp Cas 308 AP, sales tax arrears could not be recovered from the director except as provided in the winding up, i.e. in the course of winding up.

89 A proviso to the section enables the Central Government to modify the rule in relation to any class of companies. It is a sufficient compliance that a meeting was called within the permissible time though it could not be held for want of quorum. S. 288(2).

Notice

Notice of every board meeting has to be given in writing to every director who is in India.[90] "The Act does not prescribe the form of notice or mode of service and if the directors are duly informed that in future meetings would be held on the first Saturday of every month, it is a sufficient compliance of the statute."[91] Failure to give notice to any director renders the meeting invalid,[92] and the business conducted at it is void.[93] Where the general manager of a company was removed by a meeting of the board in which one director could not participate as he was not informed, the Supreme Court held that the confirmation of the proceedings and of the notice of termination served by the chairman at a subsequently regularly convened meeting of the board validated the termination. It amounted to a ratification.[94] Explaining the role of the chairman in a subsequent case, the Supreme Court said:[95]

> "The chairman of the Board of directors is the central figure in holding the meeting and is the controlling factor in the conduct of the meeting. He authenticates the minutes of the meeting and performs such other functions as empowered under the Companies Act. A chairman is always elected by the Board of directors; thus he has the full support of the majority of Directors which helps him in the control of the meeting and recording authenticated minutes."

The notice need not specify the agenda for the meeting. The agenda may be set out as a matter of prudence, but it is not required.[96] Even where agenda is specified, the directors need not confine themselves to it. Any other business conducted at the meeting would be equally valid. Any other rule "would be extremely embarrassing in the transaction of the business of companies". However, the members of the board should not be taken by surprise particularly over serious matters. A notice convening a meeting was held to be invalid because it did not specify that the meeting was being called to consider and approve the transfer of controlling interest in the private company and that too in violation of the pre-emptive provisions in the company's articles.[97]

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90 S. 286(1). Sub-section (2) penalises any officer whose duty is to give notice for any default.

91 *A Chettiar* v *Kaleeswarar Mills*, AIR 1957 Mad 309, 319.

92 See *Young* v *Ladies' Imperial Club*, [1920] 2 KB 523: [1920] All ER Rep 223, where a person consented to be a member of the committee only on a promise that she would not be troubled, a failure to send notice to her vitiated the meeting. Also see *Portuguese Consolidated Copper Mines Ltd, Re*, (1889) 42 Ch D 160 CA.

93 *Homer District Consolidated Gold Mines, Re*, (1888) 39 Ch D 546: 60 LT 97, subject, of course, to the principle of indoor management.

94 *Parmeshwari Prasad Gupta* v *UOI*, (1973) 2 SCC 543: AIR 1973 SC 2389: (1974) 44 Comp Cas 1.

95 *Nazir Hoosein* v *Darayus Bhathena*, (2000) 5 SCC 601: AIR 2000 SC 2427: (2000) 37 CLA 414 SC.

96 *See* LINDLEY LJ in *La Compagnie de Mayville* v *Whitley*, [1896] 1 Ch 788 at 796 CA.

97 *Shanta Genevieve Pommeret* v *Sakal Papers (P) Ltd*, (1990) 69 Comp Cas 65 Bom.

The law also does not prescribe any length of notice. "A few minutes' notice may suffice."[1] Even a chance meeting of directors may be resolved into a board meeting. In *Smith* v *Paringa Mines Ltd*:[2]

> A directors' meeting was duly summoned for filling up a vacancy. There were only two directors *T*, and *B*, *B*, being the chairman. *T* did not attend. *B* went to *T's* personal office and met him in the passage outside his office. While standing there *B* proposed *F's* name. *T* objected. *B*, being in the chair, gave his casting vote and declared *F* elected.

The court upheld the election and said: "There is no reason why a meeting should not be held in the passage." As against it, in another case[3] the only two directors of a company were not on speaking terms, for which reason it became necessary to appoint additional directors. One of them, *P*, waited for the other, *C*, at a railway station and finding him alighting from a train proposed three names. *C* remained silent. Thereupon *P* gave his casting vote and declared the three directors as elected. But the court did not uphold these appointments. "A director cannot have a board thrust upon him without his consent and against his will."

In this respect meetings of board are immensely different from those of shareholders which have to be held in an atmosphere of considerable formality.[4]

In the case of a closely held company the proceedings of meetings of the Board of directors used to be very informal. Minutes were signed only by the chairman. Names of directors who attended were not always recorded.

The CLB (now Tribunal) refused to draw the inference of the absence of a director from a meeting only because his signature on the minutes was not there.[5]

Quorum [S. 287]

The quorum for a meeting of the board is one-third of its total strength (any fraction to be rounded off as one) or two directors, whichever is higher. But where this quorum cannot be formed, because of interested directors, then the number of directors who are not interested, being not less than two, shall be the quorum.[6] If a meeting cannot be held for want of a quorum, it stands adjourned till the same day

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1 *Browne* v *La Trinidad*, (1887) 37 Ch D 1: 58 LT 137 CA. *See* H. Goitein, COMPANY LAW (1960) 129. A few hours' notice has, however, been held to be not sufficient, particularly in view of the fact that those who attended wanted the others opposing them not to attend. See *Homer District Consolidated Gold Mines, Re*, (1888) 39 Ch D 546: 58 LJ Ch 134: 60 LT 97.

2 [1906] 2 Ch 193. Calling meeting at a time when some directors were abroad and, therefore, could not attend and thereby to take advantage of that absence for passing resolutions which it would not have been possible to pass otherwise, this was held to be a fraudulent purpose which vitiated the meeting. The court also held that questioning resolutions and appointment of directors is a matter for civil court jurisdiction. *T. M. Paul (Dr)* v *City Hospital (P) Ltd*, (1999) 97 Comp Cas 216.

3 *Barron* v *Potter*, [1914] 1 Ch 895: 110 LT 929.

4 *See* Lord TENTERDON in *R* v *Pulsford*, (1829) 8 B & C 350, cited by LINDLEY LJ in *La Compagnie de Mayville* v *Whitley*, [1896] 1 Ch 788 at 796 CA.

5 *T. V. Prasadachandran Nair* v *Anandamandarim Hotels P Ltd*, (2002) 110 Comp Cas 294 CLB

6 Proviso to S. 287. *See also* sub-section (1) which explains the meaning of "total strength" of directors for this purpose and says that it shall be taken after deducting the number of posts which are lying vacant.

in the next week.[7] If that day is a public holiday, the meeting will be held at the next succeeding day which is not a public holiday. The quorum requirement does not become dispensed with because one out of two directors is abroad. A meeting attended by only one director was held to be not valid.[8]

Where the company's articles provided for a total number of 15 directors but at the material time only 6 directors were in office, it was held that quorum meant 1/3 of the 6 directors and, therefore, a meeting attended by two directors only was valid.[9]

Proceedings

The manner of conducting the business of the board is something to be provided for in the articles. According to the regulations given in Schedule I of the Act[10] questions arising at any meeting of the board are to be decided by a majority of votes. The chairman may be given a second or casting vote in case of an equality of votes.[11] Matters decided are put in the form of resolutions proposed and approved. A resolution may be passed either at a meeting of the board or by circulation.[12] Section 289 requires that if a resolution is to be passed by circulation it should be circulated in draft, together with all the necessary papers, to all the directors[13] and should be approved by a majority.[14] The resolutions of the board, even if passed by a majority, are binding on all the directors and all of them are bound to help others in carrying them out whether they voted with or against the majority.[15]

Minutes [S. 193]

The proceedings of every meeting of the board or of any of its committees have to be recorded in a minutes book. Explaining the purpose, Lord ESHER said in *Cawley & Co. Re*:[16]

> Minutes of the board meeting are kept in order that shareholders of the company may know exactly what their directors have been doing, why it was done, and when it was done.[17]

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7 S. 288. Business transacted without a quorum being present is void. *See*, for example, *North Eastern Ins Co Ltd, Re*, [1919] 1 Ch 198: 120 LT 223, where allotment of debentures to two directors, being resolved upon with the help of an interested director's vote, was held void. The Calcutta High Court has held that the directors can fix a time for reassembling and no further notice is necessary. *Promod Kumar Mittal* v *Southern Steel Ltd*, (1980) 50 Comp Cas 555 Cal.

8 *Hood Sailmakers Ltd* v *Axford*, (1997) 1 BCLC 721 QBD.

9 *Pradeep Kumar Banerjee* v *UOI*, (2002) 108 Comp Cas 692 Cal.

10 *See* Regulations 64-81.

11 In the absence of any such provision, the chairman does not have a casting vote, *Weakley* v *Amalgamated Union of Engineering Workers*, THE TIMES, June 12, 1975, noted 1975 JBL 222.

12 The fact that directors should act by "combined wisdom" is satisfied where they give consent with full knowledge though they do not meet at any one place. See *Collie Claim*, (1871) LR 12 Eq 246: 40 LJ Ch 567.

13 Excepting those who are not in India; (S. 289). But the number present must be sufficient to constitute a quorum.

14 Of those who are present in India. S. 289. For a study of few cases on how informal a meeting of the board may be, *See* Goitein, COMPANY LAW, (1966).

15 *Equitycorp International plc, Re*, [1989] 1 WLR 1010: 1989 BCLC 597 Ch D.

16 (1889) 42 Ch D 209 at 226: 61 LT 601.

17 For further details about the minutes book *see* Minutes of General Meeting, *infra*, as S. 193

REGISTERS

For the information of shareholders, companies are required to maintain certain registers concerning directors.

1. Register of directors [S. 303]

The first important register to be maintained is known as the Register of Directors. Every company has to keep at its registered office a register of its directors, managing director, managing agents, secretaries and treasurers, manager and secretary. The register is to contain the following particulars:

1. The full name of the director, etc. with father's name and address; if a married woman, her husband's name; nationality of origin; his business or other occupations; particulars of any office held by him in any other company; his date of birth.[18]
2. In case any of the above offices is held by a body corporate,[19] its corporate name and registered office and the details specified in clause (1) [above] of each of its directors; if the same body corporate holds office in some other companies the particulars of each such office.
3. In case any of the above offices is held by a firm,[20] the name of the firm should be given and also the details specified in clause (1) [above] of each partner in the firm; and if the firm holds office in other companies, the particulars of each such office.
4. If any directors have been nominated by a body corporate, the name of such company should be given and the particulars of each of its directors.
5. If any directors have been nominated by a firm, the particulars of such firm should be given.

A duplicate copy in the prescribed form of the contents of the register should be sent to the Registrar within thirty days of the appointment of first directors. When any change occurs in the managerial personnel a notification of the change should be sent within thirty days from the date of the change.[21]

Shareholders have the right to inspect the register without any charge and any member of the public on payment of one rupee for each inspection.[22] The articles or general meeting of shareholders may impose reasonable restrictions on hours of inspection, but they should not be less than two on each day.

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applies uniformly to both kinds of meeting.

18 Not applicable to a private company: S. 303(1)(*a*). The register should include details about a person in accordance with whose directions the board is accustomed to act. (Expln. 1).

19 The office of a director cannot now be held by a body corporate. (S. 253).

20 A firm cannot be a director.

21 S. 303(2). In case of default, the company and every officer in default is liable to a fine extending up to five hundred rupees for every day of default. [S. 303(3)]. The Central Government or Tribunal may by order compel an immediate inspection of the register. [S. 304(2)(*b*)].

22 S. 304(1). *See also* sub-section (2) which penalises refusal of inspection.

Directors have also been obliged at the pain of penalty to inform the company of any change that occurs in their position and which ought to be specified in the register.[23]

The Registrar of Companies is also under an obligation to maintain registers for recording information in this respect received from different companies. Such register is also open to public inspection on the payment of prescribed fee.[24]

2. Register of directors' shareholdings [S. 307]

Again for the information of shareholders and general public, companies are required to maintain a register of the directors' shareholding. The number of shares or debentures held by each director should be specified showing also his holdings in the company's subsidiaries and the company's holding company and other subsidiaries of the same holding company. The register must also give details of the shares held "in trust for him or of which he has any right to become the holder on payment or not". A director may, however, insist that the nature and extent of his interest over the shares should also be recorded. Where by reason of any transaction entered into by a director, any shares or debentures have to be recorded in the register or omitted from it, the register must show the date of and consideration for the transaction.[25]

The register is open to the inspection of members subject to reasonable restrictions which may be imposed by the company.[26] But during the period of fourteen days before and three days after an annual general meeting the register must remain open to the inspection of shareholders during any business hours not less than two hours in each day. Where the right of inspection is not allowed, the Central Government or Tribunal may by order compel an immediate inspection of the register.

For the purpose of this section the word "director" would include any person in accordance with whose directions the company's board is accustomed to act, and also any other company whose board is accustomed to act according to the directions of a director, or if such director holds one-third of the voting strength in that company.[27] Entries in the register have also to be made about the shareholding of managing agents, secretaries and treasurers and managers, if the company has any.[28] Directors are obliged to make necessary disclosures to enable the company to prepare the register.[29]

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23 The time given to him is twenty days from the date of change and the penalty for default may extend up to five thousand rupees. (S. 305).

24 S. 306. See *S.K. Bhattacharya* v *UOI*, (1998) 91 Comp Cas 37 Delhi, the Government was held not liable for accepting and putting on record particulars filed by one faction of the company's directors and rejecting those filed by the other faction.

25 S. 307(2). *See also* the proviso.

26 S. 307(5).

27 S. 307(10).

28 S. 307(11).

29 S. 308.

3. Register of contracts, companies and firms in which directors are interested [S. 301]

A company has also to maintain a register of such contracts in which a director is interested and of contracts with such companies or firms in which a director is interested. This register is to contain the particulars regarding the date of the contract, the names of parties, important terms and conditions of the contract, the date on which it was put before the board and the names of directors who were neutral or voted for or against the contract.

