

(1995) 08 KL CK 0022
In the High Court Of Kerala
Case No : C.M.A. 252 of 1994

Mukkattukara Catholic Co. Ltd. and Others

APPELLANT

Vs

H.V. Thomas and Others

RESPONDENT

Date of Decision : 23-08-1995

Acts Referred:

Companies Act, 1956 — Section 283, 299, 300

Citation : AIR 1997 Ker 51 : (1999) 96 CompCas 864

Hon'ble Judges : B.M. Thulasidas, J

Bench : Single Bench

Advocate : N. Ramachandran Nair and Antony Dominic, for the Appellant;
George Cherian and Jacob Mathew K., for the Respondent

Final Decision : Allowed

Judgement

B.M. Thulasidas, J.—Defendants 1 to 5 in O.S. No. 952 of 1994, who are also respondents 1 to 5 in I.A. No. 4552 of 1994 of the Sub-Court, Trissur, are the appellants. The first appellant is a public limited company, the second appellant is the Chairman and the others are members of the Board of Directors. The respondents/plaintiffs filed the suit (a) to declare that the meetings of the Board of Directors of the first defendant company held on 9-6-1994, 26-6-1994 and subsequently till 26-7-1994 are illegal and invalid and the decisions taken at those meetings are ultra vires, void and non est in the eye of law and (b) to declare that the appellants 2 to 4 have vacated their office as Directors by force of Section 283 of the Companies Act, for short the Act, and to injunct them and the 5th appellant from taking any measures for the implementation of the decisions taken at the above meetings and for other consequential reliefs. By the above I.A. they sought to restrain the appellants from taking steps on the basis of the proceedings and in pursuance of the decisions taken at the Board meetings held on 9-6-94 and 26-6-1994, including the convening of the general body meeting of the company stated to be held on 27-8-1994. It was alleged that at the meeting of the Board of Directors held on 9-6-1994, only 4 out of 7

members attended, which did not constitute the required quorum and therefore the decisions taken at the meetings are invalid. In particular it was alleged that in the notice relating to the Board meeting for 9-6-1994 no reference to the subject of allotment of shares to the close relations of the Chairman and two other Directors was made, that they had also not disclosed their interest in the matter, which was clandestinely arranged with ulterior motives and against the larger interest of the company. In the notice for the meeting held on 26-7-1994 no reference was also made to the subject of holding the annual general meeting, about which they came to know only from the advertisement that appeared in the "Deepika". It was urged that appellants 2 to 4 had automatically vacated their office in view of the provisions u/s 283 read with Sections 299 and 300 of the Act for non-disclosure of their interest in the share transactions and by participating in the proceedings held on 9-6-1994.

2. The allegations were denied in the counter affidavit filed on behalf of the first defendant, where it was contended that the meeting held on 9-6-1994 was attended by all the 7 members, that the respondents, who are members of the Board declined to sign the minutes and the same had been recorded, that the decisions taken were of usual nature that pertained to registration of transfer of shares, which is a statutory obligation of the company u/s 111 of the Act. No contract or arrangement had been entered into by or on behalf of the company. It was further stated that the Directors are not interested in the transfer of shares and no disqualification as alleged had been incurred. It was submitted that the suit and the petition are misconceived. But then the court below overruled the contention and passed the impugned order by which the appellants have been restrained from taking steps to implement the decisions taken at the board meetings held on 9-6-1994 and 26-6-1994 and were also further interdicted from convening the annual general meeting pending disposal of the suit. It was submitted that the order is illegal and deserves to be set aside.

3. Heard.

4. Indeed against the 5th appellant nothing had been said. He was not involved in the transactions impugned by the respondents, whose complaint is only against appellants 2 to 4. Indeed the allegations as to the purchase/allotment of shares is not entirely warranted in view of Annexure-A, which is a copy of the schedule of the resolution for registering transfer of shares "considered at the board meeting held on 9-6-1994. It would show that only in respect of Items 1 to 5 the 4th appellant was interested. But he did not participate in the deliberations. In respect of the other transactions discussed at the meeting, the Directors had no-interest and this had been duly recorded. The general allegation that the shares held by Alukka Jose and others were transferred in the name of close relations of the appellants, who were "interested directors" prima facie seems to be unjustified.

5. Assuming that in the matter of registration of the transfer of shares held by Alukka Jose, appellants 2 to 4 were in some manner or sense involved or

interested which they did not disclose, could it be said that they had incurred a disqualification and must be held to have vacated its office as Directors, is the question that has now to be considered. No doubt, the office of a Director would become vacant if he has acted in contravention of Section 299 of the Act, under which,--

"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, by or on behalf of the company, shall disclose the nature of his concern or interest at a meeting of the Board of Directors."

Under Section 300 of the Act,--

"No director of a company, shall, as a director, take any part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement; nor shall his presence count for the purpose of forming a quorum at the time of any such discussion or vote; and if he does vote, his vote shall be void."

The word "interest" means personal interest and not official or other interest. But it is "not limited to financial interest only and may include interest arising out of fiduciary duties or closeness of relationship." In other words, the "interest" shall be an "interest" conflicting with duty as a director.

