

MEETINGS OF BOARD AND ITS POWERS



LEARNING OUTCOMES

At the end of this Chapter, you will be able to:

- ❑ Elaborate the procedure and requirements of convening a Board meeting.
- ❑ Explain about the requisite quorum for the conduct of Board meetings.
- ❑ Recognise the concept of Audit Committee, Nomination and Remuneration Committee, and Stake-holders Relationship Committee of the Board.
- ❑ Explain the powers and restrictions imposed on the powers of Board.
- ❑ Describe the various provisions relating to contributions to be made by companies to charitable funds, political parties, National Defence Fund, etc.
- ❑ Comprehend the provisions relating to disclosure of interest by directors, restrictions on loan to directors and loans and investments made by a company.
- ❑ Explain the provision of related party and the related party transactions.
- ❑ Determine the provisions related to the payment to directors for loss of office, etc. in connection with transfer of undertaking, property or shares.



1. INTRODUCTION

The shareholders in general meetings and the directors acting collectively as a Board conduct the affairs of a company. Therefore, directors frequently meet to discuss various matters relating to the management and administration of the affairs of the company in the interest of the shareholders, the company and the public at large including society and economy and more particularly, the environment. The modern practice is to confer upon the directors the right to exercise all powers of the company in which they are appointed as directors except for those matters, which by law are required to be exercised by the company in general meetings through the shareholders. The Board of directors oversees management of the company to ensure that the interests of the shareholders are protected and the goal of wealth maximization is achieved.

The provisions related to meetings of Board and its powers are dealt with under Sections 173 to 193 of the Companies Act, 2013 (in short, the 'Act') and the relevant Rules.



2. MEETINGS OF BOARD [SECTION 173]

Section 173 of the Act contains provisions which deal with Meetings of the Board. This section requires the directors upon whose shoulders the management of the company rests to meet and interact regularly. The aim is to ensure that the powers which vest in the directors should be exercised collectively and every director should have the knowledge of the decisions taken for the smooth conduct of the business operations. The provisions of Section 173 are discussed hereunder:

(i) Frequency of Board Meetings [Section 173 (1)]¹:

- (a) **First Board meeting:** Every company shall hold the first meeting of the Board of Directors **within 30 days** of the date of its Incorporation.
- (b) **Subsequent Board meetings:** Every company shall hold minimum of 4 meetings every year but the gap between two consecutive board meetings shall not be **more than 120 days**.

Example 1: In case a company conducted its Board meeting on 2nd April, 2019, then the next meeting must be held within 120 days of this date *i.e.* ideally before 31st July, 2019; and, by 31st December, 2019, the company must conduct minimum four such meetings (including the meetings which have already been conducted in the year 2019). The Board meetings may go beyond four also in a calendar year depending upon the urgency of any business.

¹ As per Para 2.1 of Revised Secretarial Standards-1 (SS-1), the company shall hold at least four Meetings of its Board in each Calendar Year with a maximum interval of one hundred and twenty days between any two consecutive Meetings.

(ii) **Exemptions to Certain Companies [Section 173(5)]:**

In case of a **One Person Company (OPC), small company and dormant company**, the provision regarding conducting of **four** Board meetings every year is **not applicable**. These entities are required to conduct **one Board meeting in each half of a calendar year** and the gap between the two meetings must **not be less than 90 days**. This is the minimum requirement and if so done, they shall be deemed to have complied with the provisions of Section 173.

OPC having only one director: One more exemption is given to One Person Company which has only one director on its Board of Directors. Such OPC shall not be required to hold even a single Board meeting during the year. Thus, it is totally exempted from the provisions of Section 173(5)².

Modifications in respect of Section 8 companies and Private companies

1. Vide Notification No. G.S.R.466(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 584 (E) dated 13th June, 2017, Section 173 (1) shall apply to a **Section 8 company** only to the extent that the Board of Directors of such a company shall hold **at least one meeting within every six calendar months**. This is subject to the conditions that the company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

2. Vide Notification No. GSR 464(E), dated 5-6-2015, as amended by Notification No. GSR 583(E), dated 13-6-2017, in case of **private companies**, for sub-section (5) of Section 173, the following sub-section shall be substituted:

"(5) A One Person Company, small company, dormant company and a private company (if such private company is a start-up) shall be deemed to have complied with the provisions of this section if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than ninety days:

Provided that nothing contained in this sub-section and in section 174 shall apply to One Person Company in which there is only one director on its Board of Directors."

The above substitution is effective subject to the conditions that the private company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

² Refer Proviso to Section 173 (5).

(iii) **Participation by Directors in Board Meetings:**

- (a) **Means to attend Board Meetings:** Section 173(2) of the Act allows the directors of a company to attend Board meetings in the following manner:



- in person
- through video conferencing
- other audio-visual means as prescribed under Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014

Thus, the directors besides meeting in person, are also permitted to meet through electronic mode *i.e.* video conferencing or other prescribed audio-visual means.

Meaning of the term “video conferencing or other audio-visual means”: It refers to audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting. **[as per Explanation to Rule 3]**

Essentials of audio-visual means: According to Section 173 (2), the audio-visual means should be capable of-

- recording and recognising the participation of the directors; and
- recording and storing the proceedings of such meetings along with date and time.

Matters which cannot be dealt with in a meeting through electronic mode³: The Central Government may, by notification, specify matters which shall not be dealt with in a meeting through video conferencing and other audio-visual means.

Provided further that where there is quorum in a meeting through physical presence of directors, any other director may participate through video conferencing or other audio visual means in such meeting on any matter specified under the first proviso.

- (b) **Procedural points relating to meetings of Board that are held through video conferencing or other audio-visual means:** The procedural points as given in Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014, are as under:

³ As per First Proviso to Section 173 (2).

Sl. No.	Procedural aspects relating to meetings of Board that are held through video conferencing or other audio-visual means	For convening and conducting of the Board meetings
1.	Every Company shall make necessary arrangements	to avoid failure of video or audio-visual connection
2.	The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care-	<p>(A) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;</p> <p>(B) to ensure availability of proper video conferencing or other audio-visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorized participants at the Board meeting;</p> <p>(C) to record proceedings and prepare the minutes of the meeting;</p> <p>(D) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year.</p> <p>(E) to ensure that no person other than the concerned director is attending or have access to the proceedings of the meeting through video conferencing mode or other audio-visual means;</p> <p>(F) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting;</p>

3.	Notice of the meeting and the further process	<p>(A) Notices shall be sent to all the directors as per Section 173 (3);</p> <p>(B) Notices shall inform the directors regarding the options available to them to participate through video conferencing mode or other audio-visual means, along with all the necessary information to enable the directors to participate through such mode;</p> <p>(C) A director intending to participate through video conferencing mode or other audio-visual means shall communicate his intention to the Chairperson or the company secretary of the company;</p> <p>(D) If a director intends to participate through video conferencing or other audio-visual means, he shall give prior intimation to that effect, to enable the company to make suitable arrangements in this behalf;</p> <p>(E) Any director who intends to participate in the meeting through electronic mode may intimate about such participation at the beginning of the calendar year and such declaration shall be valid for one year;</p> <p>However, such declaration shall not debar him from participation in the meeting in person in which case he shall intimate the company sufficiently in advance of his intention to participate in person;</p> <p>(F) In the absence of any such intimation (<i>i.e.</i> participation through video conferencing mode or other audio-visual means) from the director, it shall be assumed that he will attend the meeting in person.</p>
4.	Process of roll call at the Board Meeting	At the commencement of the meeting, a roll call shall be taken by the Chairperson. At this point, every director participating through video

		<p>conferencing or other audio-visual means shall state, for the record, the following namely:</p> <p>(a) name;</p> <p>(b) the location from where he is participating;</p> <p>(c) received the agenda and all the relevant material for the meeting; and</p> <p>(d) no one other than the concerned director is attending /having access to the proceedings of the meeting at the location mentioned in clause (b);</p>
5.	After the roll call	The Chairperson or the Company Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting with the permission of the Chairperson and confirm that the required quorum is complete.
6.	Counting for quorum and ensuring of quorum	<p>A director participating in a meeting through video conferencing or other audio-visual means shall be counted for the purpose of quorum.</p> <p>He shall not be counted if he is to be excluded for any items of business under any provisions of the Act or the rules.</p> <p>The Chairperson shall ensure that the required quorum is present throughout the meeting.</p>
7.	Scheduled venue of the meeting as mentioned in the notice convening the meeting	Scheduled venue shall be deemed to be the venue of the meeting which is conducted through video conferencing or other audio-visual means authorized under these rules and all recordings at such meeting shall be deemed to have been made at that place.
8.	Signing of Statutory Registers placed at the scheduled venue of the	The statutory registers shall be deemed to have been signed by the directors participating through electronic mode, if they have given their

	meeting	consent to this effect and it is so recorded in the minutes of the meeting.
9.	Identification of participant	Every participant shall identify himself for the record before speaking on any item of business on the agenda.
10.	Statement interrupted or garbled	If a statement of a director in the meeting through video conferencing or other audio-visual means is interrupted or garbled, the Chairperson or Company Secretary shall request for a repeat or reiteration.
11.	Objection against a motion	If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.
12.	No access to unauthorized person	From the commencement of the meeting till its conclusion, no person except the Chairperson, Directors, Company Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.
13.	Summary of decision on each agenda item	At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, who dissented from the decision taken by majority.
14.	Preservation of draft minutes	Draft minutes shall be preserved till their confirmation. Further, the minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio-visual means.

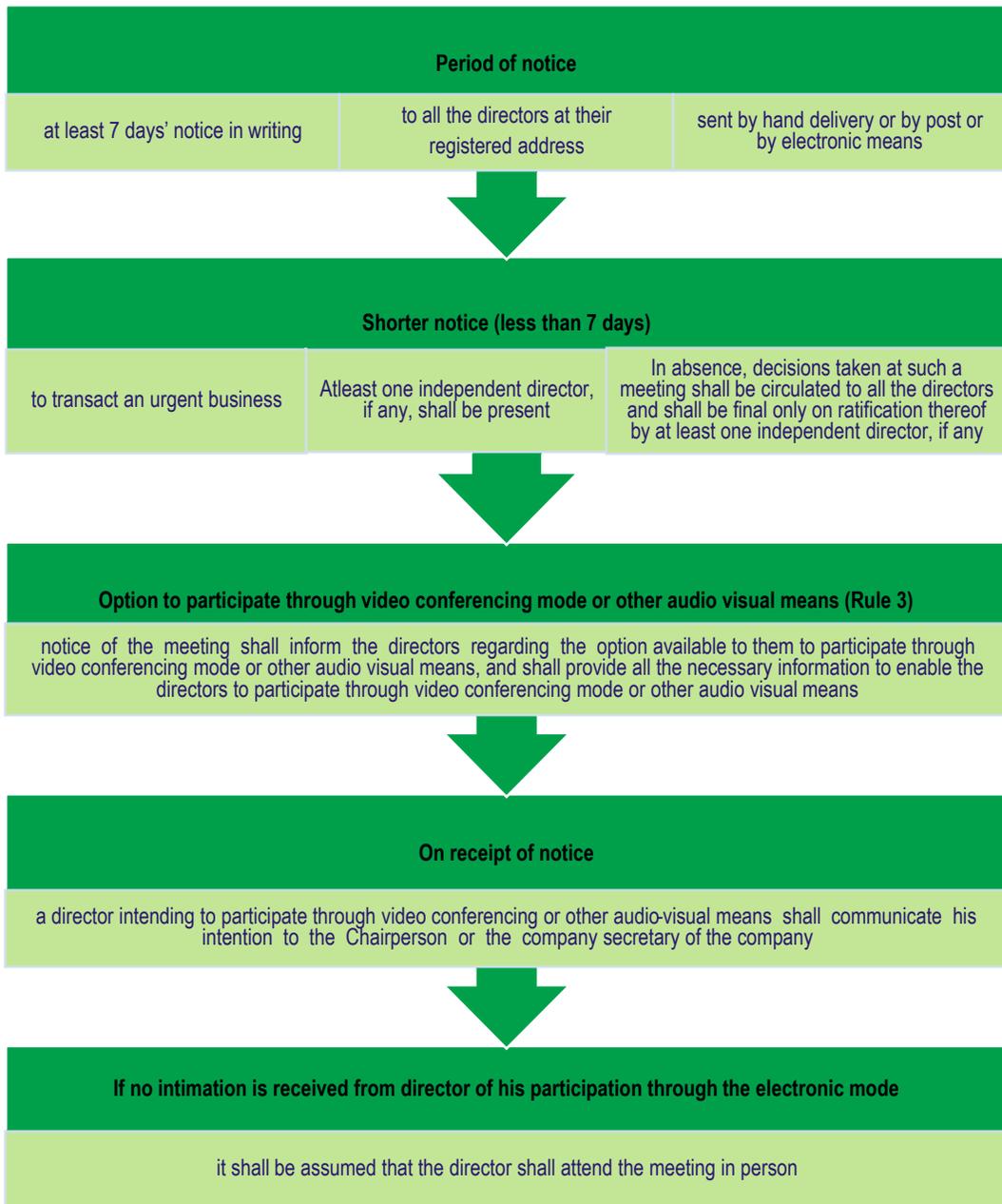
15.	Circulation of draft minutes of the meeting	The draft minutes of the meeting shall be circulated among all the directors within 15 days of the meeting either in writing or in electronic mode as may be decided by the Board.
16.	Confirmation or written comments about the accuracy of recording of the proceedings	Every director who attended the meeting, whether personally or through video conferencing or other audio-visual means, shall confirm or give his comments in writing, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.
17.	After completion of meeting	Minutes shall be entered in the minute book signed by the Chairperson

Explanation-For the purposes of this rule, "video conferencing or other audio visual means" means audio- visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

Requirement of attending all the Board Meetings:

Is it necessary for all the directors to attend all the Board meetings of the company held during a year? Apparently, the answer is no because it shall be illogical to expect from every director to attend each and every meeting but as they are the guardians of the company they must try their best to attend as many Board meetings as possible. However, a continuous absence is also detrimental if we look at Section 167 (1) (b) which states that a director shall be required to vacate his office if he absents himself from all the meetings of the Board of Directors held during a period of 12 months with or without seeking leave of absence of the Board.

(iv) Notice of the Board meeting [Section 173 (3)]:



- (v) **Penalty for failure to give notice:** Section 173(4) prescribes a penalty of ₹ 25,000 in respect of every officer⁴ of the Company whose duty is to give notice under Section 173 and who has failed to do so.

⁴According to Secretarial Standard 1 (SS-1), any Director of a company may, at any time, summon a Meeting of the Board, and the Company Secretary or where there is no Company Secretary, any person authorised

Example 2: The Board of Directors of Infotech Consultants Limited, registered in Kolkata, proposes to hold the next board meeting in the month of May, 2019. It was decided to hold board meeting in Chennai through video conferencing, though all the directors of the company reside at Kolkata. As provision in the Companies Act, 2013 does not require that the board meetings must be held at a particular place. Accordingly, there is no difficulty in holding the current board meeting at Chennai through video conferencing even if all the directors of the company reside at Kolkata and the registered office is also situated at Kolkata. However, it is to be seen that the legal requirements as prescribed by Section 173 (2) and Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 are meticulously followed.

Example 3: XYZ Ltd. is a foreign collaborator in ABC Ltd. incorporated in India under the Companies Act, 2013. The foreign collaborator holds 49% of the shareholding. The Board meetings of ABC Ltd are usually held in India and sometimes meetings of the Board are called at a very short notice for which there is a provision in the Articles of Association that during such situations, notices of the meetings of the Board can be sent by e-mail. Here in the given instance, such a provision in the Articles of Association of ABC Ltd. is valid.

In terms of the proviso to section 173(3) of the Companies Act, 2013 a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting. No exception is made for any class or classes of companies.

Further, under section 173(3) a meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

If we examine the above provision, it is amply clear that the notice is allowed to be sent, *inter-alia*, by electronic means also. Hence, the sending of notice by e-mail is a permissible mode of delivery and can be resorted to without any hindrance. In case Articles contain such a provision, there is no illegality involved even if there is a foreign collaborator in the company.

Therefore, in the given case the shorter notice by e-mail is legally permitted. It is to be noted that there should be the presence of quorum and at least one independent director at the meeting. The provision of the Articles in this regard is not so relevant since the position is quite clear in the Act itself.

In an order given by NCLAT, New Delhi in *Achintya Kumar Barua alias Manju Baruah v. Ranjit Barthkur*, was held that section 173(2) gives right to a director of company to participate in board meeting through video-conferencing or other audio-visual means. Tribunal allowed application of respondent director seeking facility of attending board meeting through video-conferencing.

by the Board in this behalf, on the requisition of a Director, shall convene a Meeting of the Board, in consultation with the Chairman or in his absence, the Managing Director or in his absence, the Whole-time Director, where there is any, unless otherwise provided in the Articles.

Appellant director raised a apprehension that it would not be possible to ensure that no person other than concerned director was attending said meeting. According to appellant, Secretarial Standards on Meetings of Board of Directors have prescribed that such option under provisions of 2013 Act and Rules should be resorted to only when facilities were provided by Company to its Directors. In instant case company had all necessary infrastructure available for conducting meeting through video-conferencing, it was held to follow provisions of section 173 as it would be in interest of Companies as well as directors and it would not be appropriate to shut-out these provisions on mere apprehensions.



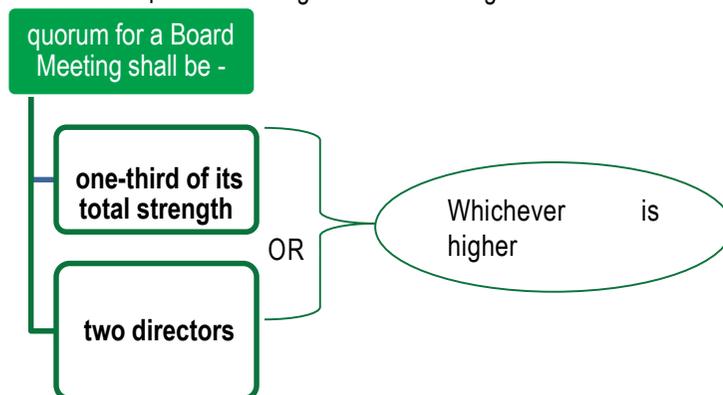
3. QUORUM FOR MEETINGS OF BOARD [SECTION 174]

A quorum is the minimum number of directors who must attend the proceedings in order to transact business validly at a duly convened Board meeting. The directors must not be disqualified to participate in the meeting. Unless the quorum is present at the meeting, it shall not be deemed to have been properly held.

Section 174 of the Companies Act, 2013 contains provisions in respect of quorum required for the meetings of the Board of Directors. These provisions are discussed as under:

(i) **Quorum for a Board Meeting [Section 174 (1)]:** In respect of quorum for Board meeting following points are noteworthy:

- The quorum for a Board Meeting shall be **one-third of its total strength or two directors**, whichever is **higher**.
- While calculating the quorum, any fraction of a number shall be rounded off as one.
- The total strength shall not include those directors whose places are vacant.
- The quorum needs to be present throughout the meeting.



It may be noted that the articles of a company cannot specify a quorum which is less than that prescribed by Section 174 (1). However, there is no bar in fixing a higher quorum than required statutorily.