LOANS TO DIRECTORS [S. 295]

Lending of money by a company to its directors is now strictly regulated by the Act. Indeed, in the following cases loans to directors are not allowed except with the previous approval of the Central Government:

1. Loans to the directors of the company, or to the directors of its holding company or to any partner or relative of any director.
2. Loans to any firm in which such a director or his relative is a partner.
3. Loans to any private company of which any such director is a member or a director.
4. Loans to any body corporate at whose general meeting any such director or directors control twenty-five per cent of voting.
5. Loans to any company whose board or other managers are accustomed to act in accordance with the instructions of the board of directors, any director or directors of the lending company.

The section prohibits not only direct lending of money by a company to its directors but also giving of any guarantee for a loan taken by a director from any other person and providing of any security for any such loan. It also prohibits the providing of any guarantee or security for a loan given by a director to any person.[30] A complaint that salary was paid to a director's wife in advance and that it amounted to a loan was rejected. It was not enough to show that the recipient was a director's wife. It had to be proved that she merited no salary for which advance payment could be made.[31] Sale of a flat of the company to a director who paid half the price at once and the rest was to be paid in instalments was held to be not a loan.[32]

This restriction, however, does not apply to a private company which is not a subsidiary of a public company and to banking companies. The section also allows loans to be given by a holding company to its subsidiaries. Further a

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30 Any officer of the company who is knowingly a party to the contravention of this section is liable to a penalty of fine and imprisonment. [Sub-section (4)]. For any violation of the section complaint has to be filed within the period of limitation. The Calcutta HC has held that a magistrate should not grant *ex parte* condonation of the delay. The directors had already paid back the amount. Relief was granted under S. 633. *Hindustan Wire and Metal Products, Re*, (1983) 54 Comp Cas 104 Cal. The proviso to the sub-section says that imprisonment shall not be awarded where the loan has been paid back.

31 *M. R. Electronics Components Ltd* v *Asstt ROC*, [1986] 3 Comp LJ 281 Mad.

32 *Predie Ardeshir Mehta* v *UOI*, (1991) 70 Comp Cas 210 Bom

guarantee or security may be given by a holding company for the loans of its subsidiaries.[33]

REMUNERATION OF DIRECTORS [Ss. 198 AND 309]

Regulation of directors' remuneration becomes necessary for several reasons, prominent among them being the prevention of diversion of corporate funds for personal use and the impact which the unduly high executive reward has upon the rest of the society.[34]

Section 309 provides that remuneration payable to directors shall be determined either by the articles of the company or by a resolution of the company in general meeting. The resolution may be ordinary or special, as the articles may require.[35] But whatever amount or mode of payment may be so determined, it shall be subject to the provisions of Sections 198 and 309.

Section 198 lays down the overall maximum of managerial remuneration which can be paid by public company or a subsidiary of a public company. The total managerial remuneration payable to directors, or manager in respect of a financial year shall not exceed eleven per cent of the net profits of the company.[36] But sometimes a company may make no or inadequate profits in a financial year. This does not mean that its directors shall remain unpaid. In such a case, the company may, with the previous approval of the Central Government, pay by way of minimum remuneration any sum as may be authorised.[37]

The Central Government has to exercise its discretion judiciously and not arbitrarily. The Company Law Board refused to sanction minimum remuneration to the ordinary directors of a company under the policy that part-time directors should be paid only when there are profits. The Calcutta High Court held that ordinary directors cannot be described as part-time directors. It was an irrelevant label and the Board should have proceeded by taking into account the present and future profitability of the company.[38]

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33 S. 295(2). *See also* S. 296 which provides that the section will apply to any transaction represented by a book debt which was in its inception in the nature of a loan or advance.

34 *See* Livingston, THE AMERICAN STOCKHOLDER, (1958).

35 It has recently been held in *Radhey Shyam* v *Official Liquidator*, AIR 1968 Raj 220: [1968] 2 Comp LJ 77, that unless there is a clear provision to that effect in the articles, the remuneration cannot be determined at a meeting of the directors themselves. *See* SHINGHAL J at 222-3.

36 Net profits mean profits calculated in the manner laid down in Ss. 349, 350 and 351, except that the remuneration of the directors shall not be deducted from gross profits. S. 198(1).

37 S. 198(4), proviso, as *substituted* by the amendment of 1988. The *substituted* provision is as follows: Notwithstanding anything contained in sub-section (1) to (3) but subject to the provisions of S. 269, read with Sch. XIII, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or wholetime director or manager, by way of remuneration any sum [exclusive of any fees payable to directors under sub-section (2) of S. 309], except with the previous approval of the Central Government. For prescribed figures *see* Pt. II of Sch. XIII. Also *see* under "Remuneration" in the succeeding chapter.

38 *Hind Ceramics Ltd* v *Company Law Board*, (1972) 42 Comp Cas 610 Cal.

In order to make this limit effective and to prevent directors from drawing more money in the guise of collateral benefits, the explanation to Section 198 provides that the word "remuneration" shall include the following:

1. any expenditure incurred in providing free accommodation and other amenities connected therewith;
2. any expenditure incurred in providing any other amenity either absolutely free or at a concessional rate;
3. any expenditure incurred in providing any obligation or service which, in the absence of provision by the company, would have to be incurred by that person;
4. any expenditure incurred in providing life insurance, pension, annuity or gratuity for any such person, his spouse or child.

Sitting Fee.—The above limit of eleven per cent does not include any fee that may be payable to directors for attending meetings of the board or of committees of the board.[39]

Guarantee Commission

It has been held that payment of guarantee commission to directors on their guarantees for the company's loans is not a part of the remuneration so as to require Government approval.[40]

***Payment of commission to officers* [S. 199]**

Where any commission or other remuneration payable to any officer or employee (other than directors) or a manager of the company is fixed by way of percentage or otherwise based on the net profits of the company, the net profits for this purpose have to be calculated in the manner set out in Sections 349 and 350.

Mode of payment

Subject to this overall limit, remuneration may be paid to directors on monthly basis or by way of fee for each meeting of the board or a committee of the board attended by him. But fee for attending meetings of the board cannot be paid on a monthly basis.[41]

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39 S. 198(2). The maximum sitting fee has been prescribed as follows: Rule 10-B, w.e.f. 15-6-1988; GSR 559(E):

Companies with capital up to Rs 50 lakhs	Rs 250
Rs 50 lakh to 5 crore	Rs 500
Rs 5 to 10 crores	Rs 750
Above Rs 10 crores	Rs 1000

The prescribed maximum was revised in 1993 (w.e.f Aug 27, 1993) to Rs 2000. GSR 581(E) and the rest has been left to companies.

40 *Suessen Textile Bearings Ltd* v *UOI*, (1984) 55 Comp Cas 492 Del. As a result of this decision the Department withdrew its circular expressing the opinion that such commission would be included in remuneration. *Circular No 3 of 16-12-1994.*

41 Ss. 198(3) and 309(2).

Ceilings

It had been held by the Delhi High Court in *Upper Doab Sugar Mills Ltd* v *Company Law Board*,[42] that the Government could not by administrative action reduce the ceiling on remuneration fixed by Sections 198 and 309. In that case the Company Law Board granted approval to appointment of a managing director subject to the condition that his salary be reduced to a ceiling below that imposed by the above sections. The court held that the Board could not do so as Section 637-A permits only such conditions to be imposed as are not contrary to the express provisions of the Act. This aspect of the decision was overruled by the Supreme Court.[43] Section 637-AA added in 1974, expressly empowers the Government to impose a lower ceiling on remuneration while approving a candidate for managing directorship.[44] But in reference to other directors the decision of the Delhi High Court still holds good.

A managing or wholetime director may be paid either on a monthly basis or a specified percentage of the net profits of the company or partly by one way and partly by the other. But the amount shall not exceed five per cent of the net profits in favour of one such director or, if there are more than one, ten per cent for all of them put together.[45]

In the case of a director who is neither wholetime nor managing director, remuneration may be paid to him by way of monthly, quarterly or annual payment, but with the approval of the Central Government, or by way of commission if the company by special resolution authorises such payment.[46]

But the amount of payment to all directors of this category should not exceed one per cent of the net profits of the company, if the company has a managing or wholetime director, or manager, and three per cent in other cases. However the company may in general meeting and with approval of the Central Government, sanction more.[47]

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42 (1971) 41 Comp Cas 643 Del.

43 *Company Law Board* v *Upper Doab Sugar Mills*, (1977) 2 SCC 198: (1977) 47 Comp Cas 173.

44 Even in reference to managing directors etc., the decision is of very little value because since the amendment of 1988, normally no approval is required if the appointment is in accordance with Sch. XIII.

45 S. 309(3).

46 S. 309(4). The Central Government by a notification had reduced the administrative ceiling imposed upon directors' remuneration in 1960 from 1.80 lakhs to 1.35 lakhs. The new ceiling on the remuneration payable to managing directors, whole or part-time directors and managers in public limited companies was Rs 90,000 annually or Rs 7,500 monthly. This allowed incentive commission of one per cent on net profits subject to a maximum of Rs 45,000 or per cent of the approved salary. Where remuneration was paid by way of commission on net profits, the ceiling was Rs 1.35 lakhs. Perquisites may be allowed up to Rs 30,000 or 1/3 of the remuneration payable. This will not include: (1) contribution to provident or superannuation funds to the extent these are not tenable: (2) reimbursement of medical expenses actually incurred subject to the limit of Rs 5,000 or one month's salary whichever is less. These ceilings had been held to be void. See *Upper Doab Sugar Mills Ltd* v *Company Law Board*, (1971) 41 Comp Cas 643 Del.

47 Such special resolution shall remain in force only for a period of five years, but may be renewed from time to time by special resolution for further periods of not more than five years at a time, provided that no renewal shall be effected earlier than one year from the date on which it is to come into force. Sub-s. (7) of S. 309.

Remuneration for professional service [S. 309(1)]

An amendment introduced in 1965 provides that the remuneration payable to a director as determined according to the above rules shall include any remuneration payable to him for services rendered by him in any other capacity. But where the services of a professional nature have been rendered and, in the opinion of the Central Government, the director rendering them possesses the requisite qualifications for the practice of that profession, extra remuneration may be paid for such services.[48]

Increase in Remuneration [S. 310]

In the case of a public company or its subsidiaries, the remuneration of directors cannot be increased in any way without approval of the Central Government.[49] However, the fee payable to directors for attending meetings of the board or a committee thereof may be increased without approval as long as it does not exceed an amount which may be prescribed.

Any increase in the remuneration of directors will have no effect (*a*) in cases where Schedule XIII is applicable, unless such increase is in accordance with the conditions specified in that schedule;[50] (*b*) in any other case, unless it is approved by the Central Government. In the case of a private company which converts itself into a public company or becomes a public company under Section 43-A, any provision as to sitting fee in excess of the prescribed amount would be deemed to be an increase in remuneration.

***Excess Payment* [S. 309(5)]**

If any director has been paid in excess of the above limits, he shall hold the excess amount in trust for the company and shall be bound to refund it. The company shall not waive the recovery of any such sum. In the case of a shareholder-director who did no other work than merely holding the office of a director, a remuneration of £30 a week was viewed as excessive, the court

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48 Where in response to a company's inquiry whether an advocate director could be paid remuneration for his services as a legal adviser, the Government expressed positive opinion, it was held that remuneration paid on the basis of this approval was valid. *Ruben Mills Ltd* v *UOI*, (1985) 57 Comp Cas 193. In this respect there is no difference between the services of a legal advisor or those of a chief consultant and those of a civil or mechanical engineer. *Stup Consultant Ltd* v *UOI*, [1986] 3 Comp LJ 260 Delhi: (1987) 61 Comp Cas 784, highlighting the duty of the Central Govt. to express opinions when its opinion has been sought. These views have been confirmed by the Department of Company Affairs *vide* 3/54/87-CL V of 14-2-1988: 1988 Chartered Secy 731; Form 25-A is prescribed for applications for approval. The Government cannot impose a restriction on the amount of remuneration payable to a professional. Any such restriction would be liable to be set aside. *Sree Gayanana Motor Transport Co Ltd* v *UOI*, (1992) 73 Comp Cas 348 Kant.

49 Since Schedule XIII limits have been removed, increase in remuneration does not require Government approval. *Fenner India Ltd* v *Addl ROC*, (1994) 80 Comp Cas 1 Mad.

50 The original Schedule XIII has been replaced by a new Schedule with effect from February 1, 1994. Now, subject to the overall limit of 5% and 10% of net profits, companies can pay any amount by way of remuneration without any ceiling and, therefore, without Government approval.

saying that £10 a week has been considered reasonable in such cases, and that, therefore, the extra payment was *ultra vires* and recoverable by the company.[51]

These restrictions do not apply to a private company, unless it is a subsidiary of a public company.[52]

***Prohibition of tax-free payment* [S. 200]**

Remuneration of a company's employees or officers cannot be made tax-free. Nor shall remuneration be calculated by reference to, or varying with, any tax payable by an officer or employee.

Compensation for loss of office [S. 318]

A company may make payment to a managing director or a director holding the office of manager or in the wholetime employment of the company, by way of compensation for loss of office, or as consideration for retirement from office. No other director is entitled to compensation. Further in the following cases no compensation is payable:

1. Where the director resigns his office in view of the reconstruction or amalgamation of the company and he is appointed in the company resulting from the reconstruction or amalgamation.
2. Where the director otherwise resigns his office.
3. Where the office of the director is vacated by virtue of Section 203 or under Section 283. Section 203 empowers the court to restrain fraudulent persons from managing companies and Section 283 provides the circumstances in which the office of a director is vacated.
4. Where the company is being wound up and the winding up is due to the negligence or default of the director.
5. Where the director has been guilty of fraud or breach of trust, or gross negligence or mismanagement in the affairs of the company.
6. Where the director has instigated or has taken part in bringing about the termination of his office.

The amount of compensation should not exceed the remuneration which he would have earned for the unexpired residue of his term or for three years, whichever is shorter. The amount should be calculated on the basis of the average remuneration actually earned by him during a period of three years before the termination, or where he held office for a lesser period, during such a

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51 *Halt Garage 1964 Ltd, Re*, [1982] 3 All ER 1016. Payment made for services actually rendered does not fall in the category of excess payment even if the appointment was defective. The company can waive recovery, *C. R. Priyachandra Kumar* v *Purasawalkam Permanent Fund Ltd*, (1995) 83 Comp Cas 150 Mad. The fact that the resolution for the waiver of recovery was defective was not considered by the court as sufficient to warrant a stay order against its implementation.