Modification

*In case of a **Section 8 Company**, Section 174 (1) stands modified to state that quorum shall be either **eight members or 25% of its total strength whichever is less**, provided that the quorum shall not be less than two members.*

The above modification is applicable subject to the condition that the Section 8 company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. [Notification No. G.S.R.466(E), dated 5th June, 2015 as amended by the Notification No. G.S.R.584 (E), dated 13th June, 2017.]

- (ii) **Participation through electronic means to be counted for Quorum:** The directors who participate by video conferencing or other audio-visual means shall also be counted for the purpose of determining the quorum at the meeting **unless** they are to be excluded for any items of business under any provisions of the Act or the rules⁵.
- (iii) **In case when there is vacancy in the Board [Section 174 (2)]:** In case there is any vacancy in the Board (*i.e.* strength is less than that mentioned in the Articles), the continuing directors may act irrespective of such vacancy.

However, the problem will arise when due to such vacancy/ies the number of directors is reduced below the quorum fixed by the Companies Act, 2013.

If this is the situation, the continuing directors or director may act for the following purposes only and nothing else:

- (a) to increase the number of directors to that fixed for the quorum *i.e.* appoint additional director; or
- (b) to summon a general meeting of the company.
- (iv) **Quorum in case of interested directors [Section 174 (3)]:** Where at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of Directors, the quorum shall be the number of non-interested directors who are present at the meeting; but their number must not be less than two. While calculating the quorum, any fraction of a number shall be rounded off as one.

Meaning of Interested Director: The term “Interested director” for the purposes of Section 174 (3) means a director within the meaning of Section 184 (2).

According to Section 184(2) “**interested director**” means every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—

- (a) with a body corporate in which such director or such director in association with any other director, holds **more than two per cent** shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or

⁵ As per Explanation to Rule 3 (5) (a) of the Companies (Meetings of Board and its Powers) Rules, 2014.

- (b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be.

Exception

*In case of a **private company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, the provisions of Section 174(3) shall apply with the exception that the interested director may participate in such meeting after disclosure of his interest pursuant to Section 184. [Notification No. G.S.R. 464(E) dated 5th June 2015 as amended by Notification No. G.S.R. 583 (E) dated 13th June, 2017]*

- (v) **Adjournment of meeting which could not be held for want of quorum:** As we have noticed that a Board meeting cannot be validly held if there is no quorum present. Thus, where a meeting of the Board could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned to the same day at the same time and place in the next week or if that day is a national holiday, till the next succeeding day, which is not a national holiday, at the same time and place.
- (vi) **Exemption to OPC:** According to Proviso to Section 173 (5), the provisions of Section 174 relating to quorum are not applicable to such One Person Company (OPC) which has only one director on its Board.

Example 4: There are 9 directors in a company and out of which 2 offices of the directors have fallen vacant. According to section 174(1) of the Companies Act, 2013, quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded off as one) or two directors whichever is higher. The total strength is to be derived after deducting the number of directors whose offices are vacant. Therefore, where total number of directors is 9 and 2 offices of the directors have fallen vacant; the total strength comes to seven. In this case $1/3$ of $7 = 2\frac{1}{3}$ directors which will be rounded off as 3 which is higher than 2. Therefore, 3 directors would constitute the quorum for the Board meetings here.

Now, if suppose, there are total 15 directors in a company and during discussion on a particular item, 13 of the directors happen to be 'interested' within the meaning of section 184(2) of the Companies Act, 2013. Under section 174(3) of the Companies Act, 2013, if at any time the number of the interested directors exceeds or is equal to two thirds of the total strength of the Board of Directors, the number of the directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum.

In the given situation, there are total 15 directors and the Board meeting commences with all of them. During the meeting, an item comes up for discussion in respect of which 13 directors happen to be 'interested directors'. In spite of the fact that the interested directors are more than two-thirds, minimum two non-interested directors who are present at the meeting shall constitute the quorum and they can validly transact that particular item of business in view of Section 174 (3).

Example 5: A meeting of the Board of 'No Holiday Ltd' was held on a holiday on account of Ganesh Chaturthi. However due to lack of quorum, the proceedings of the meeting could not be held and therefore the Chairman of the meeting with the consent of the majority decided that the Board meeting be adjourned to next week on the same day. However, the date fixed for the adjourned meeting happened to be a Sunday. In such case, where a board meeting is adjourned due to lack of quorum, then under section 174(4) the adjourned meeting can be held on the same day at the same time and place in the next week or if that day is a national holiday, till the next succeeding day, which is not a national holiday, at the same time and place, unless the Articles provide otherwise.

Since Section 174(4) specifies exclusion of only a national holiday, any original/adjourned/committee meetings can be held on Sundays and other holidays. In view of this provision, the adjourned meeting of the Board of 'No Holiday Ltd' can be held on Sunday without involvement of any illegality.

High Court of Andhra Pradesh, in *Smt. Dr. Renuka Datla v. Biological E Ltd.* in an appeal held that where with resignation of one director, number of Directors fell below minimum number of two as prescribed under section 174, subsequent Board meeting convened and conducted by said director by his withdrawal of resignation was patently illegal and consequently, further appointments of directors in such meetings were also illegal and non-est.

In the said case, three persons, constituted Board of Directors of company. One of directors died. Another director R5 submitted resignation from directorship and, thus, only one director was left on Board. However, R5 withdrew his resignation and on same date called upon a Board meeting. Whether with resignation of R5 as a Director, company failed to satisfy mandatory provisions of section 174 of having atleast two directors and with resignation of R5 coming into force with immediate effect as desired by him, he had no authority to convene any board meetings. It was held, that meetings of Board of Directors could not be said to be validly held and, thus, appointment of new directors in said meeting was also invalid.



4. PASSING OF RESOLUTION BY CIRCULATION [SECTION 175]

Section 175 of the Act and Rule 5 of the Companies (Meetings of Board and its Powers) Rules, 2014, contain provisions for passing of resolutions by circulation. Normally, a board meeting is conducted to pass resolutions. There are certain matters, which according to the provisions of the Companies Act, 2013, can only be considered and decided at the duly convened board meetings and therefore, they cannot be implemented through passing resolutions by circulation. However, in cases where the matter is not that much important and therefore, does not require its consideration at a board meeting though consent of directors is required to implement that matter or the calling of board meeting is a lengthy and costly affair keeping in view the urgent implementation of certain decisions, the company may, in respect of such matters, resort to passing of resolutions by

circulation. As a matter of fact, all such matters which do not require consideration at a board meeting can be decided through resolutions which are passed by circulation.

The provisions of Section 175 and Rule 5 are discussed as under:

- (i) **Requirements to pass resolution by circulation [Section 175 (1)]:** A resolution shall be deemed to have been duly passed by the Board or by a committee thereof by circulation in case:

the resolution has been circulated in draft, together with the necessary papers, if any, to all the directors, or members of the committee, as the case may be,

at their addresses registered with the company in India,

by hand delivery or by post or by courier, or through such electronic means as may be prescribed, and

and has been approved by a majority of the directors or members, who are entitled to vote on the resolution.

Rule 5 provides that a resolution in draft form may be circulated to the directors together with the necessary papers for seeking their approval, by electronic means which may include e-mail or fax.

- (ii) **When a resolution cannot be passed by circulation [Proviso to Section 175 (1)]:** If at least 1/3rd of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the chairperson shall put the resolution to be decided at a meeting of the Board (instead of being decided by circulation).
- (iii) **Noting of passed resolution in next meeting [Section 175 (2)]:** A resolution that has been passed by circulation shall have to be necessarily noted in the next meeting of board or the committee thereof, as the case may be, and made part of the minutes of such meeting.

Example 6: In respect of certain matter which did not require to be decided at a board meeting, PQR Ltd. thought it prudent to pass resolution thereof by circulation. Accordingly, a draft resolution was circulated among all the six directors by e-mail. Three directors did not give their consent and desired that the resolution was required to be decided at a meeting.

In the light of the Proviso to Section 175 (1) where minimum 1/3rd of the total number of directors require that any resolution under circulation must be decided at a meeting, the Chairperson shall put the resolution to be decided at a meeting of the Board. In the given case, one-half of the total number of directors (*i.e.* three out of six) requires that the resolution must be decided at a Board meeting. Since their counting is more than one-third of total strength, the Chairperson needs to take the call and put the resolution to be decided at a duly convened meeting of the Board.



5. AUDIT COMMITTEE, VIGIL MECHANISM AND PUNISHMENT [SECTION 177 AND SECTION 178 (8)]

A. AUDIT COMMITTEE

Section 177 of the Act and Rules 6 and 6A of the Companies (Meetings of Board and its Powers) Rules, 2014, contain provisions in respect of Audit Committee. These provisions are described as under:

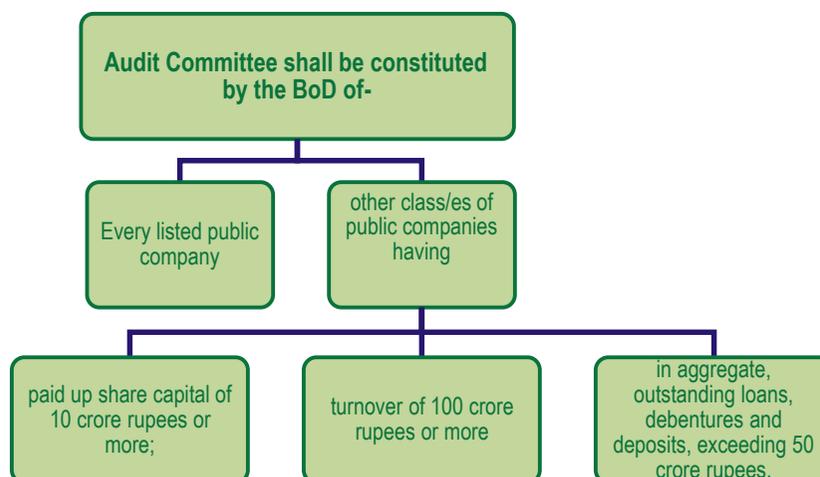
(i) Companies required to constitute an Audit Committee [Section 177 (1) and Rule 6]:

Following companies are required to constitute an Audit Committee:

- (a) every listed public company;
- (b) public companies having paid up share capital of 10 crore rupees or more;
- (c) public companies having turnover of 100 crore rupees or more;
- (d) public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

Note: The public companies stated at points (b),(c) and (d) are the classes of companies which are prescribed by Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014 and are required to constitute an Audit Committee.

In fact, Rule 6 requires that the companies prescribed in Rule 4 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 are the companies which shall constitute an Audit Committee.



Companies not required constituting an Audit Committee: Following unlisted companies are not covered by Rule 4 (1) of the Companies (Appointment and Qualifications of Directors) Rules, 2014; and therefore, are not required to constitute an Audit Committee:

- (a) a joint venture;
- (b) a wholly owned subsidiary; and
- (c) a dormant company as defined under Section 455 of the Act.

When a company ceases to constitute an Audit Committee: A company which was obligated to constitute an Audit Committee, shall not be required to constitute such Audit Committee if it ceases to fulfill any of the three conditions relating to paid-up share capital or turnover or outstanding loans, etc. [as laid down in Third Proviso to Rule 4 (1)⁶] for **three consecutive years**. It shall again be required to constitute an Audit Committee if it starts meeting any of such conditions.

Clarification: *Explanation* to Rule 4 (1)⁷ clarifies that the paid-up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

- (ii) **Composition of an Audit committee:** According to Section 177 (2), the Audit Committee shall consist of a minimum of 3 directors with independent directors forming a majority.

Further, it is required that the majority of members of the Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.

*Vide Notification No. G.S.R. 466(E), dated 05-06-2015 as amended by Notification No. G.S.R. 584 (E), dated 13-06-2017, in case of **Section 8 Companies**, the requirement of Section 177 (2) i.e. while constituting an Audit Committee, the 'Independent Directors' shall form a majority, shall not apply provided such a company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.*

- (iii) **Disclosure of composition of Audit Committee [Section 177(8)]:** The Board's report under Section 134 (3) shall disclose the composition of an Audit Committee.

In case, where the Board had not accepted any recommendation of the Audit Committee, the same shall also be disclosed in the Board's report along with the reasons therefor.

- (iv) **Responsibilities of the Audit Committee:** According to Section 177 (4), every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, *inter alia*, include,-

- (a) recommendation for appointment, remuneration and terms of appointment of auditors of the company;

⁶Rule 4 (1) of the Companies (Appointment and Qualifications of Directors) Rules, 2014

⁷Rule 4 (1) of the Companies (Appointment and Qualifications of Directors) Rules, 2014

*In case of a **Government company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, for the words “recommendation for appointment, remuneration and terms of appointment” used in Section 177 (4) (i), the words “**recommendation for remuneration**” shall be substituted- Notification No. G.S.R. 463(E), dated 05.06.2015 as amended by Notification No. G.S.R. 582 (E), dated 13.06.2017.*

- (b) review and monitor the auditor’s independence and performance, and effectiveness of audit process;
- (c) examination of the financial statement and the auditors’ report thereon;
- (d) approval or any subsequent modification of transactions of the company with related parties. The provisos to this clause are stated below:

Omnibus approval: It is provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as prescribed under Rule 6A (refer the Box below);

Conditions prescribed under Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014 for Omnibus Approval for Related Party Transactions on Annual Basis

According to Rule 6A, all related party transactions shall require approval of the Audit Committee. The Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to the following conditions:

- (1) The Audit Committee shall, after obtaining approval of the Board of Directors, specify the **criteria for making the omnibus approval** which shall include the following:
 - (a) **maximum value of the transactions**, in aggregate, which can be allowed under the omnibus route in a year;
 - (b) **the maximum value per transaction** which can be allowed;
 - (c) extent and manner of **disclosures** to be made to the Audit Committee at the time of seeking omnibus approval;
 - (d) **review**, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made;
 - (e) **transactions which cannot** be subject to the omnibus approval by the Audit Committee.
- (2) The Audit Committee shall **consider the following factors** while specifying the criteria for making omnibus approval: -

- (a) repetitiveness of the transactions (in past or in future);
 - (b) justification for the need of omnibus approval.
- (3) The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.
- (4) The omnibus approval shall contain or indicate the following: -
- (a) name of the related parties;
 - (b) nature and duration of the transaction;
 - (c) maximum amount of transaction that can be entered into;
 - (d) the indicative base price or current contracted price and the formula for variation in the price, if any; and
 - (e) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:
- However, where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval **for such** transactions subject to their value not exceeding rupees one crore per transaction.
- (5) Omnibus approval shall be valid for a period not exceeding **one financial year** and shall require fresh approval after the expiry of such financial year.
- (6) Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.
- (7) Any other conditions as the Audit Committee may deem fit.

If no approval accorded: It is further provided that in case of a transaction (which is not a transactions referred to in section 188), where Audit Committee does not approve such transaction, it shall make its recommendations to the Board.

Voidable transaction: In case of a transaction which does not involve an amount exceeding one crore rupees and which is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and if it is not ratified by the Audit Committee **within three months** from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee. In case such transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.

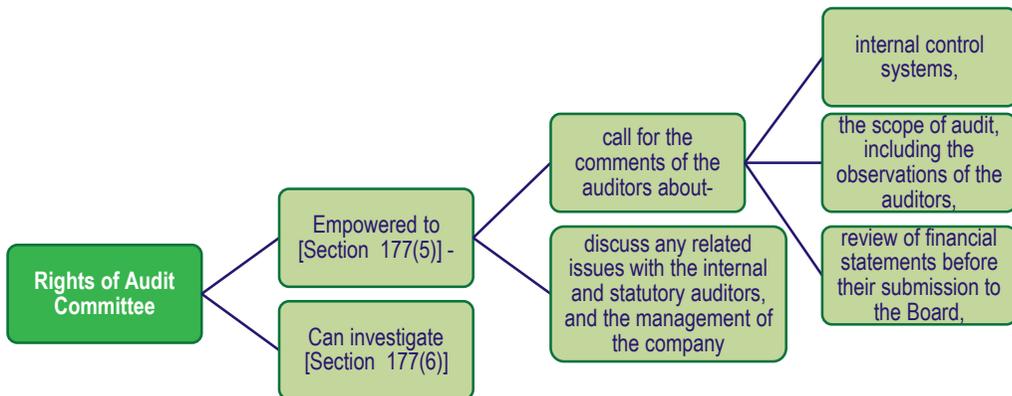
Non-applicability to a transaction between a holding and its wholly owned subsidiary company: It is also provided that the provisions of this clause shall not

apply to a transaction, other than a transaction referred to in Section 188, between a holding company and its wholly owned subsidiary company.

- (e) scrutiny of inter-corporate loans and investments;
- (f) valuation of undertakings or assets of the company, wherever it is necessary;
- (g) evaluation of internal financial controls and risk management systems;
- (h) monitoring the end use of funds raised through public offers and related matters.

(v) Rights of the Audit Committee:

- (a) The Audit Committee may **call for the comments of the auditors** about internal control systems, the scope of audit, including the observations of the auditors. It shall have right to review the financial statements before their submission to the Board. It may also discuss any related issues with the internal and statutory auditors and the management of the company. [Section 177(5)]
- (b) The Audit Committee shall have **authority to investigate** into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company. [Section 177(6)]



- (vi) Right to be heard before the Audit Committee:** The **auditors** of a company and the **key managerial personnel** shall have a right to be heard in the meetings of the Audit Committee when it considers the **auditor's report** but shall not have the right to vote. [Section 177(7)]

B. VIGIL MECHANISM

A 'vigil mechanism' is formed for the directors and employees who may report genuine concerns. Not all the companies but only the prescribes ones are required to establish 'vigil mechanism'. The

provisions contained in Section 177 (9) and (10) and Rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014 govern the concept of 'vigil mechanism'. These are stated below:

(i) **Formation of Vigil Mechanism (VM):**

According to Section 177(9),
VM shall be formed by -

- every listed company
- prescribed class of companies as per Rule 7
- the Companies which accept deposits from the public;
- the Companies which have borrowed money from banks and public financial institutions in excess of 50 crore rupees.

(ii) **Purpose of Vigil Mechanism [Section 177 (9)]:** A vigil mechanism is formed for the directors and employees who may report genuine concerns in the manner prescribed in Rule 7.

(iii) **Vigil Mechanism to ensure adequate safeguards:** According to Section 177 (10), the vigil mechanism shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the Chairperson of the Audit Committee in appropriate or exceptional cases.

(iv) **Establishment of Vigil Mechanism and Manner of Reporting:** The provisions of Rule 7 in this respect are stated as under:

- (1) **Users of Vigil Mechanism:** The directors and employees of the company can use the system of vigil mechanism for reporting their genuine concerns.
- (2) **Companies having Audit Committee:** The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the audit committee and if any of the members of the committee have a conflict of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand.
- (3) **Companies having no Audit Committee:** In case of other companies, the Board of Directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism. Other directors and employees may report their concerns to such nominated director.
- (4) **Adequate safeguards against victimisation:** As stated in Section 177 (10), the vigil mechanism shall provide for adequate safeguards against victimisation of employees and directors who avail of it.
- (5) **Direct access in exceptional cases:** As stated in Section 177 (10), the employees and directors who avail of vigil mechanism may have direct access to the Chairperson of the Audit Committee or the director nominated to play the role of Audit Committee, as the case may be, in exceptional cases.