52 S. 309(9). If a wholetime director or managing director is receiving any commission from the company, then he shall not receive any commission or remuneration from any subsidiary. S. 309(6).

period. The case of a managing director is outside the section. He may be entitled to compensation in the capacity of an employee.[53]

But where the company is in winding up or winding up commences within twelve months after the termination, no compensation shall be paid, if the assets of the company after deducting the expenses are not sufficient to pay to the shareholders the share capital, including the premium, if any, contributed by them.

Directors with unlimited liability [Ss. 322-323]

A limited company may make the liability of any or all of its directors unlimited. Similarly, the liability of a manager may be made unlimited. A provision to that effect will have to be contained in the company's memorandum. But if the original memorandum does not contain any such provision, it may, if so authorised by articles and by a special resolution, be altered so as to render unlimited the liability of any of the above managerial personnel.[54] But any such new provision will become effective against an officer only on the expiry of his existing term, unless he has accorded his consent to it.[55] In case any of the above managerial personnel proposes a person for appointment to any of the above posts, he shall add a statement to the proposal that the liability of the person holding that office will be unlimited. Before that person accepts the office or acts therein, a notice in writing that his liability will be unlimited shall be given to him.[56]

Prevention of management by undesirable persons [Ss. 202 and 203]

It has been seen that a person who is an undischarged insolvent is disqualified from being appointed to any managerial office. If any such person discharges the functions of a director, or manager of any company or takes part in the promotion, formation or management of any company, he is punishable with both fine and imprisonment.

Section 203 further provides for power to restrain fraudulent persons from managing companies. Where a person is convicted of any offence in connection with the promotion, formation, or management of a company or in the course of winding up it appears that a person has been guilty under Section 542 of fraudulent conduct of business or has been guilty of any fraud, misfeasance or breach of duty in the affairs of the company, the court or the Tribunal may make an order that such a person shall not, without the leave of the court, be a director of any company or take part in the promotion, formation, or management of any company. The order may restrain him for any period but not exceeding five years. A person who intends to apply for an order under this section shall have to give ten days' notice to the person against whom the order is sought.[57] An

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53 *Golden Handshake and Shareholders Protection*, (1978) New LJ 205. See *Taupo Totara Timber Co* v *Rowe*, [1977] 3 All ER 123 PC, where the contracted amount of compensation was allowed to be recovered on resignation on a take over.

54 S. 323(1).

55 S. 323 (2).

56 S. 322 (2). *See also* sub-section (3).

57 S. 203(3).

application for this order may be made by the liquidator of a company, or any member or creditor of the company.[58]

An English court restrained a person from being a director for a period of three years because while acting as a director of a group of five companies he did not involve himself with the financial side of the companies' affairs and thus shirked his responsibility as a director by leaving everything to his co-director and had failed to appreciate the duties attendant on conducting business with limited liability. Thus he was not fit to be concerned in the management of a company. His fellow director was restrained for a period of five years with the exception of one company which he was managing very well and for which leave was given because his departure might have jeopardised the company and the jobs of its employees.[59] Trying to find out the policy behind such restraint orders, the court cited the following passage from an earlier case.[60]

> The public is entitled to be protected, not only against the activities of those guilty of more obvious breaches of commercial morality, but also against someone who has shown in his conduct of more than one company... a failure to appreciate or observe duties attendant on the privilege of conducting business with the protection of limited liability.

Errors of judgment, miscalculations, zeal and passion to keep the company alive and also the inability for dispassionate mind by reason of tough struggle for survival in business life, all these are not to be visited with any disqualification. Thus remaining in business for the purpose of proper realisation of assets towards winding up which may be inevitable has been held to be not a disqualification though it benefited the creditors more than the crown.[61] But where an unprofitable business was carried on with the money collected for the crown by way of taxes, that was held to be a serious error.[62] The judicial approach has been thus described: "A director should only be disqualified where his conduct was dishonest, in breach of standards of commercial morality or grossly incompetent. Commercial misjudgment does not justify disqualification."[63] To this it has been added that "there must be conduct which if not dishonest is at any rate in breach of standards of commercial morality, some really gross incompetence which persuades the court that it would be a danger to the public if he were allowed to continue to be involved in the

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58 S. 203(4).

59 *Majestic Recording Studios Ltd, Re*, 1989 BCLC 1 Ch D. Other decisions to the same effect are: *J. & B. Lynch (Builders) Ltd, Re*, 1988 BCLC 376 and *Stanford Service Ltd, Re*, 1987 BCLC 607. *See* also *Mathews (DJ) (Joinery Design), Re*, (1988) 4 BCC 513, where a director was restrained on the basis of misconduct in reference to two companies in the past, though he was, having learned his lessons, managing his latest company in a very successful way. The proceedings in England are launched under Company Directors' Disqualification Act, 1986.

60 Last case cited *ibid*. The object and purpose of the provision is to protect the public from activities of unfit directors and make them to recognise their wrongdoing and face the consequences, *Official Receiver* v *Cooper*, [1999] BCC 115 Ch D.

61 *C.U. Fittings Ltd, Re*, 1989 BCLC 556 Ch D: 1988 BCC 533.

62 *Churchill Hotel (Plymouth) Ltd, Re*, 1988 BCLC 341 Ch D.

63 *McNulty's Interchange Ltd, Re*, 1989 BCLC 709 Ch D.

management of companies, before a disqualification order is made."[64] A director was disqualified for 18 months because he went on incurring debts and receiving remuneration and collecting but not paying excise duties at a time when he was not able to market any product of the company.[65] Where a director improperly allotted shares to himself in order only to defeat the attempt by the rival faction of members, to gain majority control, this was held to be sufficient cause for warranting disqualification.[66] Where the company's transactions were found to constitute a fraudulent preference, a five year disqualification was imposed upon the director who formulated such transactions.[67] Where the directors withdrew more money from the company's already overdrawn overdraft account, they doing so in the hope that Christmas sales would enable them to tide over, but that proved to be a miscalculation, a two year term of disqualification was imposed.[68] A director can be found to be unfit even though no breach of a formal legal duty could be established. The circumstances may show gross incompetence on his part.[69]

The importance of maintaining accounting records was noted in *Firedart Ltd Re*.[70] The court said that the absence of accounting records is one of the most crucial factors in disqualifying a director. Without proper accounting records the directors may go on trading even when the company is insolvent. Proper accounts may give an advance warning as to the real state of affairs and as to proper level of remuneration.[71]

Trading at losses does not necessarily mean that the directors are unfit, but to do so over a protracted period and accumulating huge losses was held to be unjustifiable.[72] Where there was a huge accumulated deficit and a lengthy history of dishonoured cheques and unsatisfied statutory and other demands for payment, it was held that an overdraft in those circumstances amounted to trading with irresponsibility.[73]

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64 *Dawson Print Group Ltd, Re*, 1987 BCLC 601, 604 see *Lo-Line Electric Motors Ltd, Re*, 1988 BCLC 698; [1988] 2 All ER 692; 1988 Ch D 477; *Douglas Construction Services Ltd, Re*, 1988 BCLC 397, both involving commercial misjudgment: *Bath Glass Ltd, Re*, 1988 BCLC 329 Ch D, the conduct must be of sufficiently serious nature. *A company (No 004803), Re, The Times, December 2, 1996*, [1997 PALMER IN COMPANY January p. 4] once it becomes apparent that the board will pay no attention to a particular director's views, his remaining on the board is dangerous because it may create the impression that his purpose was simply to continue to draw directors' fees.

65 *McNulty's Interchange Ltd, Re*, 1989 BCLC 709 Ch D.

66 *Looe Fish Ltd, Re*, (1995) 16 Corpt LA 290 Ch D.

67 *Funtime Ltd Re*, [2000] 1 BCLC 247 Ch D.

68 *City Pram & Toy Co Ltd, Re*, [1998] BCC 537 Ch D.

69 *Barrings Ltd, Re (No 5)*, [2000] 1 BCLC 523 CA.

70 [1994] 2 BCLC 340 Ch D and *Official Receiver* v *Fairall*, [1994] 2 BCLC 340 Ch D.

71 *Deadduck Ltd, Re*, [2000] 1 BCLC 148 Ch D. A director who failed to keep proper books of account was fined and disqualified for one year. *R* v *Victory (Kevin)*, [1999] 2 Cri App Rep (S) 102.

72 *Secretary of State* v *Lubrant*, (1997) 2 BCLC 115.

73 *Richborough Furniture Ltd, Re*, (1996) 1 BCLC 507 Ch D, disqualification order; *Secretary of State for Trade & Industry* v *Gash*, (1997) 1 BCLC 341 Ch D, no one personally responsible for the insolvency of the company, no disqualification. *Consolidated Insurance Co of London* v *Burrows*, (1997) 1 BCLC 48 Ch D, unfit non-executive director. *Secretary of State for Trade and Industry* v *Mc Tighe, (No 2)*, (1996) 2 BCLC 477 CA, payment to selected creditors, unfit for management.

A person who is restrained under the section cannot, without leave of the court, be "a director of or in any way, whether directly or indirectly, be concerned or take part in... the management of, a company". The word 'management' for this purpose means activities which influence policy or decisions of managerial nature affecting the company as a whole or substantially as a whole. Thus acting as a management consultant and advising on financial management and restructuring of a company may amount to being concerned in the management of a company.[74] But routine duties of clerical or administrative nature will not be sufficient to prove the contravention of a restraint order.[75]

A restraint order can be passed by the very court which convicts a director for a conduct falling within the meaning of the section.[76] It is not necessary that the offence should be in the field of management. Carrying on insurance business in the form of a company without licence under the Insurance Companies Act, 1982 (English) has been held to be an offence within the meaning of the section.[77] A *de facto* director would also be within the mischief of the section.[78]

Position of de facto directors.—The word director for the purposes of the section includes a situation in which a person has acted as a director even though not validly appointed or even if there has been no appointment at all. For a person to be regarded as a *de facto* director, there must be clear evidence to show that he was the sole person directing the affairs of the company or that he acted on equal footing with other directors in managing the affairs of the company.[79] The position of *de facto* directors has been thus stated:[80] "When deciding whether a director should be disqualified[81] the court was required to have regard to his conduct as a director regardless of whether he had been validly appointed or was merely assuming to act as a director without any appointment at all, since the conduct relevant to his future suitability to act as a director depended on his past record as a director irrespective of the circumstances in which he came to act as such. On the facts, the respondent behaved in a commercially culpable manner in trading through limited companies when he knew them to be insolvent and in using unpaid crown debts to finance such trading and he would be disqualified generally from being a

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74 *R* v *Campbell*, (1983) 78 Cr App R 95.

75 *Commissioner for Corporate Affairs (Vic)* v *Bracht*, 1988 14 ACLR 718.

76 *R* v *Austen*, (1985) 1 BCC 99, where full-term restraint was ordered because of a series of offences involving £300,000.

77 *R* v *Georgian*, (1988) 4 BCC 322; *R* v *Kemp*, 1988 BCLC 217: [1988] 2 WLR 975: 1988 QB 645.

78 *European Maritime Ltd, Re*, 1987 BCC 190; *Lo-Line Electric Motors Ltd, Re*, 1988 Ch 477: [1988] 2 All ER 692 Ch D.

79 *Richborough Furniture Ltd, Re*, (1996) 1 BCLC 507 Ch D, benefit of doubt was given to the person because there was nothing to show in what capacity he was involved with the company. Where a body corporate is the director of a company whether *de facto* or *de jure* or *shadow*, it would not follow as a matter of course that the directors of such a body corporate would *ipso facto* be regarded as the shadow directors of the other company. There must be evidence to show that the directors of such a company were instructing the directors of the other company. *Secretary of State for Trade and Industry* v *Laing*, (1996) 2 BCLC 324 CA.

80 *Lo-Line Electric Motors Ltd, Re*, [1988] 2 All ER 692 Ch D: 1988 Ch 477.

81 Under S. 300 of the Act of 1985 [English].

director for three years. However, he would in the circumstances be permitted to be a director of two particular companies subject to certain conditions."[82] The court also observed *per curiam* that the use of moneys which should have been paid to the crown to finance the continuation of an insolvent company's business is more culpable than the failure to pay commercial debts.[83]

The Acts of some countries put an extended meaning upon the word director. The Nigerian Decree defines director to include a wife, husband, father, mother, son or daughter of a director. It has been said that "the extended meaning is an attempt to catch up with the tendency of some directors or similarly placed persons to use the members of their family as fronts for those transactions that are unethical or in breach of their obligations to their companies. In one such case[84] the court said that a director might not, even if he could contract with the company negotiate such a contract as would put him in a position to profit at the expense of the company.

The category of *de facto* directors has been held not to include a wife who acted in secretarial capacity in a company controlled by her husband. The court found that she was acting merely as a dutiful spouse for the sake of helping her husband. She was not liable to be disqualified as a *de facto* director.[85] In another similar case, a lady manager was not subjected to a disqualification order. The use of the title 'director' did not make her a *de facto* director. She was not in fact directing the company. There was clear evidence of lack of involvement in things financial. She did not form part of the real corporate governance of the company. She was not in a position to permit the company to go on trading against all odds.[86]

Natural Justice

Natural justice requires that a director facing disqualification should know the charge he has to meet and if the official receiver wishes to change the nature of the allegations on which he is going to rely he must give the director prior notice of the new allegation.[87]

It has been observed that this power has begun "to develop into a powerful weapon in the arsenal of the fight against the improper management of companies".[88]

Prohibition of assignment [S. 312]

A director cannot assign his office in favour of anyone else. Any such assignment is void. The Supreme Court has distinguished "assignment" from "nomination" as well as from "appointment".[89]

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82 Head Note to the report.

83 Dictum of VINELOTT J in *Stanford Services Ltd, Re*, 1987 BCLC 617, followed; *Dewson Print Group Ltd, Re*, 1987 BCLC 605, not followed.