- (6) **Action against repeated frivolous complaints:** In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.
- (v) **Disclosure of details of vigil mechanism [Section 177 (10)]:** It is imperative for the company to disclose the details of the establishment of vigil mechanism on the website of the company and in Board's report.

C. PUNISHMENT FOR CONTRAVENTION OF SECTION 177 [Section 178(8)]: In case of contravention of Section 177, the company shall be liable to a penalty of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of one lakh rupees.

Note: In the case of a listed company, the formation, composition, responsibilities and rights of Audit Committee shall be governed by SEBI (LODR) Regulations issued under the SEBI Act, 1992.



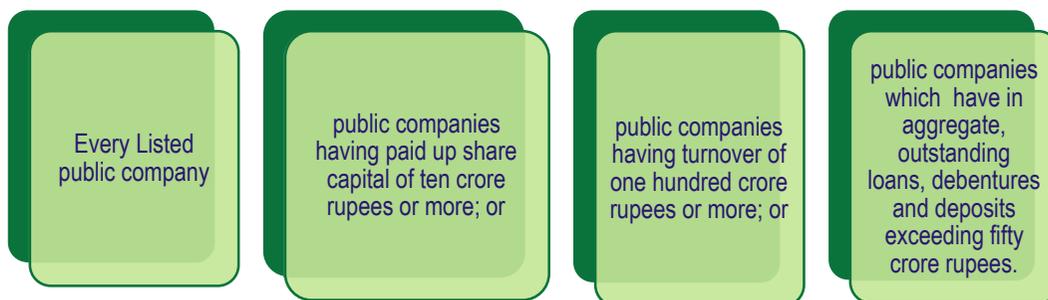
6. NOMINATION AND REMUNERATION COMMITTEE AND STAKEHOLDERS RELATIONSHIP COMMITTEE AND PUNISHMENT [SECTION 178]

Section 178 of the Act, contains provisions in respect of Nomination and Remuneration Committee as well as Stakeholders Relationship Committee.

A. NOMINATION AND REMUNERATION COMMITTEE (NRC)

Sub-sections (1) to (4) of Section 178 and Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014 lay down the provisions in respect of the Nomination and Remuneration Committee as under:

- (i) **Formation of Nomination and Remuneration Committee :** Section 178 (1) read with Rule 6 state that the Board of directors of every listed public company and a company covered under Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, shall constitute a Nomination and Remuneration Committee. Following diagram depicts the prescribed companies which are required to constitute the Nomination and Remuneration Committee:



Companies not required to constitute a Nomination and Remuneration Committee:

Following unlisted companies are not covered by Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014; and therefore, are not required to constitute a Nomination and Remuneration Committee:

- (a) a joint venture;
- (b) a wholly owned subsidiary; and
- (c) a dormant company as defined under Section 455 of the Act.

When a company ceases to constitute a Nomination and Remuneration Committee: A company which was obligated to constitute a Nomination and Remuneration Committee, shall not be required to constitute such Committee if it ceases to fulfill any of the three conditions relating to paid-up share capital or turnover or outstanding loans, etc. [as laid down in Third Proviso to Rule 4 (1)⁸] for **three consecutive years**. It shall again be required to constitute a Nomination and Remuneration Committee if it starts meeting any of such conditions.

Clarification: Explanation to Rule 4 (1)⁹ clarifies that the paid-up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

(ii) Composition of Nomination and Remuneration Committee:

- (a) The NRC shall consist of **3 or more non-executive directors** out of which not less than one-half shall be independent directors.
- (b) The Chairperson (whether executive or non-executive) of the company shall not chair such a committee. However, he may be appointed as a member of the committee.

(iii) Functions of the Nomination and Remuneration Committee: The various functions of NRC shall be as under:

- (a) **Formulation of criteria for qualifications, etc.:** The NRC shall formulate the criteria for determining qualifications, positive attributes and independence of a director [Sub section (3)].
- (b) **Recommendation of Policy regarding remuneration:** The NRC shall recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees [Sub section (3)].
- (c) **Recommendation for appointment and removal:** The NRC shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal. [Sub-section (2)]

⁸Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014

⁹Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014

Note: The expression “**senior management**” means personnel of the company who are members of its core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads.

- (d) **Manner for effective evaluation of performance:** The NRC shall specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance.
- (e) **Parameters for formulation of Policy:** According to Section 178(4), the Nomination and Remuneration Committee shall, while formulating the policy under Section 178 (3) ensure that—
- the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;
 - relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and
 - remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.
- (f) **Disclosure regarding policy:** It is imperative that such policy [i.e. policy formulated under Section 178 (3)] shall be placed on the **website** of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the **Board's report**.
- (iv) **Attending of general meetings [Section 178 (7)]:** The Chairperson or in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.

Note: In the case of a listed company, formation, composition, responsibilities and rights of Nomination and Remuneration Committee shall be governed by SEBI (LODR) Regulations issued under SEBI Act, 1992. According to the listing agreement, the members of the NRC shall be non-executive directors and the Chairperson needs to be an independent director.

Modification

*In case of a **Government company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, Sub-sections (2), (3) and (4) of Section 178, shall not apply except with regard to appointment of 'senior*

management' and other employees. - Notification No. G.S.R. 463 (E), dated 05-06-2015 as amended by Notification No. G.S.R. 582 (E), dated 13-06-2017.

B. STAKEHOLDERS RELATIONSHIP COMMITTEE (SRC)

Formation and functioning of SRC: Section 178 (5) and (6) lay down the provisions relating to the formation, constitution and functioning of the Stakeholders Relationship Committee as under:

Sl. No.	Section	With respect to	Provisions says
(i)	178 (5)	Formation and constitution of Stakeholders Relationship Committee (SRC)	The Board of Directors of a company which consists of more than 1000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee.
(ii)	178 (5)	Chairperson of Stakeholders Relationship Committee (SRC)	SRC shall be headed by a Chairperson who shall be a non-executive director. Further, SRC shall consist of such other members as may be decided by the Board.
(iii)	178 (6)	Objective of the Stakeholders Relationship Committee (SRC)	SRC shall consider and resolve the grievances of security holders of the company. It shall protect the interests of all security holders and not merely of the equity investors.

Chairperson of committees to attend the general meetings : As per section 178(7), the **chairperson** of each of the committees constituted under this section or, in his absence, **any other member** of the committee authorised by him in this behalf shall attend the general meetings of the company.

C. PENALTY FOR CONTRAVENTION [Section 178(8)]: In case of contravention of provisions of Section 178, the company shall be liable to a penalty of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of one lakh rupees.

No contravention if SRC is unable to resolve in good faith: It is to be noted that inability to resolve or consider any grievance by the Stakeholders Relationship Committee **in good faith** shall not constitute a contravention of Section 178; and therefore, **no penalty** shall be attracted. [refer Proviso to Section 178 (8)].

Note: In the case of a listed company, formation, composition, responsibilities and rights of Stakeholder Relationship Committee shall be governed by SEBI (LODR) Regulations, 2015 issued under SEBI Act, 1992.

Exemption

*Section 178 of the Act shall not apply to a **Section 8 company** provided it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar - Notification No. G.S.R. 466 (E), dated 05-06-2015 as amended by Notification No. G.S.R. 584 (E), dated 13-06-2017.*



7. POWERS OF THE BOARD [SECTION 179]

Section 179 of the Act and Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014 lay down the provisions in respect of powers of the Board. They are described as under:

- (i) **BoD is entitled to exercise the same powers as the company is authorised:** According to Section 179 (1), the Board shall be entitled to exercise all such powers as the company is authorised to exercise; and to do all such acts and things which the company is authorised to do.

In fact, the Board of Directors of a company enjoy wide-ranging powers; virtually all the powers for managing the affairs of the company except where the given matters require approval of shareholders in general meetings. In other words, the Board is empowered to exercise all such powers which shall secure the interests of the company and the shareholders.

- (ii) **Placing of restrictions on exercising of powers by the Board [Provisos to Section 179 (1)]:**
- (a) The exercise of powers by the Board of Directors is not unbridled or unrestricted. It is provided that while exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in the Companies Act, 2013, or in the memorandum or articles, or in any regulations which are not inconsistent with the Act or memorandum or articles and are duly made thereunder. This will include regulations made by the company in general meeting.
- (b) Further, the Board shall not exercise any power or do any act or thing which is directed or required, whether under the Companies Act, 2013 or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting.
- (iii) **Prospective effect of regulation made in general meeting [Section 179 (2)]:** Any regulation made by the company in general meeting shall not invalidate any prior act of the Board which would have been valid if that regulation had not been made.

Thus, a regulation made by a company in general meeting cannot have retrospective effect and therefore, cannot invalidate prior acts of the Board if they were otherwise validly executed earlier.

(iv) **Powers of Board to be exercised by means of resolutions [Section 179 (3)]:** Following powers are required to be exercised by the Board of Directors by means of the resolutions passed at a duly convened Board meeting:

- (a) to **make calls on shareholders** in respect of money unpaid on their shares;
- (b) to **authorise buy-back of securities** under Section 68;
- (c) to **issue securities**, including debentures, whether in India or outside India;
- (d) to **borrow monies**;

Note: By way of Explanation II, it is clarified that in respect of dealings between a company and its bankers, the exercise of the power by the company specified in clause (d) above shall mean the arrangement made by the company with its bankers for the **borrowing of money** by way of overdraft or cash credit or otherwise. This does not refer to the actual day-to-day operation on overdraft, cash credit or other accounts by means of which the arrangement so made is actually availed of.

- (e) to **invest the funds** of the company. *[Section 186 (5) requires this power to be exercised by a Board resolution which is passed with the consent of all the directors present at the Board meeting];*
- (f) to **grant loans or give guarantee or provide security** in respect of loans. *[Section 186 (5) requires this power to be exercised by a Board resolution which is passed with the consent of all the directors present at the Board meeting];*

Exemption

*In respect of a **Section 8 Company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under section 92 with the Registrar, the matters referred to in clauses (d), (e), and (f) of Sub-section (3) of Section 179 may be decided by the Board by **circulation** instead of at a meeting.*

[Notification No. GSR 466 (E), dated 05-06-2015 as amended by Notification No. GSR 584 (E), dated 13-06-2017]

- (g) to **approve financial statement and the Board's report**;
- (h) to **diversify the business** of the company;
- (i) to **approve amalgamation, merger or reconstruction**;
- (j) to **take over** a company or **acquire a controlling or substantial stake** in another company;

(k) **other matters** as prescribed in Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014. These matters, also to be exercised only by means of resolutions passed at the meetings of the Board, are:

- (1) to make **political contributions**;
- (2) to **appoint or remove key managerial personnel (KMP)**;
- (3) to **appoint internal auditors and secretarial auditor**.

Note: It is to be noted that the above list is not exhaustive. There are certain other powers which are also to be exercised by the Board of Directors at a duly convened board meeting. Some of them are as under:

- Making of **contributions to political parties** under Section 182
 - **Filling of casual vacancy** under Section 161 (4) when the office of a director appointed in the general meeting falls vacant before the expiry of his term in the normal course.
 - **Approving of transactions with related parties** as provided under Section 188.
 - **Giving of loans or making of investment** in the shares of other body corporates as provided under Section 186. In this case, besides passing the resolution at a board meeting, consent of all the directors present at the meeting is also required.
 - **Appointing a person as a managing director** who is also holding office of managing director or manager in another company as provided under Section 203. This power is to be exercised with the consent of all the directors present at the meeting.
- (v) **Permission to BoD to delegate some of its powers [First Proviso to Section 179 (3)]:** The Board may, by a resolution passed at a meeting, delegate the powers specified in clauses (d) to (f) above (*i.e.* borrowing of monies, investing of funds and granting of loans or giving of guarantee or providing of security in respect of loans). The delegation may be made on such **conditions** as may be specified and to the following:
1. any committee of directors,
 2. the managing director,
 3. the manager or any other principal officer of the company, or
 4. the principal officer of the branch office (if the company has a branch office).
- (vi) **Imposing of restrictions and conditions by the shareholders [Section 179 (4)]:** The company through the general meeting has powers to impose restrictions and conditions on the exercise by the Board of any of the powers specified in Section 179.

In other words, shareholders of a company are very much in their right to impose restrictions and conditions on the powers of the Board of Directors. The shareholders may exercise the

powers of imposing restrictions by passing resolutions at the general meetings and may also make regulations (having only retrospective effect) curtailing the extent of powers exercisable by the Board.

As we know, the Board of Directors are fully empowered to manage day-to-day affairs of the company. The shareholders cannot impose their will on the Board; they cannot interfere and instruct the Board to discharge certain powers in a particular manner unless there are reasons to do so. In the following representative cases, however, the shareholders are empowered to exercise the powers of the Board:

- (a) **when directors are acting *malafide*** *i.e.* their conduct is such that they are acting for their own benefits at the expense of the interests of the company. Thus, when directors are wrong-doers and their personal interest conflicts with their duty towards the company, the majority shareholders shall take decisions to undo the wrong done by the directors.
 - (b) **when all the directors are interested in a particular transaction** and therefore, incompetent to act due to absence of quorum. In such a case, shareholders shall decide through majority in the general meeting whether to entertain that transaction or not.
 - (c) **when there happens to be deadlock in the management** because the directors are not on talking terms or unwilling to act; thus, paving way for the shareholders to ensure running of the company
- (vii) **Exemption to banking companies [Second Proviso to Section 179 (3)]:** In respect of banking companies following exemptions are provided:
- (a) **the acceptance of deposits of money by a banking company in the ordinary course of its business from the public** which is repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise shall not be deemed to be a borrowing of monies within the meaning of Section 179;
 - (b) further, **the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe** shall not be deemed to be a making of loans by a banking company within the meaning of Section 179.

Note: By way of Explanation I, it is clarified that clause (d) above (*i.e.* to borrow monies) shall not apply to borrowings by a banking company from other banking companies or from the Reserve Bank of India, the State Bank of India or any other banks established by or under any Act. Thus, in such cases of borrowings by a banking company, there is no need to obtain sanction by means of a resolution passed at a duly convened Board meeting. This is practical also to provide such exemption, keeping in view the business of a banking company.



8. RESTRICTIONS ON POWERS OF BOARD [SECTION 180]

The powers of the Board of Directors of a company are not unrestricted or uncontrollable as Section 180 portrays. This Section contains directive provisions which direct that the powers in respect of specified matters shall be exercised by the Board subject to the certain restrictions *i.e.* in such cases the exercise of powers by the Board shall be restricted as per law. Section 180 is not applicable to a private company.

(i) **Matters in respect of which powers shall be exercised after obtaining consent by a special resolution:** According to Section 180 (1), following are the matters in respect of which the Board shall exercise the powers with the consent of the company by a **special resolution** and not on its own simply by passing a Board resolution at a Board meeting:

(a) To **sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company** or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings. In other words, out of multiple undertakings of a company even if one is sold, leased or disposed of, either wholly or substantially, the consent by special resolution shall be required.

Imposition of conditions by the shareholders: According to Section 180 (4), any special resolution passed by the company consenting to the transaction of sell, lease, etc., may stipulate certain conditions and if so, the same need to be specified in such resolution. Among others, the conditions shall be regarding the use, disposal or investment of the sale proceeds which may result from the transactions.

Section 180 (4) not to be taken as authorization for reduction in capital: It is provided that sub section (4) shall not be deemed to authorise the company to effect any reduction in its capital. Such reduction must be effected in accordance with the provisions contained in the Companies Act, 2013.

No need for special resolution if selling, leasing, etc. is part of ordinary business of the company: According to Section 180 (3) (b), the restriction in the form of special resolution is not attracted to the sale or lease of any property of the company where its ordinary business consists of such selling or leasing.

Clean title of the buyer, etc. [Section 180 (3) (a)]: In respect of a buyer who buys or in respect of other person who takes on lease (*i.e.* lessee) any property, investment or undertaking as is referred to in Section 180 (1) (a) in **good faith**, his title shall not be affected despite the fact that the directors resorted to selling or leasing without first obtaining the consent of the company by a special resolution.

Note 1: The expression “**undertaking**” means an undertaking in which the investment of the company **exceeds twenty per cent** of its **net worth**¹⁰ as per the audited balance sheet of the preceding financial year or an undertaking which generates **twenty per cent** of the total income of the company during the previous financial year.

Note 2: The expression “**substantially the whole of the undertaking**” in any financial year shall mean **twenty per cent or more** of the value of the undertaking as per the audited balance sheet of the preceding financial year.

Note 3: In case the provisions of Section 110 of the Act apply to the company which is resorting to sale of the whole or substantially the whole of its undertaking in terms of Section 180 (1) (c), it shall pass the special resolution containing such item of business by means of voting through postal ballot. [Refer Rule 16 (i) of the Companies (Management and Administration) Rules, 2014.]

Note 4: A One Person Company and other companies having members up to two hundred are not required to transact any business through postal ballot.[refer Proviso to Rule 16 of the Companies (Management and Administration) Rules, 2014.]

- (b) To **invest otherwise in trust securities** the amount of compensation received by it as a result of any merger or amalgamation. It implies that if the investment of the compensation amount is made in trust securities¹¹, there is no need to obtain consent of the members through a special resolution.
- (c) To **borrow money**, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves¹² and securities premium apart from temporary loans obtained from the company’s bankers in the ordinary course of business.

¹⁰ ‘Net worth’, according to Section 2 (57) of the Act means ‘the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation’.

¹¹ ‘Trust securities’ are mentioned in Section 20 of the Indian Trust Act, 1882.

¹² ‘Free reserves’ according to Section 2 (43) of the Act means ‘such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that—

- (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves’.

In simple words, '**borrowings**' (including loans raised for meeting financial expenditure of a capital nature) are not to include temporary loans which are obtained by the company from its bankers in the ordinary course of business.

Limit on 'borrowings' need to be specified: Section 180 (2) requires that every special resolution passed by the company in general meeting in relation to the 'borrowings' shall specify the **total amount** up to which monies may be borrowed by the Board of Directors. Thus, the Board cannot be given blanket powers to borrow monies up to any extent of its choice, but the special resolution must specify the total amount that can be borrowed. In other words, a rational thinking in the form of specifying a 'particular amount' must be exercised by the shareholders so that borrowings are restricted. The specifying of total amount that can be borrowed is a step in this direction. Excessive borrowings at the whims and caprices of the Board are dangerous to the company as a whole including its shareholders.

Debt raised in excess of the specified limit [Section 180 (5)]: If a company incurs debt in excess of the limit imposed i.e. more than the 'total amount' specified in the special resolution, it shall not be valid or effectual from the point of view of lender unless such lender proves that he advanced the loan in good faith and without knowledge that the limit imposed had been exceeded. Thus, lender has to be fully cautious before extending any loan to a company. The loaned amount must not be in excess of the limit imposed otherwise it shall not be legally enforceable against the company. In other words, the lender must be aware in no uncertain terms the implications of Section 180 (5) and must carefully check the financial statements as well as the special resolution, if any, passed by the company before extending any loan facility to it.

Meaning of "Temporary Loans": It is clarified by way of *Explanation* that the term '**temporary loans**' means loans repayable on **demand or within six months** from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature.

Exemption to a banking company: The acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise, shall **not** be deemed to be a **borrowing of monies** by the banking company.

- (d) To **remit, or give time for the repayment of, any debt due from a director**. Thus, if any debt is repayable by a director, then it cannot be remitted or its repayment time cannot be extended unless consent by passing a special resolution is given by the company.

- (ii) **Contribution to *bona-fide* and charitable funds, etc.:** This type of contributions by a company beyond certain limit requires passing of an ordinary resolution as required by Section 181, the provisions of which are discussed later in the Chapter.

Example 7: The Board of Directors of Stepping Stones Publications Ltd. resolved to borrow a sum of ₹ 15 crore from a nationalized bank at a Board meeting held on 15.1.2019. One of the directors, who opposed the said borrowing as not in the interest of the company has raised an issue that the said borrowing is outside the borrowing powers of the Board. The following data is given for your information:

- (i) Share Capital ₹ 5 crore
- (ii) Reserves and Surplus ₹ 5 crore
- (iii) Secured Loans ₹ 15 crore
- (iv) Unsecured Loans ₹ 5 crore

According to the provisions of Section 180(1)(c) of the Companies Act, 2013, , the borrowings should not exceed the aggregate of the paid-up share capital, free reserves and securities premium. While calculating the limit, the temporary loans obtained by the company from its bankers in the ordinary course of business will be excluded. However, from the figures available in the present case, the proposed borrowing of ₹ 15 crore will exceed the limit calculated as per the given information. Thus, the proposed borrowings are beyond the powers of the Board of directors.

In view of the above position, the management of Stepping Stone Publications Ltd., should take steps to pass a special resolution authorising to borrow the proposed amount of ₹ 15.00 crore, so that the requirement of Section 180(1)(c) is satisfied. Only thereafter, the proposed borrowing can be availed of.

Exemption

*As notified by the MCA, Section 180 of the Act (i.e. restrictions on the powers of the Board) shall not apply to a **private company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. [Notification No. 464(E), dated 5th June, 2015 as amended by Notification No. 583 (E), dated 13th June, 2017.]*

1. In an order passed by the National Company Law Appellate Tribunal, New Delhi, *Priyaranjani Fibres Ltd. v. D. Srinivasa Rao* , it was laid that where director of company entered into an agreement with outsider to sell shares of himself and others without prior approval of shareholders, said agreement would not be binding on shareholders.

In the given case, D1, director of company entered into an agreement with appellant, who was an outsider, to sell shares of himself and respondent shareholders to appellant and let management of company go in hands of appellant. However, there was nothing to show that there was any shareholders, meeting on decision to permit one of director i.e. D1 to part with management of

company to outsider. Further, company was a sick company and there could not be change of management without permission of BIFR. However, there was nothing to show that any such consent were sought and granted. further, said agreement was an agreement between D1 and appellant and there was nothing to show that respondent shareholders were party to such agreement or that company was party to such agreement. Thus it was held that, said agreement would not be binding on respondent shareholders and company.

2. National Company Law Tribunal, Chennai Bench laid down in *Smt. Sulochana v. Arunodhaya Enterprises Ltd.* that as per Section 180 of the Companies Act, 2013, Articles of association of a company authorised managing director to carry on management of affairs of company. Board of directors of company had not restrained managing director from performing any particular act or function in management of business of company. Therefore, it could be safely concluded that managing director was empowered to sell property, particularly when company itself was in business of real estate and for every genuine sale transaction managing director need not obtain permission of shareholders.



9. COMPANY TO CONTRIBUTE TO BONA FIDE AND CHARITABLE FUNDS, ETC. [SECTION 181]

Section 181 of the Act, applicable to both public and private companies, empowers the Board of Directors to contribute to *bona fide* charitable and other funds up to a particular limit which if exceeded needs to be permitted by company through passing an ordinary resolution.

Limit on contribution by the Board of Directors: The Board is empowered to contribute any amount in any financial year if the aggregate amount of such contribution does not exceed five per cent of the average net profits of the company for the three immediately preceding financial years.

Where the above limit is exceeded: In case the aggregate contribution amount in any financial year is beyond the limit specified for the Board, prior permission of the company in general meeting shall be required for such contribution.

The expression “other funds” is wide enough to enable contributions of the kind, specified in the special resolution to be made by the company. [*Straw Products Ltd. vs. Registrar of Companies [1969]*].

Example 8: The Board of Directors of Very Well Ltd., is contributing every year to a charitable organization a sum of ₹ 60, 000. In a particular year, the company suffered losses and the directors are contemplating to contribute the said amount in spite of the losses.

Under section 181 of the Companies Act, 2013, the Board of Directors of a company is authorized to contribute to *bonafide* charitable and other funds. However, in case the aggregate amount of such contribution in any financial year exceeds five per cent. of its average net profits for the three

immediately preceding financial years, prior permission of the company in general meeting shall be required.

The section does not make it mandatory for the company to have a profit for making a charitable contribution in any financial year. As the amount of donation is restricted to the average of immediately previous 3 years' profits, it is possible for a company suffering a loss to make contribution provided it is made to a *bonafide* charitable fund and the average of the three immediately preceding financial years' profits (including current losses) is positive.

In the present case, even though the company has incurred a loss it can contribute to the charitable fund only if it is a *bonafide* charitable fund and the amount is up to 5% of the average of the immediately preceding three years' profits (including current losses). In case the contribution exceeds the limit, the prior approval of the members must be taken at a general meeting of the company.



10. PROHIBITIONS AND RESTRICTIONS REGARDING POLITICAL CONTRIBUTIONS [SECTION 182]

Section 182 of the Act, deals with the provisions relating to prohibitions and restrictions regarding political contributions. These provisions are stated as under:

- (i) **Contribution by a company to political parties:** A company is permitted to contribute any amount (without any limit) directly or indirectly to any political party, notwithstanding anything contained in any other provision of the Companies Act, 2013. It is to be noted that Section 182 (1) has overriding effect.

*Meaning of Political Party*¹³: The term "political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

- (ii) **Companies not allowed contributing to political parties:** The following companies are not allowed to contribute to any political party:
- (a) a Government company; and
 - (b) a company which has been in existence for less than three financial years.
- (iii) **Procedure for making contribution:** A company shall make the contribution to a political party only after a resolution authorising the making of such contribution is passed at a meeting of the Board of Directors. In effect, such resolution shall be deemed to be justification in law for the making of the contribution authorised by it. [Proviso to Section 182(1)]

¹³ As per Explanation to Section 182.

- (iv) **Deemed political contributions [Section 182(2)]:** In addition to making any direct contribution to a political party, **following contributions** are also deemed as political contributions:
- (a) a **donation or subscription or payment** given by a company to a person who, to its knowledge, is carrying on any activity which, at the time at which such donation or subscription or payment was given, can reasonably be regarded as **likely to affect public support for a political party**;
 - (b) the **amount of expenditure** incurred, directly or indirectly, by a company **on an advertisement in any publication** being in the nature of a souvenir, brochure, tract, pamphlet or the like:
 - (1) where such publication is by or on behalf of a political party; and
 - (2) where such publication is not by or on behalf of, but for the advantage of a political party.
- (v) **Disclosure of contributed amount [Section 182(3)]:** Every company shall disclose in its profit and loss account the total amount contributed by it under Section 182 during the financial year to which the account relates.
- (vi) **Modes of contribution [Section 182 (3A)]:** The contribution to a political party under Section 182 shall be made according to following **modes**:
- by an account payee cheque drawn on a bank; or
 - by an account payee bank draft; or
 - by using electronic clearing system through a bank account; or
 - through any instrument, issued pursuant to any scheme¹⁴ notified under any law for the time being in force, for contribution to the political parties.[Section 182(3A)]
- (vii) **Punishment for contravention:** If a company makes any contribution in contravention of the provisions of Section 182, the punishment shall be as under:
- **Company:** punishable with fine up to **five times** the amount of contribution so made.
 - **Every defaulting officer:** punishable with imprisonment up to **six months** and with fine up to **five times** the amount of contribution so made.

¹⁴ A scheme relating to 'Electoral Trust Companies' has come into force in terms of Section 2 (22AA) of the Income-tax Act, 1961 read with Ministry of Finance Notification No. S.O. 309 (E), dated 31-01-2013.

*The MCA vide General Circular 19/ 2013 dated 10th December 2013, issued a clarification on disclosures to be made under Section 182 (3) while making **contributions to 'Electoral Trust'**. According to the Circular:*

With the coming into force of the scheme relating to 'Electoral Trust Companies' under Section 2 (22AA) the Income Tax Act, 1961 read with Ministry of Finance Notification No. S.O. 309(E) dated 31st January, 2013, it will be expedient to explain the requirements of disclosure on part of a company of any amount or amounts contributed by it to any political parties under Section 182(3) of the Companies Act, 2013.

The Ministry hereby clarifies that:

- (i) Companies contributing any amount or amounts to an 'Electoral Trust Company' for contributing to a political party or parties are not required to make disclosures required under Section 182(3) of Companies Act 2013. It will suffice if the Accounts of the company disclose the amount released to an Electoral Trust Company.*
- (ii) Companies contributing any amount or amounts directly to a political party or parties will be required to make the disclosures laid down in Section 182(3) of the Companies Act, 2013.*
- (iii) Electoral trust companies will be required to disclose all amounts received by them from other companies/sources in their Books of Accounts and also disclose the amount or amounts contributed by them to a political party or parties as required by Section 182(3) of Companies Act, 2013.*

Example 9: The Board of Directors of LM Ltd., incorporated in April, 2017, proposes to donate ₹ 50,000 to a political party for the F.Y. 2019-20. The average net profits determined in accordance with the provisions of the Companies Act, 2013 during the two immediately preceding financial years are ₹ 20,00,000. As per section 182(1) of the Companies Act, 2013 any company may contribute any amount directly or indirectly to any political party except a government company and a company which has been in existence for less than three financial years.

However in the given case, as LM Ltd. happens to be a company which has been in existence for less than three financial years. Hence, it is not permitted to donate any amount to the concerned political party for the F.Y. 2019-20.

Example 10: Sea Hawk Cycles Limited is a company incorporated four years ago. It has earned profits amounting to ₹ 5 lakhs, ₹ 8 lakhs and ₹ 11 lakhs respectively during the last three financial years. The Board of Directors of the company proposes to donate a sum of ₹ 50,000 to a political party. In view of the section 182(1), Sea Hawk Cycles Limited can contribute the said amount of ₹ 50,000 to the concerned political party. However, it needs to pass a board resolution authorising making of such contribution at a meeting of the Board of Directors.



11. POWER OF BOARD AND OTHER PERSONS TO MAKE CONTRIBUTIONS TO NATIONAL DEFENCE FUND, ETC. [SECTION 183]

Section 183 of the Act, empowers the Board and other authorised persons to make contributions to the National Defence Fund, etc. as described below:

- (i) **Contribution of amount to National Defence Fund/other fund as approved by the Central Government:**
 - (a) **No limit:** Contribution to the National Defence Fund or any other Fund approved by the Central Government for the purpose of national defence can be made without any limit.
 - (b) **Exercise of power:** The power to make such contribution shall be exercised by:
 - The Board of Directors of the company; or
 - Any person or authority exercising the powers of the Board of Directors or of the company in general meeting.
 - (c) **Overriding effect:** Section 183 has overriding effect *i.e.* the contribution may be made notwithstanding anything contained in Sections 180, 181 and 182 or any other provision of the Companies Act, 2013 or in the memorandum, articles or any other instrument relating to the company.
- (ii) **Disclosure in profits and loss account:** Every company shall disclose in its profits and loss account the total amount or amounts contributed by it to the National Defence Fund or any other approved fund, during the financial year to which the amount relates.



12. DISCLOSURE OF INTEREST BY DIRECTOR [SECTION 184]

The office of director in a company is that of 'trust'. A person holds the directorship in a fiduciary capacity. As trustee of the assets of the company, the director is duty bound to pass on the benefits accruing from all such transactions which belong to the company. At any stage if he becomes interested in a transaction the benefits of which rightfully accrue to the company, he must disclose his interest so that the Board and if required, the company, may take a rational decision whether to continue with that transaction or not. The disclosure of interest to be made by a director includes both 'general disclosure of interest' and 'specific disclosure of interest'. Section 184 of the Act, which contains provisions in respect of 'disclosure of interest' by the directors, is applicable to all the companies and their directors. These provisions are discussed as under:

- (i) **General disclosure of interest [Section 184(1)]:** Every director shall disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of

individuals which shall include the shareholding, in the manner prescribed in Rule 9 of the Companies (Meetings of Board and its Powers) Rules, 2014. The intention of law behind such disclosure is to make known the other directors of the company about the interest of concerned director in other companies, firms, etc.

When to make general disclosure of interest: Every director shall disclose his interest:

- (a) at the first meeting of the Board in which he participates as a director, and
- (b) thereafter, at the first meeting of the Board in every financial year, or
- (c) whenever there is any change in the disclosures already made, then at the first Board meeting held after such change.

Provisions of Rule 9: As regards **manner of disclosure** and certain other matters, the provisions of Rule 9 are given as under:

Every director shall disclose his concern / interest	• by written notice
in Form	• MBP-1.
Such Director shall	• cause it to be disclosed at the meeting held immediately after the date of the notice
All notices shall be kept	• at the registered office of the company.
Preserved	• for eight years from the end of the financial year to which they relate.
They shall be kept in the custody of the	• Company Secretary or any other person authorised by the Board

(ii) **Specific disclosure of interest:** According to Section 184 (2), a director of a company shall make a specific disclosure of interest whenever he, in any way, whether directly or indirectly, is concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into:

- (a) with a body corporate in which such director or such director in association with any other director holds **more than two per cent shareholding** of that body corporate; or
- (b) with a body corporate in which such director is a promoter, manager, Chief Executive Officer; or
- (c) with a firm or other entity in which, such director is a partner, owner or member.

When to make specific disclosure of interest: The disclosure shall be made as under:

- The interested director shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed for the first time; and
- He shall not participate in such meeting. 'Non-participation' implies that he shall not discuss the matter relating to such contract and also shall not vote if there happens to be a voting in this connection.
- It may happen that any director is not so concerned or interested at the time of entering into such contract or arrangement. However, if he becomes interested after the contract or arrangement is entered into, he shall disclose his concern or interest forthwith when he becomes so or at the first meeting of the Board held after his becoming concerned or interested.

Exception/Modification

1. In case of a **private company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, the provisions of Section 184 (2) shall apply with the exception that the interested director may participate in such meeting after disclosure of his interest. [Notification No. G.S.R. 464(E), dated 5th June, 2015 as amended by Notification No. G.S.R. 583 (E), dated 13th June, 2017.]

2. In respect of a **Section 8 company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, the provisions of Section 184(2) shall apply only if the transaction with reference to Section 188 on the basis of terms and conditions of the contract or arrangement **exceeds one lakh rupees**. [Notification No. G.S.R. 466(E), dated 5th June 2015 as amended by Notification No. G.S.R. 584 (E), dated 13th June, 2017.]

(iii) **Contract voidable at the option of company if there is non-disclosure [Section 184(3)]:**

A contract or arrangement entered into by the company shall be voidable at its option if the interested director who has a direct or indirect concern or interest in such contract or arrangement, does not disclose his interest as required by Section 184 (2) or if such director participates in the meeting where such contract or arrangement is discussed.

It may be noted that the contract is voidable and not void and the option of rescinding the contract lies with the company and not with the interested director. Thus, if the company decides to honour the contract, the interested director cannot rescind it because of irregularity.

(iv) **Punishment for contravention [Section 184(4)]:** If a director of the company contravenes the provisions of Section 184 (1) and (2) *i.e.* does not disclose his interest or furnishes wrong information in this respect, he shall be liable to a penalty of one lakh rupees.

- (v) **No restriction on directors:** Nothing in Section 184 shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contract or arrangement with the company.
- (vi) **Exemption from disclosure if the holding is up to two per cent:** According to Section 184 (5) (b), the provisions of Section 184 regarding disclosure by interested director shall not apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the either company or two or more of them together holds or hold **not more than 2%** of the paid-up share capital in the other company.

Example 11: Y Ltd. entered into a contract with Z Ltd. which has a paid-up capital of ₹50 lakhs. One of the directors of Y Ltd. is holding equity shares of the nominal value of ₹ 50,000 in Z Ltd. but he did not disclose his interest at the appropriate Board meeting.

In this case, as per section 184 (2) of the Companies Act, 2013 the disclosure of interest by directors is not required in any contract or arrangement between two companies where any of the directors of the company or two or more of them together holds or hold not more than 2% of the paid-up share capital in the other company. Here, the holding of the director of Y Ltd. in Z Ltd. is only 1% [*i.e.* $(50,000/50,00,000) \times 100 = 1\%$] which is less than 2%. Therefore, he does not require to disclose his interest regarding holding of equity shares in Z Ltd.



13. DEFECTS IN APPOINTMENT OF DIRECTORS NOT TO INVALIDATE ACTIONS TAKEN [SECTION 176]

Section 176 of the Act contains protective provisions by which actions taken by a director shall not get invalidated if subsequently it is noticed that there happened to be defects in his appointment. The validation of actions provides a kind of protection to the company as well as the third parties. The provisions of Section 176 are stated as under:

- (i) **No act done by a person as a director shall be deemed to be invalid**, if it was subsequently noticed that his appointment was invalid by reason of:
- any defect; or
 - disqualification; or
 - had been terminated by virtue of any provision contained in the Companies Act, 2013 or in the articles of the company.
- (ii) **Acts not valid if done after noticing his appointment to be invalid or to have terminated:** It is provided that Section 176 shall not be deemed to give validity to any act done by the director after his appointment has been noticed by the company to be invalid or to have terminated.

In other words, any subsequent act done by a director shall not get validated under the following circumstances:

where it comes to the notice of the company that his appointment is invalid or illegal or there is no appointment.

where it is in the notice of the company that his appointment has been terminated.

where it is noticed by the company that his acts are illegal i.e. ultra vires the company or the Companies Act.

where it was well within the knowledge of the third party that the appointment of director was not valid or there existed any irregularity or there was any disqualification attached to the director and still such party dealt with him.

where the director knows it fully that his term of office has expired but he continues to occupy his office despite such knowledge.

where a person exercises his powers as director though he apparently knows that he has no authority to exercise such powers because his appointment was invalid or he has since been terminated.

- (iii) **Protection to the acts of MD or WTD or Manager:** In terms of Section 196 (5), any act done by a managing director or whole-time director or manager before his appointment was disapproved by the company at a general meeting shall be deemed to be valid.

Example 12: Mr. Mohan was appointed as director at the Annual General Meeting of a company held on 30th September, 2018 and he functioned in the capacity as director from then onwards. Subsequently, during the mid of August, 2019, it was noticed that there were certain irregularities in his appointment and therefore, on 31st August, 2019, his appointment was declared invalid. However, Mr. Mohan continued to act as director even after 31st August, 2019.

In the given **example**, in view of the Section 176, the acts done by Mr. Mohan till the date of noticing irregularity in his appointment shall be deemed as valid and binding on the company.

Any act done by him after the date on which irregularity in his appointment was noticed by the company shall be invalid. Accordingly, acts done by Mr. Mohan after 31st August, 2019 shall be invalid and not binding upon the company.

High Court of Andhra Pradesh in *Smt. Dr. Renuka Datla v. Biological E Ltd.* laid that benefit of section 176 of the Companies Act, 2013, is generally available to third parties who enter into transactions with a company not knowing what internal structure and mechanism of company is. It was mentioned that a person such as a Managing Director or a Director who is expected to know what is right and what is wrong and what is legal and what is illegal, cannot be allowed to presume things in his favour, and if at end he fails to prove that he has acted as per law, he cannot take shelter under section 176, more so, in a case where Directors usurped their office.