84 (1968) 5 N SCC 218.

85 *Red Label Fashions Ltd, Re*, (1999) BCC 308 Ch D.

86 *Secy of State for Trade & Industry* v *Tjolle*, [1998] 1 BCLC 333 at 335 Ch D.

87 Supra *Lo-Line*.

88 1988 JBL 1, editorial note. *See* for a fuller account, Andrew Hicks, *Disqualification of Directors Forty Years On*, 1988 JBL 27.

89 *Oriental Metal Pressing Works Ltd* v *Bhaskar Kashinath Thakoor*, (1961) 31 Comp Cas 143:

A person formed a private company and transferred his business to it. He became the first managing director and had a right given to him by the articles to appoint a successor by his will. He died. His nominee assumed office. The other members challenged the appointment. The Bombay High Court held that the word "assignment" should mean "appointment" in this connection. But the Supreme Court expressed a different opinion. It said that "on a plain reading of the language used in the section, it does not seem possible to hold that the word 'assignment' in it can mean 'appointment'."

First, the section talks of "assignment of his office" by a director. The word "his" would indicate that the office contemplated was one held by the director at the time of assignment. An appointment to an office can be made only if the office is vacant. It is legitimate, therefore, to infer that by using the word "his", the Legislature indicated that an appointment by a director to the office which he previously held but did not hold at the date of the appointment, was not to be included within the word "assignment".

Secondly, Section 225 of the Act permits one-third of the total number of directors of a public company and all the directors of a private company to be appointed otherwise than by the company at a general meeting, if the articles make provision in this regard. The Act, therefore, expressly permits directors to be appointed otherwise than by the company. It follows that within the limit as to the number prescribed by the section, a power of appointment of directors can be legitimately conferred by the articles on any person including one who holds the office of a director. In order, however, that a director may exercise this power, there must be a vacant office of a director. He may himself bring about the vacancy by resignation of his office. The vacancy may also be caused by his death or expiry of the term of his office. There will be nothing illegal if the power is exercised in the case of the death of the director, by an appointment of his will.[90]

Irregular appointment and validity of acts [S. 290]

Section 290 contains provisions for validation of acts of directors. The section says that acts done by a person as a director shall be valid notwithstanding the fact that his appointment was invalid by reason of any defect or disqualification or by reason of the fact that his appointment had become terminated by virtue of any provision of the Act or the company's articles. The provision does not cover acts which have been done after the defect in the appointment or holding of the office has already become known.

The section operates to protect transactions with outsiders as well as members made by a company through its directors. One of the effects of the provision is that persons dealing with a company are entitled to presume that persons acting as directors are validly in office. An example is to be found in *Dawson* v *African Consolidated Land, etc., Co.*[91]

AIR 1961 SC 573: (1960) 63 Bom LR 505.

90 SARKAR J (afterwards CJ).

91 [1898] 1 Ch 6 CA. A parallel authority in India is *A. J. Judah* v *Rampada Gupta*, AIR 1959 Cal 715, where sale of shares in the exercise of lien by *de facto* directors was held to be protected.

> Three persons purporting to act as directors made a call which was resisted by some shareholders on the ground that they were not validly in office. One of them, unknown to the others, had vacated his office by parting with his qualification shares, although he subsequently reacquired his qualification shares and continued to act.

The court held that the provision covered not only the dealings between a company and outsiders but also with members. The call was valid.

The provision has been applied to the act of a person who ceased to be a director after taking over the company's secretaryship, although the fact could have been known from the company's public documents.[92]

A defective or irregular appointment has been distinguished from a situation where there has been no appointment at all. The person purporting to act for the company is nothing but a usurper. This approach dominated the decision of the House of Lords in *Morris* v *Kanssen*.[93]

> A person had ceased to be a director. He sat with another, who had never been appointed, to hold a meeting and appointed still another person as a director. Then all three sat together to allot shares to their new appointee.

The obvious conclusion was that the new director-allottee, being a part of the board, should have known that he was being taken in by persons who were themselves nothing but *de facto* directors. The allotment to him was also not valid for the same reason and also for the added reason that he participated in a meeting which conferred an allotment on him.[94]

Thus the section does not cover a case where there is total absence of authority or fraudulent usurpation of authority. Accordingly, the approval of a sale of assets by a director co-opted at a meeting by a person who had no authority and other directors were not even informed of the meeting was held to be of no use. The co-option and the co-optee's work both were held to be invalid.[95]

Section 290 will also not cover a situation where an act done by the incompetent board is such which even a competent board could not have done. Thus where a person not so qualified, was appointed as a managing director, the provision in the section could not be used to cover up the fact that those who sat together to appoint him were themselves not properly in office. Even a regularly constituted board could not have done that.[96]

Alternate director [S. 313]

If so authorised by the articles or by a resolution of the company, the board of directors may appoint an officiating director if any director is absent for a period

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92 *British Asbestos Co Ltd* v *Boyd*, [1903] 2 Ch 439, at 444.

93 1946 AC 459.

94 Followed in *Grant* v *John Grant & Sons Ltd*, (1950) 82 CLR 1.

95 *M. Moorthy* v *Drivers and Conductors Bus Service P Ltd*, (1991) 71 Comp Cas 138 Mad.

96 *Craven-Ellis* v *Canons Ltd*, [1936] 2 KB 403 CA, the person so appointed having acted for some time was allowed to recover remuneration on quantum meruit basis. *Shailesh Harilal Shah* v *Matushree Textiles Ltd*, AIR 1994 Bom 20, it was held that the acts of a director were valid, even though his appointment as additional director was questioned. The court, however, found the appointment to be also valid.

of three months or more from the State in which the meetings of the board are ordinarily held. Such a director is called an "alternate director". He holds office only for the period for which the original director would have been in office. He vacates his office on the expiry of such period and also when the original director returns to the State. The provisions relating to reappointment after rotational retirement apply to the original director and not to the alternate director. The provisions of Section 264 relating to filing of consent to act as director do not apply to such a director. Where there is a compelling need for an alternate director, the board of directors can be compelled to make an appointment. An American company was holding 40% interest in an Indian company. It appointed a director to watch its interests. Its appointee was not able to attend meetings of the board and, therefore, requested the board to accept his nominee as an alternate director, which was refused without proper consideration. That was characterised by the court as something wrong. His request should have been seriously considered keeping in mind the interests of the company and those of its shareholders.[1]

Appointment to place of profit [S. 314]

Following persons can be appointed to a place of profit under the company only with the consent of the company accorded by a special resolution:

1. Any director of the company.
2. (*a*) Any partner or relative of such a director.[2]
   (*b*) Any firm in which such a director or relative is a partner.
   (*c*) Any private company of which such a director is a member or director or any director, or manager of such a private company,[3] if the remuneration is to exceed an amount as may be prescribed.[4] (Not less than Rs 10,000 or more).[5]

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1 *D. Ross Porter* v *Pioneer Steel Co Ltd*, [1989] 2 Comp LJ 89 Delhi: (1989) 66 Comp Cas 363.

2 The word "relative" is defined in S. 6. Two or more persons are said to be relatives if they are the members of a Hindu undivided family or if they are husband and wife or if one is related to the other in any manner indicated in Sch. 1-A. The list given in the Schedule is as follows:

1. Father	2. Mother, including step-mother
3. Son, including step-son	4. Son's wife
5. Daughter, including step-daughter	6. Father's father
7. Father's mother	8. Mother's mother
9. Mother's father	10. Son's son
11. Son's son's wife	12. Son's daughter
13. Son's daughter's husband	14. Daughter's husband
15. Daughter's son	16. Daughter's son's wife
17. Daughter's daughter	18. Daughter's daughter's husband
19. Brother, including step-brother	20. Brother's wife
21. Sister, including step-sister	22. Sister's husband.

3 S. 314(2). See *Firestone Tyre & Rubber Co* v *Synthetics & Chemicals Ltd*, [1970] 2 Comp LJ 200: (1971) 41 Comp Cas 337 Bom.

4 The Madras High Court has held that the prohibition applies not to the relative of an ordinary director but only to the relative of a director holding a place of profit under the company. *A. R. Sudarasanam* v *MPHJS Nidhi Ltd*, (1985) 57 Comp Cas 776.

5 W.e.f. 26-3-92, DCA notification of 1-3-1992.

An appointment of any such person can, however, be made to the position of managing director, manager, legal or technical adviser, banker or trustee of the debenture-holders either under the company itself or under any of its subsidiaries, except when the remuneration is paid over by him to the company or its holding company. In a case before the Madras High Court,[6] a company appointed two of its directors as technical advisers for the purpose of surveying buildings and properties to find out their value for purposes of loans to be advanced by the company. On the Registrar's enquiry about their qualifications the company disclosed none. It was only in the court that the company stated for the first time that they had experience in the line. The court accordingly quashed the appointment:

> It is not open to a company to give the designation of technical adviser to any director and to appoint him as such and thereby avoid the consequences of Section 314. A technical adviser has to be a person with technical qualifications for the job entrusted to him which consists of rendering advice to the company in matters relating to its business.

The approval may be granted either before the appointment or at the first meeting held after the appointment. Where a relative etc. happens to be appointed without the knowledge of the director, approval may be accorded at the first meeting held after the appointment or within three months, whichever is later. Every subsequent appointment to a place of higher remuneration also requires such approval unless the original appointment was on a time scale.[7]

If a relative etc. was appointed before the director became a director of the company, this section will not apply.[8]

An office is deemed to be a place of profit if it will entitle the director in addition to his remuneration as director and in the case of any other individual, any remuneration whether as salary, fees, commission, perquisites, the right to occupy any pre[illegible] free of rent as a place of residence or otherwise.[9] A person holding the posit[illegible] branch manager under the company has been held by the Calcutta High [illegible] be holding a position of profit under the company. A special resolutio[illegible] was necessary for his appointment.[10]

When an individual, firm or body corporate is so appointed, he or it, is required to make a declaration of his or its connection with a director.[11]

If the appointment is not approved by a special resolution of the general meeting, the office is automatically vacated with a liability to refund the remuneration already received.[12]

By the Companies (Amendment) Act, 1974, a legal or technical adviser, banker or trustee for debenture-holders of the company, has been excluded from

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6 *Madura Hindu Permanent Fund Ltd* v *Govt of India*, (1977) 47 Comp Cas 318 Mad.
7 S. 314(1) (Explanation).
8 S. 314(1-A).
9 S. 314(3).
10 *Gobind Pritamdas Malkani* v *Amarendra Nath*, (1980) 50 Comp Cas 219 Cal.
11 S. 315(2-A).
12 S. 314(3).

the category of persons whose appointment to a place of profit is regulated by Section 314.

The amendment further provides that the appointment of the following persons to a place of profit under the company carrying a total monthly remuneration of such a sum as may be prescribed (not less than Rs 20,000)[13] can be made only by a special resolution and approval of the Central Government:[14]

1. any partner or relative of a director or manager;
2. any firm in which such a director or manager or relative of either is a partner;
3. any private company of which such a director or manager or relative of either is a director or member.[15]

If any such appointment is made without following the above procedure, the appointee will have to refund the benefits of the office to the company and the company cannot waive their recovery unless permitted to do so by the Central Government. [S. 314(2-B) and (2-D)]. His office shall also be deemed to have been vacated from the expiry of six months from the commencement of the Amendment Act.[16]

A person appointed to directorship by the Central Government under Section 408 is exempted from the section. [S. 314(4)].

OTHER MANAGERIAL PERSONNEL

The fundamental principle relating to the administration of a company is that its board of directors, which is the representative body, should direct and control its affairs. But at the same time the Act allows a person to accept directorship in fifteen companies[17] and does not prescribe the time and attention that he should devote to a particular company.[18] The common law excuses him from the consequences of non-attendance generally. Moreover, a board meeting is a very formal affair and cannot be called very frequently, whereas business has to be managed every day. The primary function of the board, therefore, is to lay down the business policies and make a broad, general supervision over their execution. The day-to-day administration has to be delegated to professional management.

Formerly four types of professional management were recognised, namely, managing director, managing agent, secretaries and treasurers, and manager.[19] But with effect from April 3, 1970, management by managing agents and

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13 W.e.f. 1-3-94.

14 This will not include bonus or reimbursement of medical expenses. *Suessen Textiles Bearings Ltd* v *UOI*, (1984) 55 Comp Cas 492 Del.

15 S. 314(1-B).

16 *Niemla Textile Finishing Mills* v *CIT*, (1975) Comp Cas 554 Punj. The application for approval should be in Form 24-B as renewed with effect from 1-8-1990 and contain particulars in full detail about perquisites being also required by the new form. Circular No 19 of 1990: (1990) 68 Comp Cas 97 St.

17 S. 275.

18 *See* M.J.Trebilcock, *The Liability of Directors for Negligence*, (1969) 32 MLR 499 at 504-5.

19 S. 197-A.

secretaries and treasurers has been banned.[20] Now the choice is between a managing director or manager. A company can have only one or the other but not both of them at the same time.[21]

Managing director, wholetime director or manager

A managing director as defined in the Act[22] means a director who is entrusted with substantial powers of management which would not otherwise be exercisable by him. The term includes a director occupying the position of a managing director, by whatever name called. The 'substantial powers of management' may be conferred upon him by virtue of an agreement with the company, or of a resolution of the company or its board, or by virtue of its memorandum or articles.[23]

The expression 'wholetime director' which has also been used in Section 269 along with the expression 'managing director' has been defined in the *Explanation* to sub-section (1) as including a person who is in the wholetime employment of the company. Thus he is also an employee of the company. Like the managing director, he occupies dual capacity, namely, that of a director and of an employee.[24]

A managing director can be appointed only if there is a power to that effect in the company's articles.[25]

The "substantial powers of management" that are conferred upon a managing director may be revoked or reduced or otherwise altered. Where, for example, his powers have arisen by virtue of an agreement with the company's board, the latter may revoke or alter them. The service agreement of a managing director provided that he should exercise his powers in relation to the company's business and any of its subsidiaries as may be resolved by the directors. The directors resolved that he should confine his attention only to one subsidiary. It was held that the directors' action was competent and no action lay for breach of contract.[26] A managing director, being an agent of the board of directors, cannot exercise any power over and above those of the board. He can exercise only

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20 S. 324-A [as amended in 1969].