14. LOAN TO DIRECTORS, ETC. [SECTION 185]

Section 185 of the Act contains provisions which impose restrictions on the loans, etc. being given to directors, etc. These provisions are stated below:

- (i) **Imposition of restrictions [Section 185 (1)]:** A company (subject to exemptions stated in the *Box* given later) is not permitted, directly or indirectly, to advance any loan, including any loan represented by a book debt to, or to give any guarantee or provide any security in connection with any loan taken by,—
- (a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or
 - (b) any firm in which any such director or relative is a partner.
- (ii) **Relaxation from restrictions [Section 185 (2)]:** Subject to the specified conditions, a company is permitted to:
- advance any loan including any loan represented by a book debt, or
 - give any guarantee or provide any security in connection with any loan taken,
- by any person in whom any of the director of the company is interested.

The specified conditions to be followed are:

- (a) a **special resolution** is passed by the company in general meeting.

However, the explanatory statement to the notice for the relevant general meeting shall disclose;

- the *full particulars* of the loans given or guarantee given or security provided; and
- the *purpose* for which the loan or guarantee or security is proposed to be utilized by the recipient of the loan or guarantee or security and

- any other relevant fact;
- (b) the loans are utilized by the **borrowing company** for its **principal business activities**.

Explanation: The expression "any person in whom any of the director of the company is interested" means—

- (a) any **private company** of which any such director is a director or member;
 - (b) any **body corporate** at a general meeting of which **not less than twenty-five per cent** of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or
 - (c) any **body corporate**, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.
- (iii) **Non-applicability of restrictions [Section 185 (3)]:** In the following cases, restrictions stated in Section 185 (1) or specified conditions for relaxation of restrictions stated in Section 185 (2) shall not apply:
- (a) where any loan is given to a **managing or whole-time director**—
 - (i) as a part of the conditions of service extended by the company to all its employees; or
 - (ii) pursuant to any such **scheme** which is approved by the members by a **special resolution**.
 - (b) where a company in the ordinary course of its business:
 - provides loans or gives guarantees or securities for the due repayment of any loan; and
 - in respect of such loans an **interest is charged at a rate not less than the rate of prevailing yield** of one year, three years, five years or ten years Government security closest to the tenor of the loan.
 - (c)
 - (i) where any loan is made by a holding company to its wholly owned subsidiary company; or
 - (ii) where any guarantee is given or security is provided by a holding company in respect of any loan made to its wholly owned subsidiary company.
 - (d) where any guarantee is given or security is provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company.

As a pre-condition, it must be ensured that the loans made under clauses (c) and (d) are utilized by the subsidiary company for its principal business activities.

- (iv) **Penalty for contravention:** Penalty for contravention of the provisions of Section 185 (i.e. if any loan is advanced or a guarantee or security is given or utilized contravening the provisions of Section 185) shall be as under:
- Company:** punishable with minimum fine of ₹ 5,00,000 and maximum fine of ₹ 25,00,000.
 - Every defaulting officer:** punishable with imprisonment up to six months or with minimum fine of ₹ 5,00,000 and maximum fine of ₹ 25,00,000.
 - the director or the other person to whom any loan is advanced or guarantee or security is given in connection with any loan taken by him or the other person: punishable with imprisonment up to six months or with minimum fine of ₹ 5,00,000 and maximum fine of ₹ 25,00,000, or with both.

Exemptions

1. Section 185 shall not apply to **Government company** in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security under the section.

Note: The above exemption is applicable to a Government company if it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

[Notification No. G.S.R. 463(E), dated 5th June 2015 as amended by Notification No. G.S.R. 582 (E), dated 13th June 2017.]

2. Section 185 shall not apply to a **private company-**

- In whose share capital no other body corporate has invested any money;
- If the borrowings of such a company from banks or financial institutions or anybody- corporate is less than twice of its paid-up share capital or fifty crore rupees, whichever is lower, and
- Such company has no default in repayment of such borrowings subsisting at the time of making transactions under this section.

Note: The above exemption is applicable to a private company if it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

[Notification No. G.S.R 464(E), dated 5th June 2015 as amended by Notification No. G.S.R 583(E), dated 13th June 2017.]

3. Section 185 shall not apply to the **Nidhis**, provided the loan is given to a director or his relative in their capacity as members and such transaction is disclosed in the annual accounts by a note. However, while complying with such exception, the Nidhis shall ensure that the interests of their shareholders are protected.

[Notification no. G.S.R. 465(E), dated 5th June 2015.]



15. LOAN AND INVESTMENT BY COMPANY [SECTION 186]

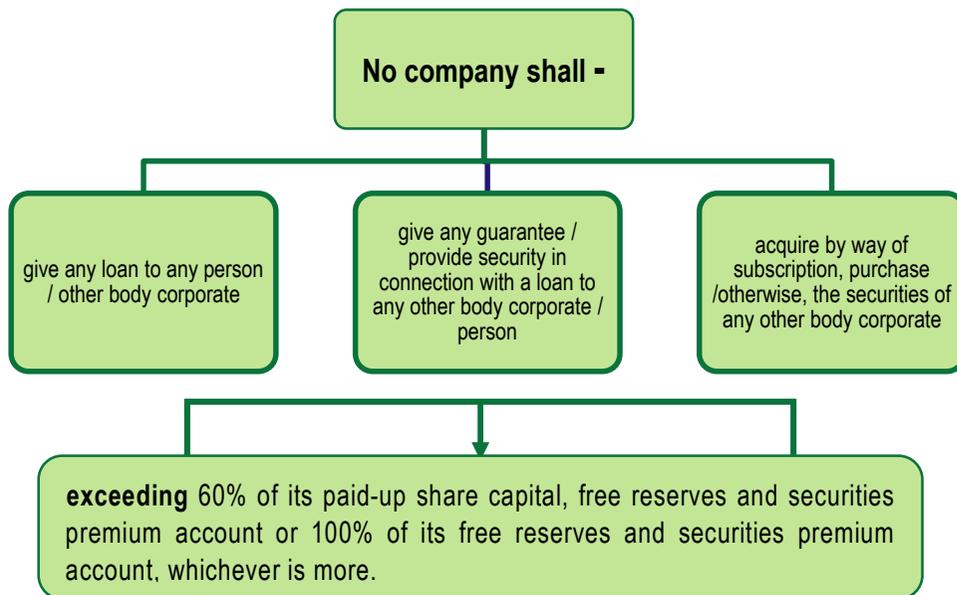
Section 186 of the Act, applicable to both public and private companies, deals with the provisions relating to 'Loan and Investment' by a company. In addition, Rules 11, 12 and 13 also contain provisions governing the making of loans and investments, giving of guarantees and providing of securities by a company. These provisions are discussed as under:

- (i) **Investment permitted through two layers of Investment Companies [Section 186(1)]:** A company, unless otherwise prescribed, is not permitted to make investment through more than two layers of investment companies. Placing of such a restriction helps in preventing diversion of funds. It is a common experience that the funds can be more flagrantly diverted if a company invests through a number of step-down subsidiaries.

Note: It is clarified by way of *clause (a) of Explanation* that the expression “**investment company**” means a company whose principal business is the acquisition of shares, debentures or other securities. Further, a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its **assets** in the form of investment in shares, debentures or other securities constitute **not less than fifty per cent** of its total assets, or if its **income** derived from investment business constitutes **not less than fifty per cent** as a proportion of its gross income.

Exception to the rule of two layers: In the following cases, the provisions of Section 186 (1) shall not apply *i.e.* rule of 'two layers' shall not be applicable:

- (a) **Acquisition of a company incorporated outside India:** If a company acquires any other company incorporated in a country outside India and if such other company has investment subsidiaries beyond two layers as per the laws of such country, the rule of 'two layers' shall not prevent this kind of acquisition.
- (b) **Subsidiary from having an investment subsidiary:** Again, the rule of 'two layers' shall not prevent a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.
- (ii) **Imposition of limit on the quantum of loan and investment made by a company:** According to Section 186 (2), following types of transactions (both direct and indirect) shall be subject to the specified limit as depicted in the diagram:
- (a) giving of **loan** to any person or other body corporate;
- (b) giving of **guarantee** or provision of **security** in connection with a loan to any other body corporate or person;
- (c) acquiring by way of subscription, purchase or otherwise the securities of any other body corporate.



Explanation: For the purposes of Section 186 (2), the word "person" does not include any individual who is in the employment of the company.

Loans and Advances to Employees – Clarification on the applicability of Section 186

*The MCA has clarified that loans and/or advances made by the companies to their employees, other than the managing or whole-time directors (which is governed by Section 185) are **not** governed by the requirements of Section 186.*

This clarification will, however, be applicable if such loans/advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy, in cases where such policy is required to be formulated.

[General Circular No. 04/2015, dated 10/3/2015.]

In other words, a company is permitted to enter into transactions of giving loan or guarantee or providing security or acquiring of securities (*i.e.* shares, debentures, etc.), in the aggregate, upto 60% of its paid-up share capital (both equity and preference), free reserves and securities premium or 100% of its free reserves and securities premium, whichever is more.

- (iii) **Prior approval by a special resolution for exceeding limit [Section 186(3)]:** Where the aggregate of the loans and investment so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under Section 186 (2), no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting.

Note 1: In case the provisions of Section 110 of the Act apply to the company which is considering giving of loans or extending guarantee or providing security in excess of the limit specified under Section 186 (3), it shall pass the special resolution containing such item of business by means of voting through postal ballot. [refer Rule 16 (j) of the Companies (Management and Administration) Rules, 2014.]

Note 2: A One Person Company and other companies having members up to two hundred are not required to transact any business through postal ballot. [refer Proviso to Rule 16 of the Companies (Management and Administration) Rules, 2014.]

Disclosure of total amount in resolution in respect of loan or guarantee or security or acquisition: As per the Rule 13 of the Companies (Meetings of Board and its Powers) Rules, 2014, a resolution passed at a general meeting in terms of Section 186 (3) to give any loan or guarantee or investment or providing any security or the acquisition under Section 186 (2) shall specify the total amount up to which the Board of Directors are authorised to give such loan or guarantee, to provide such security or make such acquisition.

Exemption from special resolution [First Proviso to Section 186 (3) and Rule 11 (1)]: However, where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of passing a special resolution as required by Section 186 (3) shall not apply.

Disclosure in financial statement [Second Proviso to Section 186 (3) and Proviso to Rule 11 (1)]: In case of exemption from special resolution, the company shall disclose the details of such loans or guarantee or security or acquisition in the financial statement as provided under Section 186 (4).

- (iv) **Disclosure to members [Section 186(4) and Proviso to Rule 13]:** The company shall make full disclosure to the members as depicted in the following diagram:

Company shall disclose to the members in the financial statements the full particulars of-		
loan given,	investment made or guarantee given or security provided,	the purpose for which the loan or guarantee or security is proposed to be utilized by the recipient of the loan or guarantee or security.

- (v) **Unanimous resolution of the Board [Section 186(5)]:**
- Any investment shall be made or loan or guarantee or security given by the company only after when the resolution sanctioning it is passed at a meeting of the Board **with the consent of all the directors present** at the meeting.

- The prior approval of the public financial institution concerned where any term loan is subsisting shall also be obtained.

Circumstances when no prior approval of public financial institution (PFI) is required [Proviso to Section 186 (5)]: Prior approval of a public financial institution (PFI) shall not be required where the aggregate of the loans and investments so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given:

- does not exceed the limit as specified in section 186(2) (i.e. 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more), and
- there is no default in repayment of loan installments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution.

- (vi) **Rate of interest on loan [Section 186 (7)]:** A loan under this section shall be given at a rate of interest which is not lower than the prevailing yield of one year, 3 year, 5 year or 10 year Government Security closest to the tenor of the loan.

1. Clarification in respect of Section 186 (7) - Rate of Interest

The MCA has clarified that in cases where effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan, there is no violation of sub-section (7) of Section 186 of the Companies Act, 2013. [General Circular No. 06/2015, dated 9th April, 2015]

2. Modification in Section 186 (7) in respect of Section 8 Companies

In respect of Section 8 Companies which have not committed a default in filing their financial statements under Section 137 or Annual Return under Section 92 with the Registrar, following proviso shall be inserted in Section 186(7):

'Provided that nothing contained in this sub-section shall apply to a company in which twenty-six per cent or more of the paid-up share capital is held by the Central Government or one or more State Governments or both, in respect of loans provided by such company for funding Industrial Research and Development projects in furtherance of its objects as stated in its memorandum of association'. [Notification No. GSR 466(E), dated 5-6-2015 as amended by Notification No. GSR 584(E), dated 13-6-2017.]

- (vii) **No giving of loan, etc., till default in respect of deposits is subsisting [Section 186 (8)]:** A company which is in default in the repayment of any deposits accepted before or after the commencement of the Companies Act, 2013 or in payment of interest thereon, shall not give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting.

- (viii) **Maintenance of Register [Section 186 (9)]:** Every company giving loan or giving a guarantee or providing security or making an acquisition shall keep a register. It shall contain such particulars and shall be maintained in such manner as is prescribed in Rule 12 of the Companies (Meetings of Board and its Powers) Rules, 2014. The requirements of Rule 12 are as under:

Every company shall, from the date of its incorporation

- maintain a register in *Form MBP 2* and
- enter the particulars of loans and guarantees given, securities provided and acquisitions made.

The entries in the register shall be made chronologically in respect of each such transaction

- within **7 days** of making loan or giving guarantee or providing security or making acquisition

Maintenance of register

- It shall be kept at the registered office of the company and shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board
- The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board

furnishing of extracts from register

- The extracts from such register may be furnished to any member on payment of fee prescribed in the Articles which shall not exceed ₹10 for each page.

- (ix) **Non-applicability of Section 186 except sub-section (1) to certain transactions [Section 186 (11)]:** Section 186, (except Section 186 (1)), shall not apply:

- (a) to any loan made, any guarantee given or any security provided or any investment:
- made by a banking company, or an insurance company, or a housing finance company in the ordinary course of its business; or
 - made by a company established with the object of and engaged in the business of financing industrial enterprises, or of providing infrastructural facilities¹⁵;

¹⁵ As per *Explanation (b)* to Section 186 of the Act, the expression “infrastructural facilities” means the facilities specified in Schedule VI.

(b) to any investment—

(i) made by an investment company;

¹⁶**Note:** The expression “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities and a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than fifty per cent. of its total assets, or if its income derived from investment business constitutes not less than fifty per cent. as a proportion of its gross income

(ii) made in shares allotted in pursuance of Section 62 (1) (a) [i.e. right shares] or in shares allotted in pursuance of rights issues made by a body corporate;

(iii) made, in respect of investment or lending activities, by a non-banking financial company registered under Chapter III-B of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities.

(x) **Restriction on the inter-corporate loans/deposits to be taken by companies registered under Section 12 of SEBI [Section 186 (6) and Rule 11 (3)]:** A company registered under Section 12 of the Securities and Exchange Board of India Act, 1992 and covered under such class or classes of companies which may be notified by the Central Government in consultation with the Securities and Exchange Board, shall not take inter-corporate loan or deposits in excess of the limits specified under the regulations applicable to this kind of company, pursuant to which it has obtained certificate of registration from the Securities and Exchange Board of India.

Further, such company shall furnish in its financial statement the details of the loan or deposits.

Note: Section 12 of the SEBI Act, 1992 requires stock broker, sub-broker, share transfer agent, banker to an issue, registrar to an issue, merchant banker, underwriter, portfolio manager, etc. to get registered with SEBI and obtain certificate of registration. There are regulations framed by SEBI which regulate such entities.

(xi) **Punishment for contravention [Section 186 (13)]:** In case of contravention of any of the provisions of Section 186, the punishment shall be as under:

- **Company:** punishable with minimum fine of ₹25,000 and maximum of ₹ 5 lakhs.
- **Every defaulting officer:** punishable with imprisonment maximum up to two years and with fine minimum of ₹25,000 and maximum of ₹1,00,000.

For the purposes of section 186, the expression “infrastructure facilities” means the facilities specified in Schedule VI.

¹⁶ As per *Explanation (a)* to Section 186 of the Act.

Note: The students may also refer the Companies (Restriction on Number of Layers) Rules, 2017, which have been enforced w.e.f. 20th September 2017.

Exemptions

Section 186 shall not apply to:

- (a) a **Government company** engaged in defence production;
- (b) a **Government company, other than a listed company**, in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.

Note: The above exception is applicable to a Government company which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

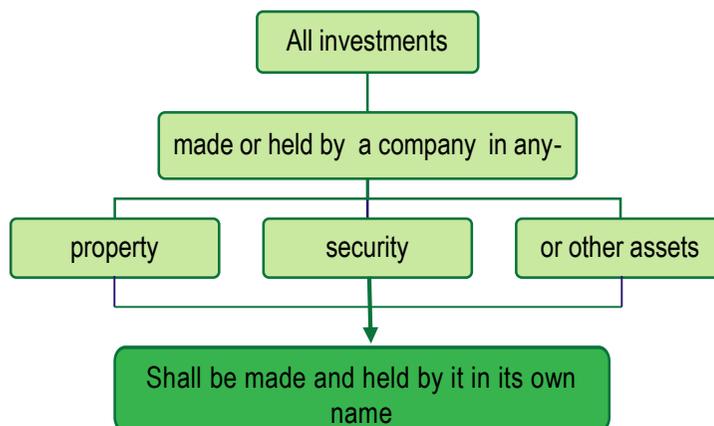
[Notification No. G.S.R. 463 (E), dated 5th June 2015 as amended by Notification No. G.S.R.582 (E), dated 13th June 2017.]



16. INVESTMENTS OF COMPANY TO BE HELD IN ITS OWN NAME [SECTION 187]

Section 187 of the Act contains provisions which, as a general rule, require that all investments made by a company shall be held by it in its own name. There are certain exemptions also. The provisions of Section 187 are discussed as under:

- (i) **Investments by a company in its own name:** According to Section 187 (1), all investments made or held by a company in any property, security or other assets shall be made and held by it in its own name. Following diagram depicts this provision:



As an exception¹⁷, it is provided that company may hold any shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

(ii) **Exemptions:** It is not always necessary that a company must hold the investments in its own name. Certain exemptions provided by Section 187 (2) are as under:

(a) **Deposit of shares and debentures with bankers for collection of dividend and interest:** A company is permitted to deposit with its bankers any shares or securities for the collection of any dividend or interest payable thereon.

(b) **Deposit or transfer to or hold in the name of its bankers shares or securities, in order to facilitate the transfer:** A company is permitted to deposit with or transfer to or hold in the name of its bankers (*i.e.* the State Bank of India or a scheduled bank), shares or securities, in order to facilitate the transfer thereof.

However, if within a period of **6 months** from the date on which the shares or securities are transferred by the company to, or are first held by the company in the name of its bankers (*i.e.* the State Bank of India or a scheduled bank), no transfer of such shares or securities takes place, the company shall, as soon as practicable after the expiry of that period, have the shares or securities re-transferred to it from its bankers or, as the case may be, again hold the shares or securities in its own name.

(c) **Deposit with or transfer to any person any shares or securities, by way of security for the repayment of any loan :** A company is permitted to deposit with or transfer to any person any shares or securities, by way of security for the repayment of any loan advanced to the company or the performance of any obligation undertaken by it.

(d) **Depository investments in the form of securities held as a beneficial owner:** A company is permitted to hold investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

(iii) **Maintenance of Register by a company in case securities are held in the name of a depository and not in its own name [Section 187 (3)]:**Section 187 (2) (d) permits a company to hold securities (*i.e.* any shares or securities) in the name of a depository, the company being the beneficial owner. In this case, though the investment in shares and securities has been made by the company but the securities are not held by it in its own name.

When the above situation arises, the company shall maintain a register which shall contain such particulars as may be prescribed (refer Rule 14 below) and such register shall be open

¹⁷ As per Proviso to Section 187 (1).

to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

Provisions regarding maintenance of register as per Rule 14: The requirements of Rule 14 of the Companies (Meetings of Board and its Powers) Rules, 2014 are as under:

- (a) **Maintenance of Register:** From the date of its registration, every company shall maintain a register in Form MBP-3.
- (b) **Entry of particulars of investments:** The company shall enter in the register, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name. It shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.
- (c) The company shall also record whether such investments are held in a third party's name for the time being or otherwise.
- (d) **Place:** The register shall be maintained at the registered office of the company and shall be preserved permanently.
- (e) **Custody of register:** The register shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board.
- (f) **Authentication of entries:** The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

Securities held by any person in which the company holds beneficial interest, compliance of section 89 requires declaration in respect of beneficial interest of any securities.

- (iv) **Punishment for contravention [Section 187 (4)]:** If a company is in default in complying with the provisions of this section, the company shall be liable to a penalty of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.



17. RELATED PARTY TRANSACTIONS [SECTION 188]

Section 188 of the Act along with Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 contain provisions which regulate 'related party transactions'. Further, Section 2(76) of the Act defines who is a 'related party'. These provisions are discussed in the following paragraphs:

(1) Meaning of 'Related Party':

As per Section 2(76), 'related party', with reference to a company, means-

- (i) a director or his relative;

- (ii) a key managerial personnel (KMP) or his relative;
- (iii) a firm, in which a director, manager or his relative is a partner;
- (iv) a private company in which a director or manager or his relative is a member or director;
- (v) a public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid-up share capital;
- (vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
- (vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Note: It is provided that sub-clauses (vi) and (vii) shall not apply to the advice, directions or instructions which are given in a professional capacity;

- (viii) any body corporate which is—
 - (A) a holding, subsidiary or an associate company of such company;
 - (B) a subsidiary of a holding company to which it is also a subsidiary; or
 - (C) an investing company or the venturer of the company.

Note: It is clarified by way of *Explanation* that "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

Exemption

*In case of a **private company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar sub-clause (viii) of clause 76 of Section 2 shall not apply with respect to Section 188. [Notification No. GSR 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13th June, 2017.]*

- (ix) such other person as may be prescribed (refer *Box* below).

In this respect, Rule 3 of the Companies (Specification of Definitions Details) Rules, 2014 provides that for the purposes of sub-clause (ix) above, a **director** other than an independent director or **key managerial personnel of the holding company or his relative** with reference to a company, shall be deemed to be a **related party**.

Further, the persons covered under sub-clauses (vi) and (vii) above shall not be related parties if advice, directions or instructions are given by them in a professional capacity.

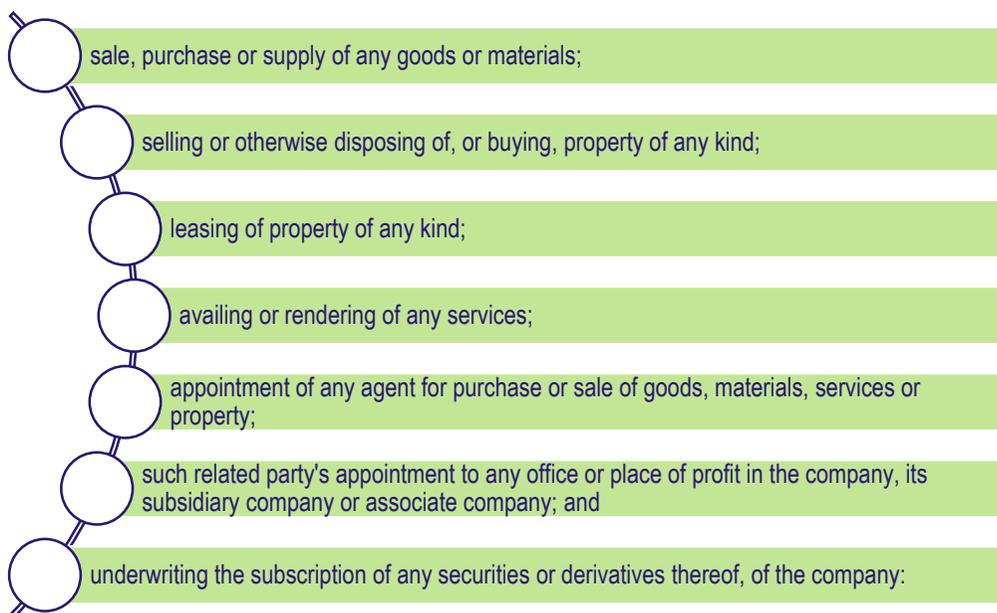
Meaning of 'Relative'

Section 2 (77) of the Act defines the term 'relative'. Accordingly, 'relative', with reference to any person, means any one who is related to another, if—

- (i) they are members of a Hindu Undivided Family;
- (ii) they are husband and wife; or
- ¹⁸(iii) one person is related to the other in the prescribed manner as under:
 - (1) Father (including step-father).
 - (2) Mother (including step-mother).
 - (3) Son (including step-son).
 - (4) Son's wife.
 - (5) Daughter.
 - (6) Daughter's husband.
 - (7) Brother (including the step-brother).
 - (8) Sister (including the step-sister).

- (2) **Related party transactions to which Section 188 is applicable:** Section 188(1) specifies certain transactions (*i.e. contracts or arrangements*) which shall be termed as 'related party transactions' if a company undertakes them with a 'related party'. Such transactions are depicted in the following diagram:

Transactions referred to in sub-section (1) of Section 188:



¹⁸ As per Rule 4 of the Companies (Specification of Definitions Details) Rules, 2014.

¹⁹Meaning of “Office or Place of Profit”

The expression “office or place of profit” means any office or place—

- (1) **where such office or place is held by a director** - if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;
- (2) **where such office or place is held by an individual other than a director or by any firm, private company or other body corporate** - if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise.

It is noteworthy that **Section 188 does not bar a company from entering into ‘related party transactions’**. They can very well be undertaken, but after following the procedure prescribed as per the law like taking permission from the Board and if required, from the company in general meeting when prescribed limits are exceeded. If the provisions do not require any procedure to be followed, these transactions can also be entered without following the prescribed procedure.

- (3) **Related Party Transactions for which no approval is required [Fourth Proviso to Section 188 (1)]**: In case any related party transaction is entered into by the company in its ordinary course of business and at an arm’s length basis, Section 188 (1) is not attracted and therefore, no approval is required. However, transactions which are not on an arm’s length basis shall require the appropriate approval.

Note: The expression “**arm’s length transaction**” means²⁰ a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

- (4) **Related Party Transactions requiring consent of the Board²¹**: In case, a related party transaction covered under Section 188 (1) (*i.e.* contract or arrangement between a company and related party) is not on arm’s length basis and also does not require approval of the shareholders, it shall be entered into by the company after obtaining consent of the Board of Directors given by a resolution at a meeting of the Board and subject to the conditions as prescribed by Rule 15 (1) of the Companies (Meetings of Board and its Powers) Rules, 2014.

¹⁹ As per *Explanation (a)* to Section 188 (1) of the Act.

²⁰ As per *Explanation (b)* to Section 188 (1) of the Act.

²¹ As per Section 188 (1) of the Act.

According to Rule 15 (1), if a company enters into a transaction with a related party, the agenda of the Board meeting at which the resolution is proposed to be moved shall disclose the **following matters**:

- (a) the name of the related party and nature of relationship;
- (b) the nature, duration of the contract and particulars of the contract or arrangement;
- (c) the material terms of the contract or arrangement including the value, if any;
- (d) any advance paid or received for the contract or arrangement, if any;
- (e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;
- (f) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and
- (g) any other information relevant or important for the Board to take a decision on the proposed transaction.

Note: According to Rule 15 (2), in case any director is interested in any contract or arrangement with a related party, he shall not be present at the meeting during discussions on the resolution relating to such contract or arrangement-

- (5) (i) **Related Party Transactions requiring approval by ordinary resolution²²:** In case a company enters into a contract or arrangement with a related party and the value of transaction exceeds the prescribed value as per Rule 15 (3), it shall be entered into with the prior approval of the company by passing an ordinary resolution.

The provisions of Rule 15(3) are explained as under:

- (A) Approval by an ordinary resolution is required where the transaction or transactions to be entered into as contracts or arrangements with respect to clauses (a) to (e) of Section 188 (1) are as per the following criteria:

Details of transactions to be entered into as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of Section 188	Prescribed limits for seeking approval by a resolution relating to the specified transactions
(i) Sale, purchase or supply of any goods or materials, directly or through appointment of agent,	If the value of such transaction or transactions amounting to 10% or

²² As per First Proviso to Section 188 (1) and Rule 15 (3) of the Companies (Meetings of Board and its Powers) Rules, 2014.

as mentioned in clause (a) and clause (e) respectively of sub-section (1) of Section 188.	more of the turnover of the company. Note: Above limit shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.
(ii) Selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of Section 188.	If the value of such transaction or transactions amounting to 10% or more of net worth of the company. Note: Above limit shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.
(iii) Leasing of property of any kind , as mentioned in clause (c) of sub-section (1) of Section 188.	If the value of such transaction or transactions amounting to ten per cent or more of the turnover of the company. Note: Above limit shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.
(iv) Availing or rendering of any services , directly or through appointment of agent, as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188.	If the value of such transaction or transactions amounting to 10% or more of the turnover of the company. Note: Above limit shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

- (B) Where the transaction or transactions to be entered into as contract or arrangement is for **appointment to any office or place of profit in the company**, its subsidiary company or associate company at a monthly remuneration **exceeding ₹2.5 lakh rupees as mentioned in clause (f) of sub-section (1) of Section 188**, approval by an ordinary resolution is required.

- (C) Where the transaction or transactions to be entered into as contract or arrangement is **for remuneration for underwriting** the subscription of any securities or derivatives thereof, of the company **exceeding 1% of the net worth as mentioned in clause (g) of sub-section (1) of Section 188**, approval by an ordinary resolution is required.

²³**Note 1: Turnover or Net Worth:** The turnover or net worth shall be computed on the basis of the audited financial statement of the preceding financial year.

²⁴**Note 2: The explanatory statement to be annexed to the notice** of a general meeting convened pursuant to Section 101 shall contain the following particulars, namely:

- (a) name of the related party;
- (b) name of the director or key managerial personnel who is related, if any;
- (c) nature of relationship;
- (d) nature, material terms, monetary value and particulars of the contract or arrangement;
- (e) any other information relevant or important for the members to take a decision on the proposed resolution."

- (ii) **No voting by a related member [Second Proviso to Section 188(1)]:**A member of the company who is a related party shall not vote on the resolution meant for approving any contract or arrangement which may be entered into by the company.

²⁵**Note:** However, nothing contained in the second proviso shall apply to a company in which ninety per cent or more members, in number, are relatives of promoters or are related parties.

Exemptions

1. *First and Second Proviso to Section 188(1) shall not apply to:*
 - (a) a **government company** in respect of contracts or arrangements entered into by it with any other government company;
 - (b) a **government company**, other than a listed company, in respect of contracts or arrangements other than those referred to in clause(a), in case such company obtains approval of the Ministry or Department of the Central Government which is

²³ As per Explanation (1) to Rule 15 (3).

²⁴ As per Explanation (3) to Rule 15 (3).

²⁵ As per Third Proviso to Section 188 (1).

administratively in charge of the company, or as the case may be, the state Government before entering into such contract or arrangement.

Note: The above exemption is applicable to a Government company which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

[Notification No. G.S.R. 463(E), dated 5th June 2015 as amended by Notification No. G.S.R. 582(E), dated 13th June 2017.]

2. Second Proviso to Section 188(1) **shall not apply to a private company** provided it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

Note: This exemption implies that a member of a private company is permitted to vote on the resolution irrespective of the fact that such member is a related party.

[Notification No. G.S.R. 464(E), dated 5th June 2015 as amended by Notification No. G.S.R. 583(E), dated 13th June 2017.]

Scope of Second Proviso to Section 188(1) - Clarification

The second proviso to sub-section (1) of Section 188 requires that **no member of the company shall vote on a resolution** to approve the contract or arrangement (referred to in the first proviso), if such a member is a related party.

The MCA has clarified that 'related party' referred to in the Second Proviso has to be construed with reference only to the contract or arrangement for which the said resolution is being passed.

Thus, the term '**related party**' in the above context refers only to such related party as may be a related party in the context of the contract or arrangement for which the said resolution is being passed. [General Circular No. 30/2014, dated 17th July, 2014]

- (6) **Transactions between a holding company and its wholly owned subsidiary [Fifth Proviso to Section 188 (1)]:** In case transactions are entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting, there is no need for seeking approval of the company by passing an ordinary resolution by the members.

Explanation (2) to Rule 15 (3) states that in case of a wholly owned subsidiary, the resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between the wholly owned subsidiary and the holding company.

(7) **Related party transactions voidable at the option of the Board/shareholders [Section 188 (3)]:** A contract or arrangement shall be voidable at the option of the Board or, as the case may be, of the shareholders:

(a) **Contract/arrangement entered without obtaining the consent of the Board or approval by a resolution:** Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting as required under Section 188 (1), and

No ratification by Board/shareholders: if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within 3 months from the date on which such contract or arrangement was entered into.

Further, if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

(b) **Company may proceed to recover loss in contravention of the provisions of this section:** Section 188 (4) provides that it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of Section 188 for recovery of any loss sustained by it as a result of such contract or arrangement.

(8) **Punishment for contravention [Section 188 (5)]:** Any director or any other employee of a company who had entered into the contract or arrangement, or authorised it, in violation of the provisions of Section 188 shall be punishable as under:

In the case of	Punishment
Listed company	liable to a penalty of twenty-five lakh rupees, and
Any other company	liable to a penalty of five lakh rupees

(9) **Disclosures of 'related party transactions' in Board's report [Section 188 (2)]:** Every contract or arrangement entered into under Section 188 (1) (i.e. the related party transactions) shall be mentioned in the Board's report to the shareholders along with the justification for entering into such contract or arrangement.

Applicability of Section 188 to Corporate Restructuring, Amalgamations etc.

The MCA has clarified that transactions arising out of Compromises, Arrangements and Amalgamations dealt with under specific provisions of the Companies Act, 2013, will not attract the requirements of Section 188 of the Companies Act, 2013. [General Circular No. 30/2014, dated 17th July, 2014]

1. The National Company Law Tribunal, of Kochi Bench in *Sulochana Gupta v. RBG Enterprises (P.) Ltd.* Passed an order under Section 188 of the Companies Act. It was held that where directors of company have siphoned huge amounts from company in pretext of remuneration to themselves and to their spouses (full time employees assisting company) without approval of majority of shareholders, was related party transactions and said to be contrary to provisions of law and in breach of Articles of Association of company and thus, were held to be declared as invalid.

2. The High Court of Madras in *Vikramjit Singh Oberoi v. Registrar of Companies* held that payment of royalty is a license fees for use of brand/trade name, same do not qualify as contract related to sale, purchase or supply of goods, materials or services and therefore, section 188 does not apply.

Further with respect to Financial Statement, Board's report, etc. where company had availed services, such as car rentals, laundry services etc. from related party in ordinary course of business on an arm's length basis, it was held that company was not required to disclose same in its board report as per the requirement of section 134 read with 188 of the Companies Act, 2013.

18. REGISTER OF CONTRACTS OR ARRANGEMENTS IN WHICH DIRECTORS ARE INTERESTED [SECTION 189]

Section 189 of the Act, contains provisions for maintenance of Register of contracts or arrangements in which directors are interested. According to this section:

- (i) **Maintenance of register of contracts or arrangements [Section 189(1)]:** It is mandatory for all companies to keep one or more registers giving separately the particulars of all contracts or arrangements as required under:
 - (a) Section 184(2) [Disclosure of Interest by Directors]; or
 - (b) Section 188 [Related Party Transactions].
- (ii) **Manner of preparation of register:** Such register shall be prepared in the prescribed manner and shall contain prescribed particulars. [Section 189(1)]

As regards prescribed manner and particulars, we may refer Rule 16 of the Companies (Meetings of Board and its Powers) Rules, 2014 which states that the Register of contracts or arrangements shall be maintained in Form No. MBP 4. The company concerned shall enter therein:

- the particulars of company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest, as mentioned under Section 184 (1).

As an exception, the particulars of the company or companies or bodies corporate in which a director himself together with any other director **holds two percent or less of the paid-up share capital** would not be required to be entered in the register.

- the particulars of contracts or arrangements with a body corporate or firm or other entity as mentioned under Section 184 (2), in which any director is, directly or indirectly, concerned or interested; and
 - the particulars of contracts or arrangements with a related party with respect to transactions to which Section 188 applies.
- (iii) **When to make entries in the Register:** As per Rule 16, the entries in the Register shall be made at once and in the chronological order. They shall be authenticated by the Company secretary or any other person authorised by the Board.
- (iv) **Register to be signed [Section 189(1)]:** The register, after being duly filled and updated, shall be placed before the next meeting of the Board and signed by all the directors present at the meeting.
- (v) **Disclosure to be made by a director or KMP [Section 189(2)]:** Every director or key managerial personnel (KMP) shall, within a period of 30 days of his appointment, or relinquishment of his office, as the case may be, disclose the particulars specified in Section 184(1) relating to his concern or interest in the other associations which are required to be included in the register or such other information relating to himself as may be prescribed.
- (vi) **Register to be kept at registered office [Section 189(3)]:** The register shall be kept at the registered office of the company and it shall remain open for inspection at such office during business hours.
- (vii) **Preservation and custody:** According to Rule 16 (3), the register shall be preserved permanently and shall be kept in the custody of the Company Secretary or any other person authorised by the Board for the purpose.
- (viii) **Extracts from register [Section 189(3) and Rule 16 (4)]:** The company shall provide extracts from such register to a member of the company on his request, within seven days from the date on which such request is made upon the payment of such fee as may be specified in the articles of the company, subject to a maximum of ₹10 per page.
- (ix) **Register to be produced at AGM [Section 189(4)]:** The register shall be produced at the commencement of every annual general meeting (AGM). It shall remain open and accessible during the continuance of the meeting to any person having the right to attend the meeting. Thus, even a proxy has a right to inspect the Register.
- (x) **Exceptions [Section 189(5)]:** Section 189(1) shall not apply to any contract or arrangement *i.e.* the particulars of a contract or arrangement shall not be entered in the Register-
- (a) if it is for the **sale, purchase or supply of any goods, materials or services** and the value of such goods and materials or the cost of such services **does not exceed ₹ 5,00,000 in the aggregate in any year;** or

- (b) if it is entered into by a **banking company for the collection of bills** in the ordinary course of its business.
- (xi) **Penalty for contravention [Section 189(6)]**: Every director who fails to comply with the provisions of Section 189 regarding maintenance of 'Register of contracts or arrangements in which directors are interested' and the Rules made there under shall be liable to a penalty of ₹ 25,000.