21 S. 197-A. *See also* K.P. Khaitan, *Balance of Power in Company Law*, Chapter V of LECTURES ON MERCANTILE LAW, 61 (1961), a publication of the Indian Law Institute. The Department has advised companies not to use expressions like special directors, executive directors, etc. because such designations are likely to mislead the members of the public [Circular No 2 of 1990 of 29-5-1990 published in (1990) 68 Comp Cas 83 st.] Such designations give an impression to the public at large and those dealing with companies and their executives that they are full-fledged directors entitled to act as such on behalf of the companies. If in fact, these executives are not directors on the board, it will be patently wrong on the part of companies.

22 S. 2(26).

23 *Ibid.* The two provisos to the definition provide that delegation of duties of routine nature does not make a director, a managing director, and that a managing director shall act under the superintendence of the board of directors.

24 Lord NORMAND, *Anderson* v *James Sutherland (Peterhead) Ltd*, 1941 SC 230 at 238, Scotland.

25 SWINFEN EADY J *Boschoek Proprietary Co Ltd* v *Fuke*, [1906] 1 Ch 148, 159: 94 LT 398.

26 *Harold Holdsworth & Co* v *Caddies*, [1955] 1 All ER 725; *Caddies* v *Harold Holdsworth & Co*, 1951 SC HL 27, Scotland.

such powers as have been delegated to him. A managing director commenced proceedings against the company's secretary to recover from him the money which he had withdrawn from the company's bank account. He commenced the proceedings without any authorisation from the board. The proceedings were struck out.[27]

But revocation of the appointment itself is something different. A managing director is entitled to compensation if his appointment is prematurely determined even if there is a power to that effect in the articles. Thus, where a managing director was appointed to hold office as long as he was a director, retained his qualification shares and worked efficiently, his dismissal while he still fulfilled these qualifications was held unjustified entitling him to damages.[28] Similarly, where the termination is brought about by an alteration of the articles in a manner inconsistent with the terms of appointment, damages would have to be paid.[29] Where the appointment is not for a fixed period, removal at any time may entail no liability in damages. In one of the cases before the Court of Appeal,[30] the duration of appointment was not specified. The managing director was removed on a month's notice, and the directors' action was upheld by the company in general meeting. He sued for damages on the ground that the notice given to him was not reasonable. The articles contained a clause enabling the company to remove a managing director without notice. It was held that in view of this sweeping power, the requirement of reasonable notice could not be read into the contract.

The requirement of good faith or of "proper purpose" can be read even into an absolutely discretionary power. The decision of the board of directors in removing a managing director can be challenged on the ground that they did so not in the interest of the company but to promote their own.[31] While the appointment may require approval of the Central Government, the removal of a managing director does not require to be so approved. The managing director is an agent of the board of directors. He cannot restrain a meeting of the board called to consider his removal. The approval of his appointment by the Central Government does not militate against the board of directors' power to remove him.[32]

Where his appointment is defective within his knowledge, for example, made by directors who have failed to acquire their qualification shares, no

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27 *Mitchell & Hobbs (UK) Ltd* v *Mill*, (1996) 2 BCLC 102 QBD. Criminal proceedings can be launched only through board authorised person, *CBS Gramophone Records and Tapes (India) Ltd* v *P. A. Noorudeen*, (1992) 73 Comp Cas 494 Ker, it was a proceeding for dishonour of a cheque; *Swastic Coaters P Ltd* v *Deepak Bros*, (1997) 89 Comp Cas 564. An authorised representative's complaint was dismissed because of his default in appearing on the day of hearing.

28 *Nelson* v *James Nelson & Sons Ltd*, [1914] 2 KB 770: [1914-15] All ER Rep 433 CA.

29 *Shindler* v *Northern Raincoat Co Ltd*, [1960] 1 WLR 1038: [1960] 2 All ER 239; *Southern Foundries Ltd* v *Shirlaw*, 1940 AC 701: [1940] 2 All ER 445. It has been held by the Delhi High Court in *Shrimati Jain* v *Delhi Flour Mills Co Ltd*, (1974) 44 Comp Cas 228, that where a person has been appointed managing director for a term of 5 years, but he ceases to be a director before the expiry of the term, the agreement also ceases to be operative.

30 *Read* v *Astoria Garage (Streatham) Ltd*, [1952] Ch 637 CA: [1952] 2 All ER 292.

31 *Hindle* v *John Cotton Ltd*, (1919) 56 SLR HL, Scotland.

32 *Pyare Lal Gupta* v *D. P. Agarwal*, (1983) 53 Comp Cas 586 All.

remuneration or compensation is payable; but if the company has accepted his work, it must pay him reasonable remuneration on the principle of *quantum meruit*.[33]

A managing director, being a manager, is an employee of the company to that extent.[34] The remuneration payable to him is taxable as salary. This has been so held by the Supreme Court in *Ram Prashad* v *Commissioner of Income Tax*.[35] The court discussed at great length the distinction between a servant and an agent and concluded that the managing director is more like an agent than a servant, but this does not prevent him from entering into a contract of employment with the company.[36] But he is not a clerk or a servant so as to be entitled to preferential payment.[37] A managing director was held liable when the stock of the company diminished during his tenure and he was not able to give a satisfactory account of the loss. He was also not excusable under Section 633 because he was not honest about the matter.[38]

Appointment when compulsory

Sub-section (1) of Section 269 declares that on and from the commencement of the Companies (Amendment) Act, 1988, (enforced w.e.f. 15-6-1988) every public company and its subsidiaries, whether public or private, having a paid-up share capital of such sum as may be prescribed, shall have a managing or a wholetime director or a manager. The sum of rupees five crores has been prescribed for this purpose.[39]

Procedure of appointment [S. 269]

Appointment can be made in accordance with the company's articles. Usually the articles leave it to the directors to appoint any one of themselves as the managing director. If this power is conferred on the board of directors, the general meeting of shareholders cannot interfere.[40]

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33 *Craven-Ellis* v *Canons Ltd*, [1936] 2 KB 403: [1936] 2 All ER 1066 CA and *see* Evans D. Marshall, *Quantum Meruit & Managing Director*, (1966) 27 Mod LR 608.

34 A managing director occupies the dual capacity of being a director as well as an employee of the company. He can be regarded as a principle employer for the purposes of the ESI Act, 1948, *Employees State Ins Corpn* v *Appex Engg P Ltd*, [1998] 1 Comp LJ 10 SC. He is not a mere servant, he is also an agent of the company with capacity to bind the company in the sphere of management entrusted to him, *Happy Home Builders (Karnataka) P Ltd* v *Delite Enterprises*, (1994) 13 Corpt LA 405 Kar.

35 (1972) 2 SCC 696: (1972) 42 Comp Cas 544.

36 *Id.* at 548/553. He is an officer of the company for tax purposes and, therefore, can be prosecuted for filing false particulars. *M.R. Pratap* v *V.M. Muthukrishnan*, (1992) 3 SCC 384: (1992) 74 Comp Cas 400 SC.

37 *Newspaper Proprietary Syndicate Ltd, Re*, [1900] 2 Ch 349: 83 LT 341.

38 *T.A. Angappan* v *Coimbatore Mills Ltd*, (1983) 54 Comp Cas 5 Mad. The mill was taken over by the Government of India.

39 As per Rule 10-A of the Companies (Central Govt's) Rules and Forms. The return to be filed with the Registrar and the accompanying certificates shall be in Form 25-C. The prescribed figure of Rs 1 crore was revised by a Press Note issued by the Ministry of Industry, Deptt of Co Affairs, dated Sept 19, 1990. Source: (1990) 60 Comp Cas 47 St; GSR 795(E) of Sept 18, 1990. The reason given is: "This measure will provide operational freedom to companies in managing their own affairs without undue interference from other sources."

40 *Thomas Logan* v *Davis*, (1911) 105 LT 419 CA.

Section 269 has been recast by the amendment of 1988. In the case of companies reaching figure of paid-up share capital which may be prescribed,[41] the appointment of a managing director, wholetime director or manager has been made compulsory. The appointment has to correspond with the conditions specified in Parts I and II of Schedule XIII which parts are subject to the provisions of Part III. A return of the appointment in prescribed form must be filed with the Government within 90 days. Approval of the Central Government is not necessary in such cases. But if the appointment does not comply with the Schedule, approval becomes necessary.[42] Application for approval must be made within 90 days. The Central Government would not accord the approval if it is satisfied that the candidate is not a fit and proper person for the post and his appointment is not in public interest and the terms and conditions of the appointment are not fair.

If there is no approval, the appointee should vacate office from the date of the communication of the refusal to the company failing which he incurs a penalty of Rs 5000 for every day of usurpation of the office.[43]

Where the Government *suo motu* or on information received is *prima facie* of opinion that an appointment has been made without approval in contravention of the requirements of the Schedule, the Government shall be competent to refer the matter to the National Company Law Tribunal for decision. The Tribunal has to give notice to the company, the appointee and any other officer of the company who was responsible for compliance of Schedule XIII to show cause why the appointment should not be terminated and the penalty of sub-section (10) imposed. The Tribunal should give appropriate opportunity and then may make an order declaring that there has been a contravention. The declaration will have the following effects:

1. The company is liable to a fine extending up to Rs 50,000;
2. Every officer of the company who is in default is liable to a fine of Rs 1,00,000;
3. The appointment comes to an end and the appointee is liable to a fine of Rs 1,00,000 and is also liable to refund the entire amount of salaries, commission and perquisites received by him up to the date of the order.

Any violation of the order of the Board or any default in meeting its consequences is further punishable under sub-section (*ii*). Every officer of the company who is in default and the managing or wholetime director or the manager, shall be punishable with imprisonment extending up to three years and with fine extending up to Rs 500 for every day of default. Whether such a

41 Public companies and private companies which are subsidiaries of public companies with a paid-up capital of Rs 5 crores or more. The earlier GSR 794(E) of 10-6-1988 which prescribed the figure of Rs 1 crore has been replaced by GSR 795(E) of Sept 18, 1990, which prescribed the figure of Rs 5 crores.

42 *Central Govt Deptt of Co Affairs* v *Aurofood Ltd*, (2002) 111 Comp Cas 841 CLB, where approval is necessary because of loss bearing company, it was held that the requirement was not applicable where there was a profit in the year of the appointment.

43 S. 269(6).

double penalty amounts to a violation of the doctrine of double jeopardy, only time will tell.

Sub-section (12) provides that the acts of such a person done by him up to the date of the finding that his appointment was void would be valid provided that they were otherwise valid.

The section concludes with an *Explanation* that the word "appointment" includes reappointment and "wholetime director" includes a director in the wholetime employment of the company.

The function to grant or withhold approval is that of the Central Government. The Government has to determine whether the proposee is a fit and proper person and may refuse to grant approval where there is a pending prosecution against him.[44] The Supreme Court pointed out in *Rampur Distillery & Chemical Co Ltd* v *Company Law Board*[45] that the Government can take into account the entire conduct and actings past and present and the fact that the proposee has been adversely commented upon by an inquiry committee. The court will not interfere in the matter unless the Government's refusal proceeds on facts totally irrelevant to the issue.[46] Further, the Government has the power to make the appointment subject to any conditions that it thinks fit to impose.[47] The utility of this power was demonstrated by the decision of the Delhi High Court in *Raymond Engineering Works* v *Union of India*.[48]

> A company's prospectus disclosed that it had purchased its managing agent's property at 6 lakhs of rupees, but did not disclose that the managing agent had himself paid only Rs 3 1/2 lakhs for it. In other words, the profit of approximately Rs 3 lakhs was concealed. The company brought no action. It applied to the Central Government for approval of the appointment of the same managing agent as managing director. The Government granted approval subject to the condition that he refunded Rs 2,75,000 to the company, the balance allowed to him as reasonable expenditure.

The Delhi High Court upheld the condition. "The profit may not be illegal. But the Government was entitled to think that it was unconscionable profit."[49]

The Government may reduce the period of appointment proposed by the company.[50] If the approval is granted subject to any alterations, reasons for the

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44 *Rampur Distillery & Chemical Co* v *Company Law Board*, [1969] 1 Comp LJ 204 Delhi; On appeal to the Supreme Court: (1969) 2 SCC 774. A refusal or a partial or conditional approval must carry a statement of reasons for the same otherwise the order would be liable to be quashed. Where in its approval the Government made this alteration that retirement benefits like provident fund and gratuity, would be linked with salary and not commissions, etc., and gave no reasons for the same, the alteration was set aside. *Bennett, Coleman & Co Ltd* v *UOI*, (1993) 78 Comp Cas 666 Delhi.

45 (1969) 2 SCC 774: (1970) 40 Comp Cas 916: AIR 1970 SC 1789: [1970] 2 Comp LJ 1.

46 *Id.* See also *Canara Workshop Ltd* v *UOI*, (1966) 36 Comp Cas 63 Mys.

47 S. 637-A.

48 AIR 1970 Delhi 5: [1970] 2 Comp LJ 162

49 RANGARAJAN J: [1970] 2 Comp LJ 162. The learned Judge cited the following authorities: *A.R. Hussain Khan* v *ROC*, AIR 1965 Mad 307; *Rohtas Industries* v *S.D. Agarwal*, (1969) 1 SCC 325: AIR 1969 SC 707: (1969) 39 Comp Cas 781.