*In respect of a **Section 8 company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, the provisions of Section 189 shall apply only if the transaction with reference to Section 188 on the basis of terms and conditions of the contract or arrangement **exceeds one lakh rupees**. [Notification No. G.S.R. 466(E), dated 5th June 2015 as amended by Notification No. G.S.R. 584 (E), dated 13th June, 2015.]*



19. CONTRACT OF EMPLOYMENT WITH MANAGING OR WHOLE-TIME DIRECTORS [SECTION 190]

A Company may enter into a contract of employment with managing or whole-time directors. Section 190 of the Act contains provisions relating to keeping of such contract of employment. These provisions are stated as under:

- (i) **Maintenance of copy of contract of employment**: Every company shall keep at its registered office,—
- (a) **where a contract of service with a managing or whole-time director is in writing**, a copy of the contract; or
 - (b) **where such a contract is not in writing**, a written memorandum setting out its terms.
- (ii) **Inspection**: The copies of the contract or the memorandum shall be open to inspection by any member of the company without payment of fee.
- (iii) **Penalty for non-compliance [Section 190 (3)]**: If any default is made in complying with Section 190, the penalty shall be as under:
- **Company**: liable to a penalty of ₹ 25,000 for each default
 - **Every defaulting officer**: liable to a penalty of ₹ 5,000 for each default.
- (iv) **Exception [Section 190 (4)]**: The provisions of Section 190 shall not apply to a **private company**.



20. PAYMENT TO DIRECTOR FOR LOSS OF OFFICE, ETC., IN CONNECTION WITH TRANSFER OF UNDERTAKING, PROPERTY OR SHARES [SECTION 191]

Section 191 of Act, applicable to all companies, contains provisions which regulate payment to the directors for loss of office, etc., in connection with transfer of undertaking, property or shares by a company. These provisions are discussed as under:

- (i) **No compensation except after specific disclosures and after approval of payment proposal by members:** Section 191(1) enumerates happening of certain specific events in relation to a company and also states, *inter-alia*, whether or not any director of that company shall receive compensation, etc. on happening of such events. These events are given as under:
- (a) the **transfer** of the whole or any part of any **undertaking or property** of the company; or
 - (b) the **transfer** to any person of all or any of the **shares** in a company being a transfer resulting from—
 - (i) an offer made to the general body of shareholders.
 - (ii) an offer made by or on behalf of some other body corporate with a view to a company becoming a subsidiary company of such body corporate or a subsidiary company of its holding company;
 - (iii) an offer made by or on behalf of an individual with a view to his obtaining the right to exercise, or control the exercise of, not less than 1/3rd of the total voting power at any general meeting of the company; or
 - (iv) any other offer which is conditional on acceptance to a given extent,

Disclosure of particulars and approval in general meeting: In connection with above events, a **director of a company** shall not receive any payment **unless** particulars as may be prescribed (*refer Rule 17 below*) with respect to the payment proposed to be made by the transferee or person, including the amount thereof, have been disclosed to the members of the company and the proposal has been approved by the company in general meeting.

Subject to the conditions of disclosure and approval as mentioned above, a director of a company may receive payment:

- by way of compensation for loss of office, or
- as consideration for retirement from office, or
- in connection with such loss or retirement from such company, or

- from the transferee of such undertaking or property, or
- from the transferees of shares or
- from any other person, not being such company.

According to **Rule 17 (1)** of the Companies (Meetings of Board and its Powers) Rules, 2014, the specified particulars which need to be disclosed to the members of the company for approving the proposal by passing a resolution at a general meeting are as under:

- (a) name of the director;
 - (b) amount proposed to be paid;
 - (c) event due to which compensation becomes payable;
 - (d) date of Board meeting recommending such payment;
 - (e) basis for the amount determined;
 - (f) reason or justification for the payment;
 - (g) manner of payment - whether payable in cash or otherwise and how;
 - (h) sources of payment; and
 - (i) any other relevant particulars as the Board may think fit.
- (ii) **Payment lawful if within prescribed limits [Section 191 (2)]:** Any payment made by a company to a MD or WTD or manager of the company by way of compensation for loss of office or as consideration for retirement from office or in connection with such loss or retirement shall be considered as lawful if it is subject to limits or priorities as prescribed in Rule 17 (2) of the Companies (Meetings of Board and its Powers) Rules, 2014.

According to Rule 17 (2), such payment, to be lawful, shall not exceed the limit as set out under Section 202.

- (iii) **No compensation payable under specific circumstances:** According to Rule 17 (3), no compensation shall be paid to the MD or WTD or manager of the company for the loss of office or as consideration for retirement from office (except 'notice pay' and 'statutory payments' according to the terms of their appointment) or in connection with such loss or retirement if:
- (a) the **company is in default** in repayment of **public deposits or payment of interest thereon**;
 - (b) the company is in default in **redemption of debentures** or payment of interest thereon;
 - (c) the company is in default in **repayment of any liability**, secured or unsecured, payable to any bank, public financial institution or any other financial institution;

- (d) the company is in default in **payment of any dues towards** income tax, VAT, excise duty, service tax or any other tax or duty, by whatever name called, payable to the Central Government or any State Government, statutory authority or local authority (other than in cases where the company has disputed the liability to pay such dues);
 - (e) there are **outstanding statutory dues to the employees or workmen** of the company which have not been paid by the company (other than in cases where the company has disputed the liability to pay such dues); and
 - (f) the company has **not paid dividend** on preference shares or not redeemed preference shares on due date.
- (iv) **Payment proposal cannot be taken as approved if no quorum present [Section 191 (3)]:** If the payment is not approved for want of quorum either in a meeting or an adjourned meeting, the proposal shall not be deemed to have been approved.
- (v) **Receipt of payment in contravention of Section 191 (1) [Section 191 (3)]:** In case a director of a company receives payment of any amount in contravention of Section 191 (1) or the proposed payment is made before it is approved in the meeting, the amount so received by the director shall be deemed to have been received by him in trust for the company.
- In other words, the director shall not own such amount but keep it as trustee of the company.
- (vi) **Penalty for non-compliance [Section 191 (5)]:** If a director of the company makes any default in complying with the provisions of Section 191, he shall be liable to a penalty of **one lakh rupees**.
- (vii) **No effect on disclosures [Section 191 (6)]:** Section 191 shall not be taken to prejudice the operation of any law requiring disclosure to be made with respect to any payment received under Section 191 or such other like payments made to a director. In other words, if required by any law, the disclosures regarding any payment of compensation shall be made.

Note: Due to the notifying of Section 247 (1) w.e.f. 18-10-2017, the valuation of stocks, shares, debentures, securities, etc. will be conducted by a Registered Valuer as appointed by the Audit Committee or in its absence by the Board of Directors. Before this, it was being conducted by an independent merchant banker registered with SEBI or an independent chartered accountant in practice having a minimum experience of ten years.

21. RESTRICTION ON NON-CASH TRANSACTIONS INVOLVING DIRECTORS [SECTION 192]

Section 192 of the Act places restrictions on the non-cash transactions involving directors and the company or *vice-versa*. The provisions of Section 192 also operate if non-cash transactions involve

a person who is a director of the company's holding, subsidiary or ²⁶associate company. A person connected with any such director is also included. These provisions are discussed as under:

- (i) **Restriction on acquiring assets for consideration other than cash:** According to Section 192 (1), no company shall enter into an arrangement by which—
 - (a) **a director of the company or its holding, subsidiary or associate company or a person connected with him acquires** or is to acquire assets for consideration other than cash, from the company; or
 - (b) **the company acquires** or is to acquire assets for consideration other than cash, from such director or person so connected.
- (ii) **Relaxation of restriction:** The above restriction shall be relaxed *i.e.* the company may enter into an arrangement involving non-cash transactions as stated in clause (i) above, if prior approval for such arrangement is accorded by a resolution of the company in general meeting.

Where the director or connected person is a director of its holding company, approval shall also be required to be obtained by passing a resolution in general meeting of the holding company.
- (iii) **Contents of notice issued for approval of resolution:** The notice for approval of the resolution in general meeting issued by the company or holding company shall include the particulars of the arrangement. It shall also include the value of the assets involved in such arrangement duly calculated by a registered valuer.
- (iv) **What happens if Section 192 is contravened:** Any arrangement entered into by a company or its holding company in contravention of the provisions of Section 192 shall be voidable at the instance of the company. The arrangement shall not be voidable;
 - (a) if the restitution of any money or other consideration which is the subject-matter of the arrangement is no longer possible and the company has been indemnified by any other person for any loss or damage caused to it; or
 - (b) if any rights are acquired *bona fide* for value and without notice of the contravention of the provisions of this section (*i.e.* Section 192) by any other person.

²⁶ An associate company is defined by Section 2 (6) of the Act. Accordingly, an 'associate company' in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation: For the purpose of this clause,

- (a) the expression 'significant influence' means control of at least 20% of total voting power, or control of or participation in business decisions under an agreement;
- (b) the expression 'joint venture' means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.



22. CONTRACTS BY ONE PERSON COMPANY (OPC) [SECTION 193]

Section 193 of Act contains provisions in respect of contracts entered into by a One Person Company (OPC) which is limited by shares or by guarantee. This section becomes applicable when such OPC enters into a contract with its sole member who is also its director. Section 193 operates in the following manner:

- (i) Preferably, such contract should be in **writing**.
- (ii) If not in writing, the OPC shall ensure that the **terms of the contract or offer are contained in a memorandum or are recorded in the minutes** of the first meeting of the Board of Directors of the company held next after entering into contract.
- (iii) **Exception:** If the contracts are entered into by the company in the ordinary course of its business then provisions of Section 193 are not applicable.
- (iv) **Submission of information to the registrar:** The company shall inform the Registrar about every such contract entered into by the company and recorded in the minutes of the meeting of its Board of Directors. This shall be done within a period of 15 days of the date of approval by the Board.

TEST YOUR KNOWLEDGE**Multiple Choice Questions**

1. *Chetan Motorboats Limited, incorporated on 25th June, 2019 is desirous of making donations to a reputed political party. Out of the following options, choose the one which correctly depicts as to when Chetan Motorboats Limited shall be eligible to make such donations to a political party:*
 - (a) *Chetan Motorboats Limited shall be eligible to make donations to a political party after one year from the date of its incorporation.*
 - (b) *Chetan Motorboats Limited shall be eligible to make donations to a political party after two years from the date of its incorporation.*
 - (c) *Chetan Motorboats Limited shall be eligible to make donations to a political party after three years from the date of its incorporation.*
 - (d) *Chetan Motorboats Limited shall be eligible to make donations to a political party after five years from the date of its incorporation.*

2. *Out of the total strength of six Directors of SQ Transformers Limited, five are attending a Board Meeting to consider the investment of funds of the company. The resolution relating to investment shall be taken as passed in which of the following cases:*
 - (a) *When all the five Directors of SQ Transformers Limited attending the meeting consent to such investment of funds.*
 - (b) *When any four Directors of SQ Transformers Limited out of five attending the meeting consent to such investment of funds.*
 - (c) *When any three Directors of SQ Transformers Limited out of five attending the meeting consent to such investment of funds.*
 - (d) *Investment proposal must be consented to by the total strength of six Directors of SQ Transformers Limited.*

3. *The Board of Directors of Shanta Hospitality Services Limited is desirous of contributing certain amount to Ashirwad Dharmarth Sansthan, a bona fide charitable organization operating in the National Capital Region, during the financial year 2021-2022. The profits and losses of the earlier five financial years are as under:*

Year	Profit/ (Loss)
2020-2021	(30,00,000)
2019-2020	1,80,00,000
2018-2019	2,10,00,000
2017-2018	1,85,00,000
2016-2017	1,40,00,000

From the following four options, select the appropriate one which indicates the amount that the Board of Directors of Shanta Hospitality Services Limited can contribute to Ashirwad Dharmarth Sansthan:

- (a) The Board of Directors of Shanta Hospitality Services Limited cannot contribute any amount to Ashirwad Dharmarth Sansthan in the financial year 2021-2022 since it suffered losses of Rs. 30,00,000 in the immediate previous financial year 2020-2021.
 - (b) The Board of Directors of Shanta Hospitality Services Limited can contribute maximum of Rs. 9,00,000 to Ashirwad Dharmarth Sansthan in the financial year 2021-2022.
 - (c) The Board of Directors of Shanta Hospitality Services Limited can contribute maximum of Rs. 6,00,000 to Ashirwad Dharmarth Sansthan in the financial year 2021-2022.
 - (d) The Board of Directors of Shanta Hospitality Services Limited can contribute maximum of Rs. 3,00,000 to Ashirwad Dharmarth Sansthan in the financial year 2021-2022.
4. A seven days' notice of the Board Meeting was served on all the ten directors of Goodluck Publishers Limited by sending it on their registered postal addresses. However, before the holding of scheduled Board Meeting, some unavoidable happenings took place. Mr. M was hospitalised because of serious stomach pain just two days before the Meeting. Mr. Y proceeded to London since his son met with an accident and the incidence required his immediate presence. As scheduled earlier, Mr. X and Mr. B went to Australia for attending a technical seminar that would help improving the existing publishing techniques. Mr. A, extremely busy in finalizing the arrangements relating to his daughter's marriage, was also unable to attend the impending board meeting. A day before the board meeting, Mr. E's grand-mother got hospitalised and therefore, he was involved in taking care of her but he assured to attend the meeting through video conferencing. Mr. P was scheduled to arrive for the meeting by 2 p.m. on the same day of the meeting but his flight got delayed by eight hours. Mr. D, Mrs. G and Mr. H were in the town and were available for the Board Meeting. Could the Board Meeting be held as per the scheduled time?

- (a) *The Board Meeting cannot be held because minimum sixty percent directors (i.e. 6 out of 10) must attend it at the scheduled time to complete the quorum.*
 - (b) *The Board Meeting cannot be held because minimum fifty percent directors (i.e. 5 out of 10) must attend it at the scheduled time to complete the quorum.*
 - (c) *Since the quorum is complete, the available directors can hold the Board Meeting as per the schedule.*
 - (d) *The Board Meeting cannot be held because minimum seventy percent directors (i.e. 7 out of 10) must attend it at the scheduled time to complete the quorum.*
5. *Seafood Marketing Limited, incorporated on 1st April, 2019, conducted four Board Meetings during the Financial Year 2019-20 i.e. on 6th April, 2019, 28th August, 2019, 30th September, 2019 and 30th March, 2020. Select the correct option from those given below as to whether there is contravention of provisions or not regarding frequency of holding the Board Meetings by Seafood Marketing Limited:*
- (a) *There is no contravention of the provisions relating to holding of Board Meetings because four Board Meetings have been held by Seafood Marketing Limited during the Financial Year 2019-20.*
 - (b) *There is no contravention of the provisions relating to holding of Board Meetings by Seafood Marketing Limited because the first Board Meeting was held within 30 days of the incorporation of the company.*
 - (c) *There is contravention of provisions in respect of conduct of the Board Meetings by Seafood Marketing Limited because gap between initial two consecutive Board Meetings (held on 6th April, 2019 and 28th August, 2019) is 143 days and further, gap between next two consecutive Board Meetings (held on 30th September, 2019 and 12th March, 2020) is 163 days.*
 - (d) *There is contravention of provisions in respect of conduct of the Board Meetings by Seafood Marketing Limited because gap between initial two consecutive Board Meetings (held on 6th April, 2019 and 28th August, 2019) is 123 days and further, gap between next two consecutive Board Meetings (held on 30th September, 2019 and 12th March, 2020) is 143 days.*

Descriptive Questions

1.
 - (i) *What is the procedure to be followed, when a board meeting is adjourned for want of quorum?*
 - (ii) *How is a resolution by circulation passed by the Board or its Committee?*
2. *Mr. P and Mr. Q who are the directors of C-Tech Limited informed the company about their inability to attend the Board meeting because the notice thereof was not served on them.*

Discuss whether there is any default on the part of C-Tech Limited and the consequences thereof.

3. *A director goes abroad for a period of more than 3 months and an alternate director has been appointed in his place under Section 161(2). During the period of absence of the original director, a board meeting was called. In this connection, with reference to the provisions of the Companies Act, 2013, advise who should be given the notice of Board meeting i.e. the “original director” or the “alternate director”?*
4. *Examine with reference to the provisions of the Companies Act, 2013 whether notice of a Board Meeting is required to be sent to the following persons:*
 - (i) *An interested Director;*
 - (ii) *A Director who has expressed his inability to attend a particular Board Meeting;*
 - (iii) *A Director who has gone abroad (for less than 3 months).*
5. *Out of the powers exercisable by the Board under Section 179 of the Companies Act, 2013, the Board of MN Limited wants to delegate the power to borrow monies otherwise than on debentures to the Managing Director. Advise whether such a delegation is possible? Would your answer be different, if the delegation is made to the manager or any other principal officer including a branch officer of the company?*
6. *Advise the Board of Director of Spectra Papers Ltd. regarding validity and extent of its powers, under the provisions of the Companies Act, 2013 in relation to the following matters:*
 - (i) *Buy-back, for the first time, the shares of the Company upto 10% of the paid-up equity share capital without passing a special resolution.*
 - (ii) *Delegation of power to the Managing Director so that he can invest surplus funds of the company in the shares of some other companies.*
7. *An Audit Committee of a listed company constituted under Section 177 of the Companies Act, 2013, submitted its report containing the recommendations in respect of certain matters to the Board. The Board, however, did not accept the recommendations. In the light of the situation, analyze whether:*
 - (a) *The Board is empowered not to accept the recommendations of the Audit Committee.*
 - (b) *If so, what alternative course of action, would the Board resort to?*
8. *MNC Ltd., a company, whose paid up capital was ` 8.00 crore, has issued right shares in the ratio of 1:1. The said company is listed with Mumbai Stock Exchange. Whether the company is required to appoint any Audit Committee and if yes, draft a suitable Board Resolution to appoint an Audit committee covering the aspects as provided in the Companies Act, 2013.*
9. *The Balance Sheets of last three years of PTL Ltd., contain the following information and figures:*

	As at 31.03.2017	As at 31.03.2018	As at 31.03.2019
	₹	₹	₹
Paid up capital	50,00,000	50,00,000	75,00,000
General Reserve	40,00,000	42,50,000	50,00,000
Credit Balance in Profit & Loss Account	5,00,000	7,50,000	10,00,000
Debenture Redemption Reserve	15,00,000	20,00,000	25,00,000
Securities Premium	2,00,000	2,00,000	2,00,000
Secured Loans	10,00,000	15,00,000	30,00,000

On going through other records of the Company, the following is also determined:

Net Profit for the year (as calculated in accordance with the provisions of the Companies Act, 2013)	12,50,000	19,00,000	34,50,000
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In the ensuing Board Meeting scheduled to be held on 5th September, 2019, among other items of agenda, following items are also appearing:

- (i) To decide about borrowing from financial institutions on long-term basis.
- (ii) To decide about contributions to be made to charitable funds.

Based on above information, you are required to find out as per the provisions of the Companies Act, 2013, the amount upto which the Board can borrow from Financial institution and the amount upto which the Board of Directors can contribute to Charitable funds during the financial year 2019-20 without seeking the approval in general meeting.