50 S. 269(4).

same must be stated. The Gujarat High Court struck down an order which stated no reasons.[51] The appointment was for a period of five years; monthly salary Rs 5,000; annual increment Rs 500; commission on profits 1% subject to the ceiling of half the annual salary; gratuity, medical benefits and residential accommodation. The Government approved the appointment but reduced the term to two years and also slashed the salary and other benefits, but assigned no reasons. Despite reminders from the parties and the court, the Government refused to make the order a speaking order. The court was left with no choice but to strike it down.[52]

Disclosure by company of directors' interest [S. 302]

Where a director is in any way, directly or indirectly, concerned or interested in the person who has been appointed as the company's manager or managing director, the company is required to send to members within 21 days of the appointment an abstract of the terms and conditions of the appointment together with a memorandum clearly specifying the nature of the concern or interest of the director in question. A similar procedure has to be followed when the terms and conditions of the appointment are altered. In the case of a managing director, an abstract of the terms and conditions of the appointment or of any variation thereof has to be sent to members whether any director is interested in the matter or not and where any director is interested, a memorandum specifying the nature of the interest has also to be sent. The same procedure has to be complied with where a director acquires an interest subsequent to the appointment. Contracts for the appointment of manager or managing director have to be kept at the registered office of the company. The members have the right to inspect them and to get extracts in the same manner and subject to the same fee as in the case of register of members.

Disqualifications [S. 267]

According to Section 267, a person suffering from any of the following disqualifications cannot be appointed a managing or wholetime director:

1. A person who is an undischarged insolvent, or has at any time been adjudged an insolvent.
2. A person who suspends, or has at any time suspended, payment to his creditors, or makes or has made a composition with them.
3. A person who is or has been convicted by a court of an offence involving moral turpitude.[53]

Subject to these disqualifications, any person may be appointed as managing director,[54] provided that he is not holding the office of a managing

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51 *Cibatul Ltd* v *UOI*, (1980) 50 Co np Cas 437 Guj.

52 Following *Orient Paper Mills* v *UOI*, AIR 1969 SC 48 and *Siemens Co of India* v *UOI*, (1976) 2 SCC 981.

53 Where the High Court suspended the sentence, it was held that the conviction still stood and the disqualification made the appointment void, *Rama Narang* v *Ramesh Narang*, (1995) 2 SCC 513: (1995) 83 Comp Cas 194: (1995) 16 Corpt LA 247 SC.

54 The relative of a managing director can be appointed as a wholetime director without approval. An approval would be necessary only if the remuneration paid to a director was over and above

director or manager in any other company.[55] However, a person holding such office in one other company may be appointed managing director. But this kind of appointment can be made with the approval of a resolution passed at a meeting of the board of directors and with the consent of all the directors present at the meeting. Specific notice of the meeting and of the resolution should be given to all the directors then in India.[56] Again, the Central Government may permit any person to be appointed as a managing director of more than two companies if the Government is satisfied that it is necessary that the companies should, for their proper working, function as a single unit and have a common managing director.[57]

The maximum term of appointment can be five years at a time[58] and a new term cannot be sanctioned earlier than two years from the date on which it is to come into force.[59] No change can be made in the terms of appointment without the approval of the Central Government.[60]

Remuneration

The remuneration of a managing director, in whatever mode paid, cannot exceed 5% of the net profits. But if there are more than one managing directors, the limit is 10% for all of them together.[61] It was held by the Supreme Court in *Company Law Board* v *Upper Doab Sugar Mills Ltd* [62] that the Company Law Board could reduce this ceiling as part of the conditions of approval for appointment. A public limited company, which had appointed two managing directors for the first time, sought approval of the appointment. The proposed remuneration for each managing director was Rs 5,000 per month and 3-1/2% commission on profits. The Board granted the approval subject to the condition that total remuneration from both sources should not exceed Rs 1,20,000 for each such director. This was a part of the policy adopted by the Board that no individual should be paid remuneration exceeding Rs 1,20,000 per annum or Rs 10,000 per month. The Board cited a large number of instances in which this condition had been imposed. But the argument of other instances which had remained unchallenged did not appeal to the Delhi High Court[63] and the administrative ceiling so imposed was held to be beyond (*ultra vires*) the rule-

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the remuneration to which he would be entitled as managing or wholetime director because up to that point he would not be regarded as holding a place of profit under the company or when the appointment is not in accordance with Sch. XIII. 1989 Chartered Secretary, 525 carries the above clarification. Form 25-A is prescribed for seeking approval. Circular No 10 of 1990 of 28-5-1990; (1990) 69 Comp Cas 83 st.

55 S. 316(1).

56 Proviso to S. 316(2). Because of the changes made in Sch. XIII such approval is not necessary if the appointee opts to draw remuneration from only one of the two companies.

57 S. 316(4).

58 S. 317(1).

59 S. 317(3).

60 S. 268. According to S. 317(4) these restrictions do not apply to a private company which is not a subsidiary of a public company.

61 S. 309(3). For further details *see* Chap. 10 on Directors.

62 (1977) 2 SCC 198: (1977) 47 Comp Cas 173.

63 *Upper Doab Sugar Mills* v *Company Law Board*, (1971) 41 Comp Cas 643 Del.

making power of the Board. The judgment proceeded on the hypothesis that if the Act itself imposes a ceiling, any reduction of that by administrative regulations would conflict with the Act and hence be *ultra vires*. But the judgment was reversed by the Supreme Court[64].

Any controversy is now of academic interest only. The amendment of 1974 had added Section 637-AA which enables the Central Government while conferring approval to fix a limit on remuneration below the limits specified in the Act. In fixing such limit, the Government was required to have regard to the financial position of the company, the remuneration of the candidate on other grounds from the same company, his remuneration from other companies, his qualifications and public policy relating to removal of income disparities. Each individual case must be considered on its own merits. A company appointed two executive directors and sought approval. The approval was granted on reduced salary. The company was informed that the reduction had been made in accordance with the guidelines provided by the Ministry. The court said that the Government must take a decision in each individual case. The decisive guidelines laid down in general were outside the scope of the power in Section 637-AA and, therefore, *ultra vires*.[65] The remuneration of a managing or wholetime director or manager may be increased, where Schedule XIII is applicable, in accordance with its provisions and in other cases with the approval of the Central Government.[66]

New Schedule XIII.—All these matters as to remuneration have gone into the limbo of history in view of the complete change-over of Schedule XIII. Now there is no longer any statutory ceiling on remuneration except 5-10 % of the profits. Where because of low profits the remuneration exceeds the above-stated

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64 *Company Law Board* v *Upper Doab Sugar Mills Ltd.* (1977) 2 SCC 198: (1977) 47 Comp Cas 173.

65 *Mahindra and Mahindra Ltd* v *UOI*, (1983) 53 Comp Cas 337 Delhi.

66 A managerial person shall also be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in paragraph 1 of this section:

(*a*) contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income Tax Act, 1961,

(*b*) gratuity payable at a rate not exceeding half a month's salary for each completed year of service, and

(*c*) encashment of leave at the end of the tenure.

In addition to the perquisites specified in paragraph 2 of this section, an ex patriate managerial person (including a non-resident Indian) shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in paragraph 1 of this section:

(*a*) **Children's education allowance.**—In case of children studying in or outside India, an allowance limited to a maximum of Rs 5000 per month per child or actual expenses incurred, whichever is less. Such allowance is admissible upto a maximum of two children.

(*b*) **Holiday passage for children studying outside India/family staying abroad.**—Return holiday passage once in a year by economy class or once in two years by first class to children and to the members of the family from the place of their study or stay abroad to India if they are not residing in India with the managerial person.

(*c*) **Leave travel concession.**—Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

percentage, an amount varying from Rs 75,000 to Rs 2,00,000 per month may be paid depending upon the effective capital of the company. Where it exceeds the link with effective capital, there alone Government approval would be needed. The new Schedule [Part II] was made effective from March 2, 2000.[67]

Where a managerial personnel is working in more than one company, he can draw remuneration from one or both companies provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial personnel.

Secretaries and Treasurers

"Secretaries and treasurers" means any firm or company (not being the managing agent) which, subject to the superintendence, control and directions of the board of directors, has the management of the whole, or substantially the whole, of the affairs of a company. The expression includes any firm or company which occupies the position of "secretaries and treasurers".[68]

The Companies (Amendment) Act, 1969, which came into force on April 3, 1970, banned the appointment of secretaries and treasurers.

Manager

A 'manager' means an individual who has the management of the whole or substantially the whole of the affairs of a company. He is subject to the control and superintendence of the company's board.[69]

In *Gibson* v *Barton*,[70] BLACKBURN J defined 'manager' "as a person who has the management of the whole of the affairs of the company; not an agent who is to do a particular thing, or a servant who is to obey orders, but a person who is entrusted with power to transact the whole of the affairs of the company".[71] The word does not apply to a person who acts once or twice in a particular capacity; he must be in charge of all the affairs of the company. Accordingly, the manager of a branch of a bank does not come within the meaning of the word "manager".

A managing director, and a manager have this common feature that they have the management of the whole or substantially the whole of the affairs of the company. Yet there is an important difference between the position of a managing director and that of a manager. A managing director is a part of the company's board of directors and not subordinate to it. He is not a servant of the company.[72] A manager, on the other hand, being a paid executive of the company, is subject to the superintendence, control and directions of the board of directors.

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67 The company may meet travelling expenses to home on expiry of term, DCA Circular No 9 of July 28, 1993.

68 S. 2(44).

69 S. 2(24).

70 (1875) 10 QB 329.

71 Adopted by SHADILAL J (afterwards CJ) in *Basant Lal* v *Emperor*, AIR 1918 Lah 170, 171: 43 IC 791.

72 *Newspaper Proprietary Syndicate Ltd, Re*, [1900] 2 Ch 349: 83 LT 341 and *Ram Prashad* v *CIT, Delhi*, (1972) 2 SCC 696: (1972) 42 Comp Cas 544.

The Act prohibits the appointment of any firm, body corporate or association as manager.[73] Further, following persons are disqualified from appointment:

1. A person who is an undischarged insolvent or who has been adjudged insolvent within the preceding five years.
2. A person who suspends or has within the preceding five years suspended payment to his creditors or makes or has made within the above period a composition with them.
3. A person who has within the preceding five years been convicted by a court in India of an offence involving moral turpitude.[74]

The Central Government, however, reserves the right of removing the above disqualifications either generally or in relation to any company or companies.[75]

A person cannot be appointed as manager if he is a manager or managing director in any other company.[76] However, a person holding such office in only one other company may be appointed, provided the appointment is made or approved by a resolution passed at a meeting of the board with the consent of the directors present at the meeting.[77] Specific notice of the meeting and the resolution should have been given to all the directors then in India.[15] But the Central Government may permit a person to be appointed manager of more than two companies where it is necessary that the companies should, for their proper working, function as a single unit and have a common manager.[78]

The remuneration of a manager cannot exceed in the aggregate five per cent of the net profits.[79] In other respects, the same restrictions apply as in the case of a managing director.

The procedure of appointment and requirement of approval are now the same as in the case of managing director.[80] The same is true of any increase in remuneration.[81] He cannot assign his office[82] and can be appointed for a term of five years at a time.[83]

Secretary

Definition

Section 2(45) provides that the expression "secretary" means a company secretary within the meaning of Section 2(1)(*c*) of the Company Secretaries Act, 1980 and includes any other individual possessing the prescribed qualification and appointed to perform the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties. This

73 S. 384.
74 S. 385(1).
75 S. 385 (2).
76 S. 386(1).
77 S. 386(2).
78 S. 386(4).
79 S. 387.
80 S. 388 which makes Ss. 269, 310, 311, 312 and 317 applicable to a manager.
81 Ss. 310 and 311.
82 S. 312.
83 S. 317.

transformation of the definition has been brought about by the amendment of 1988 which has also introduced the concept of a "secretary in wholetime practice" and defines it by saying that it means a secretary who shall be deemed to be in practice within the meaning of Section 2(2) of the Company Secretaries Act, 1980 and who is not in full-time employment.

When appointment obligatory and who can be appointed

Section 383-A makes it obligatory for a company having such paid-up share capital as may be prescribed (Rs 50 lakhs)[84] to have a wholetime secretary.[85] The section also provides that where the board of directors of a company has only two members, neither of them shall be the secretary of the company. A proviso to sub-section (1) has been inserted by the Companies Amendment Act, 2000 to require the filing of a certificate of compliance. It is as follows:

> "Provided that every company not required to employ a wholetime secretary under sub-section (1) and having a paid-up share capital of ten lakh rupees or more shall file with the Registrar a certificate from a secretary in wholetime practice in such form and within such time and subject to such conditions as may be prescribed, as to whether the company has complied with all the provisions of this Act and a copy of such certificate shall be attached with Board's report referred to in Section 217."

No firm or body corporate can hold the office of a secretary, and no individual can be a secretary in more than one company at the same time.

Elevation of status of Secretary: Authority for contracts

The fact that duties of administrative nature can also be assigned to a secretary is a legislative recognition of the fact that the secretary has become an important executive officer of the company.[86] The courts have not lagged behind in this respect. The English Court of Appeal in its decision in *Panorama Development (Guildford)* v *Fidelis Furnishing Fabrics*[87] has declared that a modern

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84 *Substituted* for Rs 50,000 by the Companies (Appointment and Qualifications of Secretary) Amendment Rules, 1993.

85 As to the power of the Institute of Company Secretaries to disqualify a qualified secretary, see *Suraj Prakash Oberoi* v *Institute of Company Secretaries of India*, (1986) 60 Comp Cas 536 Delhi. It cannot reject an application for membership in a discriminatory manner. *Kalyan Kumar Mukherjee* v *Institute of Company Secretaries of India*, (1987) 62 Comp Cas 466 Cal. Sub-s. (1-A) added by the amendment of 1988 provides that the default in compliance with the provision will make the company and every officer in default punishable with a fine of Rs 500 for everyday. But it will be a defence to show that all reasonable steps to comply with the provision were taken or that the financial position of the company was such that it was beyond its capacity to engage a wholetime secretary. *State of Gujarat* v *Coromandal Investment P Ltd*, (1991) 71 Comp Cas 470 Guj, since a person can discharge the duties of a secretary without joining the company as an employee, hence, there is no violation if he is an employee of some other company.

86 The appointment should be by a resolution of the board of directors and removal can also be by the appointing authority. The commencement and cessation of office should be reflected in the register of directors required to be maintained under S. 303.

87 [1971] 3 WLR 440: [1971] 3 All ER 16: (1971) 2 QB 711 CA. In India rules as to qualifications and appointments of secretaries have been promulgated by the Companies (Appointment and Qualifications of Secretary) Rules, 1988. A company with a paid-up share capital of not less than Rs 50 lakhs is required to have a wholetime secretary. Members of the

secretary is not a mere clerk but an officer of the company with executive duties and responsibilities. He has authority to sign contracts connected with the administrative side of a company's affairs and has ostensible authority to enter into a wide range of contracts. In this respect his position has altered very materially since the previous century. The facts of the case were:

> The plaintiff ran a car-on-hire business. The defendant company's secretary hired cars from the plaintiff ostensibly for the company's business, telling him that the cars were wanted to carry important customers of the company. He wrote on the company's paper ordering the cars, signing himself "Company Secretary". In fact, he used the cars himself and not for the company's purposes.

It was held that the secretary had ostensible authority to enter into contracts for hiring cars for which the company must pay. Lord DENNING MR had to face arguments based on previous decisions. In one of them it was stated that "a company secretary fulfils a very humble role; and that he has no authority to make any contracts or representations on behalf of the company".[88] A statement from a case of 1887 was also cited.[89] "A secretary is a mere servant; his position is that he is to do what he is told, and no person can assume that he has any authority to represent anything at all..." Replying to these arguments, his Lordship said:[90]

> But times have changed. A company secretary is a much more important person nowadays than he was in 1887. He is an officer of the

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Institute of Company Secretaries of India can be appointed as wholetime secretaries. Companies with a capital of less than Rs 50 lakhs can appoint any other person as their secretary, but he too must be qualified under the Act. Rule 4 prescribes the qualifications. It says that no individual is qualified unless he possesses any one or more of the following qualifications:

1. Membership of the Institute of Company Secretaries.
2. Pass in the intermediate examination of the Institute and licenced under S. 25 of the Company Secretaries Act, 1980.
3. Postgraduate degree in commerce or corporate secretaryship granted by any University in India.
4. Degree in Law granted by any University.
5. Membership of the Institute of Chartered Accountants.
6. Membership of the Institute of the Cost & Works Accountants of India constituted under the Act of 1959.
7. Postgraduate degree or diploma in managerial science granted by any University, or the Institutes of Management, Ahmedabad, Calcutta, Banglore or Lucknow.
8. Postgraduate diploma in company secretaryship granted by the Institute of Commercial Practice under the Delhi Administration or Diploma in Corporate Laws and Management granted by the Indian Law Institute, New Delhi.
9. Postgraduate diploma in Company Law and secreterial practice granted by the University of Udaipur.
10. Membership of the Association of Secretaries and Managers, Calcutta.

When a company's capital reaches the mark of Rs 50 lakhs, within one year it should appoint a qualified secretary. Published in (1989) 65 Comp Cas 243 st.

88 Citing Lord MACNAGHTEN in *George Whitechurch Ltd* v *Cavanagh*, 1902 AC 117 at 124.

89 *Barnett, Hoares & Co* v *South London Tramways Co*, (1887) 18 QBD 815 at 817; 1902 AC 117. These decisions were supported in *Ruben* v *Great Fingall Consolidated*, 1906 AC 439.

90 [1971] 2 QB 711 at 716.

company with extensive duties and responsibilities. This appears not only in the modern Companies Act, but also by the role which he plays in the day-to-day business of companies. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company's business. So much so that he may be regarded as held out as having authority to do many things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of a company's affairs, such as employing staff, and ordering cars, and so forth. All such matters now come within the ostensible authority of a company's secretary.

SALMON LJ was equally sure of this development in the position of the secretary:

> Whatever the position of company's secretary may have been in 1887, I am quite satisfied that it has altered a great deal from what it was then. At the end of the last century a company secretary still occupied a very humble position very little higher, if any, than that of a minor clerk. Today, not only has the status of a company secretary been much enhanced, but the state of affairs has been recognised by the statutes.... I think there can be no doubt that the secretary is the chief administrative officer of the company. As regards matters concerned with administration, the secretary has ostensible authority to sign contracts on behalf of the company. If a company is ordering cars so that its servants may go and meet foreign customers at airports, nothing is more natural than that the company should hire those cars through its secretary. The hiring is part of his administrative function. Whether the secretary would have any authority to sign a contract relating to the commercial management of the company, for example, a contract for the sale or purchase of goods in which the company deals, does not arise for decision in the present case, but contracts such as the present fall within the ambit of administration.

Liability of Company for Secretary's Acts

A company was not held liable for the conduct of the secretary in trapping persons for taking shares in the company[91] and for issuing a forged share certificate.[92] But he is the proper authority for delivery of the certificates which have been properly prepared.[93] The confirmation of a contract by the secretary, which was made by an unauthorised director, was held to be of no effect.[94] He cannot borrow money on behalf of the company. Thus, where a director advanced a sum of money to the company on the request of the secretary, the company was held not liable. Though the transaction was confirmed at a meeting of the board, that meeting was incompetent, there being no quorum when

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91 *Barnett, Hoares & Co* v *South London Tramways Co*, (1887) 18 QBD 815: 1902 AC 117.
92 *Ibid.*
93 *Clavering Son & Co* v *Goodwins, Jardine & Co*, 18 R 652.
94 *Houghton & Co* v *Nothard, Lowe & Wills Ltd*, [1927] 1 KB 246: 1928 AC 1: (1927) All ER Rep 97.

the interested director was not counted.[1] He has no authority for legal proceedings without instructions from responsible organs.[2] Similarly, without proper authority he cannot call meetings, or register transfer of shares[3] or remove any shareholder's name from the register.[4]

Secretary is included in the list of officers as given in Section 2(30). Thus, he is an officer for all the purposes of the Act and suffers from the same disabilities as do the directors. The provisions relating to loans to directors, contracts with directors, register of directors, etc., will apply. In a case where the board of directors delegated to the managing director their power of appointing and removing all officers, and a question arose whether the secretary of the company, being an "officer" would fall within the spell of the above-mentioned power of removal. The Punjab and Haryana High Court held that this could not be so, for, otherwise, even directors being "officers", would be removable by the managing director. The court felt fortified in its view by the opening words of Section 2 which constitute a preamble to all the definitions, which are: "unless the context otherwise requires", and when the power of removal of officers is handed over to the managing director, the context requires that the "secretary" should be excluded from the scope of the word "officer" for this purpose.[5]

On the footing of an officer, the secretary would be accountable for any secret profit he might derive from his office. To the extent to which his position or authority permits him to deal with the company's money, property or transactions, he would also be regarded as a constructive trustee of the company in those respects.[6] A secretary was held to be personally not liable for misapplication of the company's funds by someone else though he might have known about it. A director might have become liable in a parallel situation.[7] There has also been a judicial observation to the effect that a company secretary owes no fiduciary duty to the company.[8]

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1 *Cleadon Trust Ltd, Re*, [1939] Ch 286 CA.

2 *Daimler Co* v *Continental Tyre & Rubber Co*, [1916] 2 AC 307; *Edington* v *Dumbar Steam Laundry Co*, (1903) 11 SLT 117 OH, Scotland.

3 *Zinotty Properties Ltd, Re*, [1984] 3 All ER 754: [1984] 1 WLR 1249, where it was held that the act of a company's secretary in transferring the shares of the company personally to one *C* was not effective to make *C* a registered member because the secretary cannot act without the authority of the board of directors which at that time had ceased to exist because of the company's failure to hold successive general meetings.

4 *State of Wyoming Syndicate, Re*, [1901] 2 Ch 431; *Indo-China Steam Navigation Co, Re*, [1917] 2 Ch 100 and *Chida Mines Ltd* v *Anderson*, (1905) 22 TLR 27.

5 *Haryana Seeds Development Corpn Ltd* v *J. K. Agarwal*, (1989) 65 Comp Cas 95 P&H.

6 See *McKay* case, [1875] 2 Ch D 1, where the view expressed was that when the secretary wrongfully acquired company property, he did so in his capacity as an officer of the company. However, he would now be described as a constructive trustee. For an indication of the modern view of the fiduciary position of the secretary, see *New Zealand Netherlands Society "Oranje" Inc* v *Kays*, [1973] 2 All ER 1222. For other cases, see *Stapleford Colliery Co, Barrow* case, *Re*, (1880) 14 Ch D 432 CA, liability to account for improper commission in the company's transactions, *Morvah Consols Tin Mining Co Ltd, Re*, (1875) 2 Ch D 1: [1874-80] All ER Rep Ext 2212; *Mckay* case, (1875) 2 Ch D 1 AC; *Gulabdas Bhaidas, Re*, (1892) ILR 17 Bom 672.

7 *Joint Stock Discount Co* v *Brown*, (1869) 8 Eq 381, 396.

8 *Brown* v *Bennet*, (1998) 2 BCLC 97 at 106-107 Ch D.

Administrative officer

The Calcutta High Court[9] has held that the amendment of 1974 which has elevated the position of the secretary to that of an administrative officer, has not altered the basic position of the secretary to such an extent as to enable him to undertake serious litigation on behalf of the company without a decision of the company's board. The court cited the following passage from HALSBURY'S LAWS OF ENGLAND:

> He (the secretary) has no power, without the resolution of the directors, to call a meeting of the company or to commence proceedings on behalf of the company, nor can he alter the register of members, but any such act may be ratified by the directors.[10]

After citing more extensively from HALSBURY'S LAWS OF ENGLAND[11] the court suggested:

> From the above summary it is quite clear that the secretary cannot usurp the functions and powers of the board or the company, but due to the enormous growth of company activities he has been empowered to discharge various ministerial and administrative duties on behalf of the company which generally can be performed by an authorised agent. In due course of time the secretary has been given certain statutory powers, like signing the annual returns, etc. But under no circumstances can he discharge the functions of the board or act on behalf of the company in matters of policy or substantive steps which is not administrative or ministerial in nature.

The court cited the following statements from a decision of the Supreme Court:

> Ordinarily the functions of the secretary of the corporation would be ministerial and administrative. As a secretary only, he would have no authority to bind the corporation by entering into contracts or other commitments on its behalf.[12]

Officer who is in default [S. 5]

The word "officer" has been defined to "include any director, manager, or secretary or any person in accordance with whose directions or instructions the Board of directors or any one or more of the directors is or are accustomed to act."[13]

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9 *Mohan Lal Mittal* v *Universal Works Ltd*, (1983) 53 Comp Cas 36 Cal. The secretary commenced a proceeding under Ss. 397 and 398. But see *N. Ramachandran* v *Cardamo Marketing Co (Travancore) Ltd*, (1990) 69 Comp Cas 205 Ker, where the secretary who was managing the affairs of the company was held to be competent to verify the plaint of the company because he was acquainted with the facts and it was immaterial that his appointment was still not approved.

10 Paras 546-47 (Vol VII, 4th Edn).

11 Paras 546-47 (Vol VII, 4th Edn).

12 *Lakshmiratan Cotton Mills Ltd* v *Aluminium Corpn of India Ltd*, (1971) 1 SCC 67: AIR 1971 SC 1482.

13 As introduced by the Amendment Act, 2000, S. 2(30).

There are many penal provisions in the Act. Almost all of them provide for punishment by way of fine or imprisonment of directors or other principal officers of the company.[14] It is common with companies to grant positions merely for ceremonial purposes. Such persons may not be much concerned with the affairs of the company and, therefore, may not deserve to be punished. In order to ascertain those who really deserve to be punished, the Companies Acts have all along for all serious defaults used the expression "the officer who is in default". In actual practice, however, it was very difficult to find out who was in charge of a particular affair of a company in respect of which a default had been registered so as to hold him liable as an officer in default. Many cases failed for this reason. Section 5, as redrafted by the amendment of 1988, is an attempt to meet this problem.[15] The provision is as follows:

S. 5. Meaning of "officer who is in default".—For the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any punishment or penalty, whether by way of imprisonment, fine or otherwise the expression "officer who is in default" means all the following officers of the company, namely:

(*a*) the managing director or managing directors;

(*b*) the wholetime director or wholetime directors;

(*c*) the manager;

(*d*) the secretary;

(*e*) any person in accordance with whose directions or instructions the Board of directors of the company is accustomed to act;

(*f*) any person charged by the Board with the responsibility of complying with that provision:

Provided that the person so charged has given his consent in this behalf to the Board;

(*g*) where any company does not have any of the officers specified in clauses (*a*) to (*c*), any director or directors who may be specified by the Board in this behalf or where no director is so specified, all the directors:

Provided that where the Board exercises any power under clause (*f*) or clause (*g*), it shall, within thirty days of the exercise of such powers, file with the Registrar a return in the prescribed form.

The effect of the new provision is that professional managers, like managing directors, managers, wholetime directors or secretaries, will be

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14 S. 2(30) says that the term "officer" includes any director, manager or secretary or any other person in accordance with whose directions or instructions, the board of directors or any one or more of the directors is or are accustomed to act. A person who gives such instructions or directions is called a "shadow director". Section 7 tries to find out the identity of such person. It says that except where the Act expressly provides otherwise, a person shall not be deemed to be, within the meaning of the Act, a person in accordance with whose directions or instructions the board of directors of a company is accustomed to act, by reason only that the board acts on advice given by him in a professional capacity. Where a company was in the position of being a shadow director in another company, it was held that by that reason alone its directors would not be regarded as the shadow directors of the other company, *Secretary of State for Trade and Industry* v *Laing*, (1996) 2 BCLC 324 CA. In *Kaytech International plc*, (1999) 2 BCLC 351 CA, the Court of Appeal observed that all the factors in the definition would have to be considered. The individual concerned must have assumed the status and functions of a director so as to have openly exercised real influence on the corporate governance of the company. In this case the individual was acting as a director in the camouflage of a secretary.