10. Following data relates to Prince Company Limited:

Authorised Capital (Equity Shares)	₹ 100 crore
Paid – up Share Capital	₹ 40 crore
General Reserves	₹ 20 crore
Debenture Redemption Reserve	₹ 10 crore
Provision for Taxation	₹ 5 crore
Securities premium	₹ 2 crore
Loan (Long Term)	₹ 10 crore
Short Term Creditors	₹ 3 crore

Board of Directors of the company by a resolution passed at its meeting decided to borrow an additional sum of ` 90 crore from the company's Bankers. Being the company's financial advisor, you are required to advise the Board of Directors regarding the procedure to be followed in this respect under the Companies Act, 2013.

11. One of the Objects Clauses of the Memorandum of Association of Info Limited conferred upon the company power to sell its undertaking to another company with identical objects. Company's Articles also conferred upon the directors whereby power was conferred upon them to sell or otherwise deal with the property of the company. At an Extraordinary General Meeting of the company, members passed an ordinary resolution for the sale of its assets on certain terms and authorized the directors to carry out the sale. Directors refused to comply with the wishes of the members whereupon it was contended on behalf of the members that they were the principals and directors being their agents, were bound to give effect to their (members') decisions.

Examining the provisions of the Companies Act, 2013, answer the following:

Whether the contention of members against the non-compliance of members' decision by the directors is tenable?

Whether it is possible for the members to usurp the powers which by the Articles are vested in the directors by passing a resolution in the general meeting?

12. (i) R Ltd. wants to constitute an Audit Committee. Draft a board resolution covering the following matters [compliance with Companies Act, 2013 to be ensured].
- (1) Members of the Audit Committee
 - (2) Chairman of the Audit Committee
 - (3) Any 2 functions of the said Committee
- (ii) What would be the minimum likely turnover or capital of this company?
- (iii) What is the role of the Audit Committee vis-a-vis the statutory auditor when the company wishes to engage them to perform certain engagements which are not restricted under Section 144?

ANSWERS

Answer to Multiple Choice Questions

1.	c	2.	a	3.	c	4.	c	5.	c
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Answer to Descriptive Questions

1. (i) Section 174(4) of the Companies Act, 2013 provides that, if a Board meeting could not

be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned to the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a national holiday, at the same time and place.

- (ii) (a) The Companies Act, 2013 permits a decision of the Board of Directors to be taken by means of a resolution by circulation. Board's approvals can be taken in two ways - one, by a resolution passed at a Board Meeting and the other, by means of a resolution passed by circulation.

In terms of Section 175(1) of the Companies Act, 2013 no resolution shall be deemed to have been duly passed by the Board or by a committee thereof by circulation, unless the following provisions have been complied with:

- (1) the resolution has been circulated in draft, together with the necessary papers, if any,
- (2) the draft resolution has been circulated to all the directors, or members of the committee, as the case may be;
- (3) the Draft resolution has been sent at their addresses registered with the company in India;
- (4) such delivery has been made by hand or by post or by courier, or through prescribed electronic means;

Rule 5 of the *Companies (Meetings of Board and its Powers) Rules, 2014* provides that a resolution in draft form may be circulated to the directors together with the necessary papers for seeking their approval, by electronic means which may include E-mail or fax.

- (5) such resolution has been approved by a majority of the directors or members, who are entitled to vote on the resolution;
- (b) However, if at least 1/3rd of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the Chairperson shall put the resolution to be decided at a meeting of the Board (instead of being decided by circulation).
- (c) A resolution that has been passed by circulation shall have to be necessarily noted in the next meeting of Board or the Committee, as the case may be, and made part of the minutes of such meeting.
2. Under section 173(3) of the Companies Act, 2013 a meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Section 173(4) further provides that every officer of the company whose duty is to give notice under this section and who fails to do so shall be liable to a penalty of ₹ 25,000.

In the given case, as no notice was served on Mr. P and Mr. Q who are the directors of C-Tech Limited, every officer responsible for such default in serving notice shall be punishable with fine of ₹ 25,000 as required by Section 173 (4).

Neither the Companies Act, 2013 nor the Companies (Meetings of the Board and its Powers) Rules, 2014 lay down any specific provision regarding the validity of a resolution passed by the Board of Directors in case notice was not served to all the directors. The Companies Act, 2013 clearly provide for the notice to be sent to every director. The Supreme Court, in case of *Parmeshwari Prasad vs. Union of India (1974)* has held that the resolutions passed in the board meeting shall not be valid, since notice to all the Directors was not given in writing. Hence, even though the directors concerned knew about the Board meeting, the meeting shall not be valid and resolutions passed thereat also shall not be valid.

3. According to Section 161(2) of the Companies Act, 2013, the Board of Directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint a person, not being a person holding any alternate directorship for any other director in the company or holding directorship in the same company, to act as an alternate director for a director during his absence for a period of not less than three months from India.

According to Section 173(3), a meeting of the Board may be called by giving at least 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

There is no legal precedence whether the notice of the meeting is to be sent to the original director or the alternate director. But as a matter of prudence such notice may be served to both the alternate director as well as the original director who is for the time being outside India.

4. Notice of Board meeting

- (i) **Interested director:** Section 173(3) of the Companies Act, 2013 makes it mandatory that every director needs to be given proper notice of every board meeting. It is immaterial whether a director is interested or not. In case of an interested director, notice must be given to him even though in terms of Section 184 (2) he is precluded from participation *i.e.* engaging himself in discussion or voting at the meeting on the business in which he is interested.
- (ii) **A Director who has expressed his inability to attend a particular Board Meeting:** In terms of section 173(3) even if a director states that he will not be able to attend the next Board meeting, notice must be given to that director also.
- (iii) **A director who has gone abroad:** A director who has gone abroad is still a director. Therefore, he is entitled to receive notice of board meetings during his stay abroad.

The Companies Act, 2013, allows delivery of notice of meeting by electronic means also i.e. through e-mail. This factor carries weight because the Companies Act, 2013 permits a director to participate in a meeting by video conferencing or any other audio-visual means also, in addition to physical presence.

5. Under section 179(3) of the Companies Act, 2013, the Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board:
- (a) To make calls on shareholders in respect of money unpaid on their shares;
 - (b) To authorise buy-back of securities under section 68;
 - (c) To issue securities, including debentures, whether in or outside India;
 - (d) To borrow monies;
 - (e) To invest the funds of the company;
 - (f) To grant loans or give guarantee or provide security in respect of loans;
 - (g) To approve financial statement and the Board's report;
 - (h) To diversify the business of the company;
 - (i) To approve amalgamation, merger or reconstruction;
 - (j) To take over a company or acquire a controlling or substantial stake in another company;
 - (k) Any other matter which may be prescribed.

Provided that the Board may, by a resolution passed at a meeting, delegate to any Committee of Directors, the Managing Director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in clauses (d) to (f) on such conditions as it may specify.

From the foregoing provisions, it is clear that the Board of MN Limited shall be perfectly in order if it delegates the power to borrow monies under clause (d) of Section 173 (3) to the Managing Director or to the manager or any other principal officer.

6. (i) According to clause (b) of Section 179(3), The Board of Directors of a company shall exercise the power to authorize buy-back of securities under section 68, on behalf of the company by means of resolutions passed at meetings of the Board.

According to Section 68(2), no company shall purchase its own shares or other specified securities, unless—

- (a) the buy-back is authorised by its articles;
- (b) a special resolution has been passed at a general meeting of the company authorising the buy-back:

However, nothing contained in this clause shall apply to a case where—

- (1) the buy-back is, 10% or less of the total paid-up equity capital and free reserves of the company; and
- (2) such buy-back has been authorised by the Board by means of a resolution passed at its meeting,

From the foregoing provisions, it is clear that in case a company, for the first time, resorts to buy-back of its own shares, when the buy-back is limited to 10% of its paid-up share capital, a special resolution will not be required if such buy-back has been authorised by the Board by means of a resolution passed at its meeting. Thus, the Board of Director of Spectra Papers Ltd. is empowered to buy-back the shares because the buy-back is limited to 10% of the paid-up share capital, by means of a resolution passed at the Board meeting.

- (ii) According to clause (e) of Section 179(3), the Board of Directors of a company shall exercise the power to invest the funds of the company, on behalf of the company by means of resolutions passed at the meetings of the Board.

The Board may, under the Proviso to Section 179(3), delegate the power to invest the funds of the company through a board resolution passed at a duly convened Board Meeting. However, the investment in shares of other companies will also be governed by a specific provision contained in Section 186(5), according which no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

Thus, a unanimous resolution of the Board is required. Further, Section 186 does not provide for delegation. Hence, the proposed delegation of power to the Managing Director to invest surplus funds of the company in the shares of some other companies, is not in order.

7. (a) According to Section 177(8) of the Companies Act, 2013, the Board's Report shall, under the provisions of Section 134 (3) which is laid before the general meeting where the financial statements of the company are placed before the members, disclose the composition of the Audit Committee and where the Board has not accepted any recommendations of the Audit Committee, the same shall also be disclosed along with the reasons therefor. Hence, the Board is empowered not to accept the recommendations of the Audit Committee but only under genuine circumstances and supported by legitimate reasons for non-acceptance.

(b) If the Board does not accept the recommendations of the Audit Committee, it shall disclose the same in its report under section 134 (3) which is placed before the general meeting of the company.

8. Under section 177(1) of the Companies Act, 2013 the Board of Directors of every listed public company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee. Therefore, MNC Ltd. being a listed company will be bound to constitute an Audit Committee under the Act.

Further under section 177(2) the Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.

Further, majority of the members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.

The draft Board Resolution for the constitution of an Audit Committee may be as follows:

“Resolved that pursuant to the provision contained in section 177 of the Companies Act 2013 and the applicable clause of Listing Agreement with the Mumbai Stock Exchange, an Audit Committee of the Company be and is hereby constituted with effect from the conclusion of this meeting, with members as under:

1. Mr. A -- An Independent Director.
2. Mr. B -- An Independent Director
3. Mr. C – An Independent Director
4. Mr. D -- An Independent Director
5. Mr. FE -- Financial Executive
6. Mr. MD -- Managing Director

Further resolved that the Chairman of the Committee, who shall be an Independent Director, be elected by the committee members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit Committee shall be the chairman of the Audit Committee and 2 other members (other than the Managing Director),.

Further resolved that the terms of reference of the Audit Committee shall be in accordance with the provisions of section 177(4) of the Companies Act, 2013.

Further resolved that the Audit committee shall conduct discussions with the auditors periodically about internal control system, the scope of audit including the observations of the auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations, if any.

Further resolved that the recommendations made by the Audit Committee on any matter relating to financial management including the audit report shall be binding on the Board. However, where such recommendations are not accepted by the Board, the reasons for the same shall be recorded in the minutes of the Board meeting and communicated to the shareholders.

Further resolved that the Company Secretary of the Company shall be the Secretary to the Audit Committee.

Further resolved that the Chairman of the Audit Committee shall attend the annual general meeting of the Company to provide any clarifications on matters relating to audit as may be required by the members of the company.

Further resolved that the Board's Report/Annual Report to the members of the Company shall include the particulars of the constitution of the Audit Committee and the details of the non-acceptance of any recommendations of the Audit Committee with reasons therefor."

9. (i) **Borrowing from Financial Institutions:** As per Section 180(1)(c) of the Companies Act, 2013, the Board of Directors of a company, without obtaining the approval of shareholders in a general meeting, can borrow money including moneys already borrowed upto an amount which does not exceed the aggregate of paid up capital of the company, free reserves and securities premium. Such borrowing shall not include temporary loans obtained from the company's bankers in the ordinary course of business. Here, free reserves do not include the reserves set apart for specific purpose.

Since the decision to borrow is to be taken in a meeting to be held on 5th September, 2019, the figures relevant for this purpose are the figures as per the Balance Sheet as at 31.03.2019. According to the above provisions, the Board of Directors of PTL Ltd. can borrow, without obtaining approval of the shareholders in a general meeting, upto an amount calculated as follows:

Particulars	₹
Paid up Capital	75,00,000
General Reserve (being free reserve)	50,00,000
Credit Balance in Profit & Loss Account (to be treated as free reserve)	10,00,000
Debenture Redemption Reserve (This reserve is not to be considered since it is kept apart for specific purpose of debenture redemption)	---
Securities Premium	2,00,000
Aggregate of paid-up capital, free reserves and securities premium	137,00,000
Total borrowing power of the Board of Directors of the company, i.e., 100% of the aggregate of paid-up capital, free reserves and securities premium	137,00,000

Less: Amount already borrowed as secured loans	30,00,000
Amount upto which the Board of Directors can further borrow without the approval of shareholders in a general meeting.	107,00,000

- (ii) **Contribution to Charitable Funds:** As per Section 181 of the Companies Act, 2013, the Board of Directors of a company without obtaining the approval of shareholders in a general meeting, can make contributions to genuine charitable and other funds upto an amount which, in a financial year, does not exceed five per cent of its average net profits during the three financial years immediately preceding, the financial year.

According to the above provisions, the Board of Directors of the PTL Ltd. can make contributions to charitable funds, without obtaining approval of the shareholders in a general meeting, upto an amount calculated as follows:

Net Profit for the year (as calculated in accordance with the provisions of the Companies Act, 2013):

Particulars	₹
For the financial year ended 31.3.2017	12,50,000
For the financial year ended 31.3.2018	19,00,000
For the financial year ended 31.3.2019	<u>34,50,000</u>
TOTAL	<u>66,00,000</u>
Average of net profits during three preceding financial years	<u>22,00,000</u>
Five per cent thereof	<u>1,10,000</u>

Hence, the maximum amount that can be donated by the Board of Directors of PTL Ltd. to a genuine charitable fund during the financial year 2019 -2020 will be limited to ₹ 1,10,000 and the said donation shall not require seeking of approval from the shareholders at a general meeting.

10. **Borrowing by the Company (Section 180 of the Companies Act, 2013):** As per Section 180(1)(c) of the Companies Act, 2013, the Board of Directors of a company, without obtaining the approval of shareholders in a general meeting through a special resolution, can borrow the funds including funds already borrowed upto an amount which does not exceed the aggregate of the paid-up share capital, free reserves and securities premium. Such borrowing shall not include temporary loans obtained from the company's bankers in ordinary course of business.

Free reserves do not include the reserves set apart for specific purpose.

According to the above provisions, the Board of Directors of Prince Company Limited can borrow, without obtaining approval of the shareholders in a general meeting, upto an amount calculated as follows:

Particulars	₹
Paid up Share Capital	40 Crore
General Reserve (being free reserve)	20 Crore
Debenture Redemption Reserve (This reserve is not to be considered since it is kept apart for specific purpose of debenture redemption)	----
Securities Premium	2 Crore
Aggregate of paid-up share capital, free reserve and securities premium	62 Crore
Total borrowing power of the Board of Directors of the company, i.e, 100% of the aggregate of paid-up share capital, free reserves and securities premium	62 Crore
(Less: Amount already borrowed as Long term loan)	<u>(10 Crore)</u>
Amount upto which the Board of Directors can further borrow without the approval of shareholders in a general meeting.	52 Crore

In the present case, the directors of Prince Company Limited by a resolution passed at its meeting have decided to borrow an additional sum of ₹ 90 Crore from the company's bankers. Apparently, the proposed borrowing will be beyond the powers of the Board of Directors.

The management of Prince Company Limited, therefore, should take steps to convene the general meeting and pass a special resolution by the members in the meeting as stated in Section 180(1)(c) of the Companies Act, 2013. Then only, the proposed borrowing of ₹ 90 crore will be valid and binding on the company and its members.

- 11. Powers of Board:** In accordance with the provisions of the Companies Act, 2013, as contained under Section 179(1), 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 authorized to exercise and do:

Provided that in exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder including regulations made by the company in general meeting.

Provided further that the Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the members or articles of the company or otherwise to be exercised or done by the company in general meeting.

Section 180 (1) of the Companies Act, 2013, specifies the powers which the Board of Directors of a company shall exercise only with the consent of the company by a special resolution. Clause (a) of Section 180 (1) defines one such power as the power to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the

company or where the company owns more than one undertaking of the whole or substantially the whole or any of such undertakings.

Therefore, the sale of the undertaking of a company can be made by the Board of Directors only with the consent of members of the company accorded by passing a special resolution.

Even if the power is given to the Board by the memorandum and articles of the company, the sale of the undertaking must be approved by the shareholders in general meeting by passing a special resolution.

Therefore, the correct procedure to be followed is for the Board to approve the sale of the undertaking clearly specifying the terms of such sale and then convene a general meeting of members to have the proposal approved by a special resolution.

In the given case, the procedure followed is completely incorrect and violative of the provisions of the Companies Act, 2013. The shareholders cannot on their own make out a proposal of sale and pass an ordinary resolution to implement it through the directors.

The contention of the shareholders is incorrect in the first place as it is not within their authority to approve a proposal independent of the Board of Directors. It is for the Board to approve a proposal of sale of the undertaking and then let the members to approve it by a special resolution. Accordingly, the contention of the members that they were the principals and the directors as their agents were bound to give effect to the decisions of the members is not correct.

Further, in exercising their powers the directors do not act as agent for the majority of members or even for all the members. The members therefore, cannot by resolution passed by a majority or even unanimously supersede the powers of directors or instruct them how they shall exercise their powers. The shareholders have, however, the power to alter the Articles of Association of the company in the manner they like subject to the provisions of the Companies Act, 2013.

12. (i) Audit Committee – Board’s Resolution:

“Resolved that pursuant to Section 177 of the Companies Act, 2013, an Audit Committee consisting of the following Directors be and is hereby constituted.

1. Mr. ---- Independent Director
2. Mr. ---- Independent Director
3. Mr. ----Independent Director
4. Mr. ---- Independent Director
5. Mr. ---- Managing Director.
6. Mr. ---- Chief Financial Officer”

“Further resolved that the Chairman of the Audit Committee shall be elected by its members from amongst themselves and shall be an independent director”.

“Further resolved that the quorum for a meeting of the Audit committee shall be three directors (other than the Managing Director), out of which at least two must be independent directors”.

“Resolved further that the Audit Committee shall perform all the functions as laid down in section 177(4) of the Companies Act, 2013 including but not limited to:

- a. make the recommendation for appointment, remuneration and terms of appointment of the auditors of the company;
- b. review and monitor the independence and performance of auditors of the company and the effectiveness of the audit process”.

“Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations if any”.

- (ii) Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014 states that every listed public company and a company covered under Rule 4 of Companies (Appointment and Qualification of Directors) Rules, 2014 shall constitute an Audit Committee. Rule 4 has prescribed the following classes of companies to constitute an Audit Committee:

- (a) public companies having a paid-up share capital of 10 crore rupees or more;
- (b) public companies having turnover of 100 crore rupees or more;
- (c) public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

Hence, in the given case, the likely turnover of R Ltd. shall be ₹ 100 crore or more or capital shall be ₹ 10 crore or more.

- (iii) According to section 177(5), the Audit Committee is empowered to:

- (1) call for the comments of the auditors about:
 - (A) internal control systems,
 - (B) the scope of audit, including the observations of the auditors,
 - (C) review of financial statement before their submission to the Board,
- (2) discuss any related issues with the internal and statutory auditors and the management of the company.