15 The new provision has been enforced w.e.f. 15-1-1988, GSR 782(E), dated 13-7-1988.

regarded as officers in default without any further inquiry.[16] This category will also include those in accordance with whose directions or instructions the board of directors is accustomed to act. For the rest it would have to be shown that they were under responsibility. The board can specify who would be responsible for the observance of particular provisions. The consent of such a person should be taken and it should be filed with the Registrar within 30 days in the prescribed form.[17] Such a person would then be held liable for the default in question without any further inquiry. Where there is no professional manager like managing or wholetime director or manager and the board has not designated any person in the above manner, then all the directors will be held as officers in default.[18]

A director was not allowed to be prosecuted for violation of the provisions (S. 370) relating to inter-corporate loans committed during the period before he joined as a director.[19]

A company is a person within the meaning of Section 2(1)(*m*) and Section 27 of the Consumer Protection Act, 1986. The company is liable to be punished for dishonouring the decree of a consumer forum. A director of the company who was responsible for causing the disobedience was also liable to be prosecuted.[20]

Sole selling agents [S. 294]

Definition

The expression "sole selling agent" is not defined in the Act. The definition of

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16 *Ravindra Narain* v *ROC*, (1994) 81 Comp Cas 925 Raj, other directors could be prosecuted only when there was no managing director, wholetime director or manager.

17 Form 1-AA has been prescribed for the purpose.

18 It has been laid down in an Australian case that on a complaint against a director of a company for knowingly and wilfully permitting the company to commit a breach of [a provision of the Companies Act] the prosecution must prove beyond reasonable doubt that the director knew of the acts constituting the breach and in the free exercise of his will authorised or permitted them to be carried out. It is not necessary for the prosecution to prove that the directors knew that the acts were unlawful. *Mel* v *Flavel*, (1986) 45 South Australian States Reports (SASR) 69 SC. Officers who have not been designated can be prosecuted only by showing their connection with management and default on their part. *R. Banerjee* v *H.D. Dubey*, (1992) 2 SCC 552: (1992) 75 Comp Cas 722 SC. It must be alleged in the complaint that the director proceeded against was a director at the material time and knew of the default. *Registrar of Cos* v *Bipini Behari Nayak*, (1995) 83 Comp Cas 95 Ori. A prosecution under the Insecticide Act, 1968 against a company secretary was not allowed to proceed because there was no allegation that the default was due to his neglect, or consent or connivance. *B.B. Nagpal* v *State of Haryana*, (1995) 83 Comp Cas 596 P&H. Where show-cause notice was not given to the director sought to be prosecuted, the proceeding was quashed, *Sivandhi Adityan* v *Addl ROC*, (1995) 83 Comp Cas 616 Mad. *Rajiv Gupta* v *State*, (2001) 104 Comp Cas 26 Delhi, a company and its directors could not escape from penal liability under S. 138 of the Negotiable Instruments Act, 1881 on the ground that winding up petition had been presented and was pending at the material time. *Orient Syntex Ltd* v *Besant Capital Tech Ltd*, (2001) 104 Comp Cas 669 Bom, dishonour of a cheque issued for repayment of loan made the directors *prima facie* liable because borrowing is their exclusive domain under S. 292.

19 *Siva Prasad* v *Registrar of Cos*, (1997) 88 Comp Cas 420 AP.

20 *Ravi Kant* v *Consumer Disputes Redressal Commission*, (1997) 89 Comp Cas 471: [1997] 3 Comp LJ 174 Delhi.

"agent" as given in Section 182 of the Contract Act should, therefore, apply.[21] When a company gives a person the exclusive right to sell its goods in a particular area, he is called a "sole selling agent". He alone is given the selling right in respect of the goods. Thus, for example, in *Shalagram Jhajharia* v *National Co*:[22]

> A company appointed a "Corporation as its exclusive distributors in USA, its possessions, Canada and Mexico for sale of jute packing cloth..."

The Calcutta High Court held the corporation to be a sole selling agent and it made no difference that a subsequent clause in the contract described the corporation as "a buyer on principal to principal basis". "The relationship is to be determined not by name but conduct of the parties and the purport of their dealings."[23] Thus a "sole selling agent" has to be distinguished from "a buyer with the sole right to sell the goods of a particular manufacturer".[24]

Appointment and Terms

Section 294 regulates the appointment and terms of a sole selling agency. The appointment may be made by the board, but it must be "subject to the condition that it shall cease to be valid if it is not approved by the company in the first general meeting" held after the date of appointment.[25] If this condition is not expressly mentioned in an appointment made by the board, the appointment is invalid *ab initio*. "The provision is mandatory, not merely directory."[26] Further if approval is not obtained at the first general meeting held after the appointment, or if it is disapproved there, it ceases to be valid from the date of the meeting.[27] When the appointment has become invalid, it is to be regarded as dead and cannot be resuscitated or revived by ratification at a subsequent meeting.[28]

The appointment can be made for a period of five years only at a time, but the term may be extended from time to time for five years on each occasion.[29]

A managing agent who has ceased to hold his office cannot be appointed as sole selling agent for a period of three years from the date of the termination of the managing agency. Such appointment may, however, be made with the approval of the Central Government.[30]

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21 According to that section an "agent means a person employed to do any act for another or to represent another in dealings with third parties". See *Shalagram Jhajharia* v *National Co*, [1965] 1 Comp LJ 112 at 118 Cal.

22 [1965] 1 Comp LJ 112 Cal.

23 [1965] 1 Comp LJ 112 Cal.

24 *See*, for example, *W.T. Lamb & Sons* v *Goring Brick Co*, [1932] 1 KB 710; *Hope Prudhomme & Co* v *Hamel & Horley*, ILR (1925) 49 Mad 1: AIR 1925 PC 161: 88 IC 307.

25 S. 294(2).

26 *Arantee Manufacturing Corpn* v *Bright Bolts Ltd*, [1967] 2 Comp LJ 54: (1967) 37 Comp Cas 758 Cal. The object of the provisions is to protect the interests of the company and to prevent unnecessary expenditure. *Ramesh B. Desai* v *UOI*, AIR 1988 Delhi 288. *A.V. Kasargod* v *ROC*, (2001) 105 Comp Cas 676 Kant, the condition of approval in the first meeting is mandatory.

27 S. 294(2-A).

28 *Shalagram Jhajharia* v *National Co*, [1965] 1 Comp LJ 112 Cal, BOSE CJ at 123.

29 S. 294(1) and the proviso.

30 S. 294(4)

Investigation of Terms

The Central Government may for some good reason require a company to furnish to it certain information regarding the terms and conditions of the appointment.[31] The purpose is to enable the Central Government to determine whether or not the terms and conditions are prejudicial to the interest of the company. If the company refuses or neglects to furnish the information, the Central Government may appoint a suitable person to investigate and report on the terms and conditions of the appointment. If the terms are found to be prejudicial to the interests of the company, the Central Government may, by order modify them so as to make them harmless to the company. In *Firestone Tyre & Rubber Co* v *Synthetics & Chemicals Ltd*[32] a company manufacturing a commodity of which there was an acute shortage could not pay dividends for five years owing to lack of profits, but during the same period the sole selling agents had drawn a commission of over 84 lakh rupees. The Company Law Board accordingly advised the company that the terms were detrimental to the interest of the company and the commission should be reduced.

The constitutional validity of this power was brought in question before the Bombay High Court in *Nanavati & Co P Ltd* v *R.C. Dutt*.[33] On the application of some of the shareholders of a company, the Central Government demanded information as to the terms and conditions on which the company appointed its sole selling agents. The Central Government found the terms to be prejudicial to the interest of the company and, therefore, in the exercise of its powers[34] the Government modified the terms as follows:

(*i*) the rebate of 5% payable to the agents was reduced to 3-1/2%,

(*ii*) the term with regard to 60 days' credit was altered, and

(*iii*) the provision for rebate on direct sales effected by the company was taken away.

The allegations were that the power was violative of Article 14 of the Constitution as it could be exercised in the case of a particular company, while in many other companies sole selling agents were allowed to work on similar conditions and that the Company Law Board had not adopted any definite policy in selecting companies for varying sole selling agency agreements and finally that the power to vary does not include the power to abrogate. The court rejected all these contentions and held that the power was valid and validly exercised. TULZAPURKAR J explained the effect of the provision in the following words:

> It is no doubt true that under clause (*a*) of Section 294(5) it is for the Central Government to decide whether there is a good reason to call for information or not and it is also true that under clause (*c*) it is for the Central Government to form its opinion on the point as to whether the terms and conditions of the appointment of a sole selling agent are prejudicial to the interest of the company or not, but that does not mean that it is open to the

31 S. 294(5).

32 [1970] 2 Comp LJ 200: (1971) 41 Comp Cas 337 Bom.

33 (1967) 37 Comp Cas 171 Bom.

34 Under S. 294(5) read with Government of India Notification dated February 1, 1964.

> Central Government to pick and choose any company it likes at random. The discretion to select is undoubtedly with the Central Government, but the section itself lays down a policy or principle for the guidance of the exercise of such discretion... and that guiding principle is that the terms and conditions of appointment... (are) prejudicial to the interests of the company.[35]

Referring to the contention that the Central Government had completely thrown out one of the terms of the agreement, whereas it had power only to "vary" them, the learned Judge said:

> It appears that the ordinary dictionary meanings of the expressions 'variation' and 'vary' have been given a go-bye and artificial definitions have been introduced by Section 2(50) so as to include the concept of 'abrogation' within the expression 'variation'.

The matter then came before a Bench of the High Court.[36] The Bench upheld the constitutional validity of the provision, but quashed the order of the Government on other points. Though the power of the Company Law Board is of administrative nature, the principle of natural justice should be followed. As the sole selling agents were not given any notice to show cause, the order was bad. The power to vary the terms no doubt includes the power to abrogate them but abrogation of the contract itself would be a different thing. To convert a sole selling agent into an ordinary agent is not a mere variation of a term, but substitution of one kind of contract for another. This is beyond the powers of the Government.

Where a company has more than one selling agent in any area or areas, the Central Government may require similar information, this time for the purpose of determining whether any one of them should be declared as the sole selling agent for any area.[37]

When a person is appointed to investigate the terms and conditions of an appointment, it is the duty of the company and its officers to produce before him relevant books and papers and to give him all assistance in connection with the investigation.[38]

Compensation for loss of office [S. 294-A]

According to Section 294-A "a company shall not pay or be liable to pay to its sole selling agent any compensation for the loss of his office in the following cases":

1. Where the appointment ceases to be valid because it is disapproved of by the company in general meeting.
2. Where he resigns his office in view of the reconstruction or amalgamation of the company and is appointed as the sole selling agent of the company resulting from the reconstruction or amalgamation.

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35 (1967) 37 Comp Cas 171 at 184 Bom.

36 *Nanavati & Co P Ltd* v *R.C. Dutt*, (1975) 45 Comp Cas 91 Bom.

37 S. 294(6).

38 S. 294(7). The company and every officer in default is punishable with fine.

3. Where he voluntarily resigns his office.
4. Where he has been guilty of fraud or breach of trust or gross negligence in the conduct of his duty as the sole selling agent.
5. Where he has instigated or taken part in bringing about the termination of the agency.

In other cases compensation for loss of office may be paid.

The amount of compensation shall not exceed the remuneration which he would have earned for the unexpired residue of his term, or for three years, whichever is shorter. The amount should be calculated on the basis of the average remuneration actually earned during a period of three years immediately before the termination, or where he held his office for a period lesser than three years, during such period.

The Companies (Amendment) Act, 1974 introduced the following changes.

Where the product of a company has a ready market, sole selling agents become redundant and in order to dispense with them Section 294-AA has been introduced. The section provides that where the Central Government is of the opinion that the demand for goods or services of a certain category is substantially in excess of production and supply and, therefore, the services of sole selling agents are not necessary for creating a market, the Government may by notification in the Official Gazette declare that sole selling agents shall not be appointed in such cases.[39]

A person, firm or company who or which has substantial interest in the company, should not be appointed as sole selling agents except with the previous approval of the Central Government.[40] A company having paid-up share capital of fifty lakh rupees or more can appoint a sole selling agent only with the consent of the company by a special resolution and the approval of the Central Government.[41]

The provisions of sub-sections (5), (6) and (7) of Section 294 (which deal with investigation and modification of terms), have been made applicable to the sole purchasing or buying agents of a company also.[42] The provisions of Section 294-AA(2), (3) and (8) have been extended to a sole agent for the purchasing and buying of goods on behalf of the company.

Where a company has already made an appointment before the commencement of the Amendment Act, but the appointment is such that if the amendment had been in force it would have required approval of the Central

39 S. 294-AA(1).The Central Government under this section can examine the question whether the notice was according to law and whether the shareholders had accorded their consent. It is not a forum for challenging the validity of the meetings or the resolutions passed thereat. That should be done by separate proceedings. *Ramesh B. Desai* v *UOI*, AIR 1988 Delhi 303; (1990) 69 Comp Cas 33. It is not a judicial function, but just only administrative function of approval. The Government should follow the guidelines issued by it but is free to change those guidelines. Courts do not generally interfere in writ proceedings in executive decisions relating to economic matters.

40 *Id.* (2).

41 *Id.* (3).

42 *Id.* (4).

Government, such approval should be obtained within six months, otherwise the appointment shall stand terminated at the expiry of six months [Section 294-AA(6)].

Meaning of "substantial interest"

The Explanation appended to Section 294-AA explains the meaning of substantial interest:

1. In relation to an individual, it means the beneficial interest held by such individual or any of his relatives whether singly or taken together, in the shares of the company.
2. In relation to a firm, it means the beneficial interest held by one or more partners of the firm or any relative of such partner, whether singly or taken together, in the shares of the company.
3. In relation to any body corporate, it means the beneficial interest held by such body corporate or one or more of its directors or any relative of such a director, whether singly or taken together, in the share capital of the company, the aggregate paid-up amount on which exceeds five lakh rupees or 5% of the paid-up share capital of the company, whichever is less.

Managing agents

The managing agency system was abolished by the Companies (Amendment) Act, 1969.

Company as an undisclosed principal [S. 416]

Whenever an authorised functionary of a company makes a contract on behalf of the company by keeping the company a secret or undisclosed principal, he has to make a memorandum of the contract in writing showing the terms and the parties with whom the contract is made. He should file the memorandum with the company and send a copy of it to each of its directors. The company should lay a copy of the memorandum before the board of directors at its next meeting. If these formalities are not complied with, the contract becomes voidable at the option of the company. The defaulting officers can be punished with fine extending up to Rs 200.