6. As held in *Firestone Tyre & Rubber Co. v. Synthetics and Chemicals Ltd.*, (1974) 44 Com Cas 377 ker,--

"This is not a technical or arbitrary rule but a rule founded upon the highest and truest principles of morality. This rule applies not only when there is a conflict of interest or conflict of interest and duty but also where there is a Conflict of two duties. It is immaterial whether the interest is a personal interest or arises out of a fiduciary capacity or whether the duty which is owed is in a fiduciary capacity. Actual conflict is also not necessary. A possibility of conflict is enough. Nor does the application of the rule depend upon the extent of the adverse interest. The interest or concern need not be direct; it may be indirect. Section 300(1) is not a disqualifying section; it is a prohibitory section. The object intended to be attained by the enactment of such prohibition is to prevent the conflict between interest and duty which might otherwise inevitably arise. The rule is one of principle which depends not at all on any corrupt means *rea* in the mind of the person holding the conflicting capacities. The rule extends to all manner of relationships.

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The prohibitions contained in Section 300(1) of the Companies Act, 1956, are prescribed in public interest and policy to safeguard the interest of the share holders."

In *Avanthi Explosives v. Principal Sub-Judge*, (1987) 1 Comp Cas 301 ker : 1986 TLR 1761 it was held:

"The obligation of a director to disclose his interest in a contract entered into or to be entered into is an obligation similar to that of a trustee. The directors are in the position of trustees according to common law and they have a fiduciary relation towards the shareholders. It is well known that the trustees will become disqualified if they have any interest adverse to that of the beneficiaries and that they have to account for any secret profit made by them. The provisions of Section 283(1)(i) of the Companies Act, 1956, are, therefore, mainly a re-enactment of the obligations of a trustee arising out of common law."

In *Narayandas Shreeram Somani Vs. The Sangli Bank Ltd.*, it was held (at page 173):

"A director of a company stands in a fiduciary position towards the company and is bound to protect its interest. He must not place himself in a position in which his personal interest conflicts with his duty. He must not vote as a director or any contract or arrangement in which he is directly or indirectly interested, unless authorised by the company's articles. Standard articles give effect to this rule of equity. In case he votes in such a case, his vote would not count towards the quorum, that is to say, the minimum number fixed for the transaction of business by a board meeting. A quorum must be a disinterested quorum."

7. There may be conflict of interests or of duties, where a director has some interest in a contract or arrangement entered into by the company or on its behalf. He cannot at the same time protect his interest as also of the company. As I understand, Section 300 of the Act does not cover a case of registration of transfer of shares where the company only performs its statutory function and is limited to contract or arrangements by or on its behalf. u/s 110 of the Act, an application for registration of transfer of shares or other interest of a member of a company may be made.

Under Sub-section (2):

"Where the application is made by the transferor and relates to partly paid shares, the transfer shall not be registered, unless the company gives notice of the application to the transferee and the transferee makes no objection to the transfer within two weeks from the receipt of the notice.

xxxxx xxxxx xxxxx ." u/s 111 of the Act,--

"(1) If a company refuses, whether in pursuance of any power of the company under its articles or otherwise, to register the transfer of, or the transmission by operation of law of the right to, any shares or interest of a member in, or debentures of, the company, it shall, within two months from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferee and the transferor or to the person giving intimation of such

transmission, as the case may be, giving reasons for such refusal."

Remedies are provided against the refusal under the other sub-clauses of that section, with which we are not concerned. What is important is that in that exercise by the company, no element of contract or arrangement within the meaning of Section 300 of the Act is involved, with respect to which there can be an "interested director" in the sense in which the expression can be understood under the Act. In this context Section 301 of the Act is relevant, and it provides:

"(1) Every company shall keep one or more registers in which shall be entered separately particulars of all contracts or arrangements to which Section 297 or Section 299 applies, including the following particulars to the extent they are applicable in each case, namely :--

- (a) the date of the contract or arrangement;
- (b) the names of the parties thereto;
- (c) the principal terms and conditions thereof;
- (d) in the case of a contract to which Section 297 applies or in the case of a contract or arrangement to which Sub-section (2) of Section 299 applies, the date on which it was placed before the Board;
- (e) the names of the directors voting for and against the contract or arrangement and the names of those remaining neutral."

By Sub-section (2), particulars of such contracts or arrangements to which Section 297, or as the case may be Sub-section (2) of Section 299 applies, shall be entered in the relevant register. Under Sub-section (3) the register aforesaid shall also specify, in relation to each director of the company, the names of the firms and bodies corporate of which notice has been given by him under Sub-section (3) of Section 299. Sub-section 3-A provides, that--

"Nothing in Sub-sections (1), (2) and (3) shall apply--

- (a) to any contract or arrangement for the sale, purchase or supply of any goods, materials or services if the value of such goods and materials or the cost of such services does not exceed one thousand rupees in the aggregate in any year; or
- (b) to any contract or arrangement (to which Section 297 or, as the case may be, Section 299 applies) by banking company for the collection of bills in the ordinary course of its business or to any transaction referred to in Clause (c) of Sub-section (2) of Section 297.

Sub-clause (4) provides for the consequence of default."

8. The facts in *Shailesh Harilal Shan and Others, etc. Vs. Matushree Textiles Limited and Others etc.*, are these (at page 22):--

"the plaintiffs complained that the 8th annual general meeting convened on

September 30, 1991 was proposed to be held beyond the statutory period contemplated u/s 166 of the Act and, therefore, the Company is not entitled to call meeting unless appropriate orders are obtained from appropriate forum seeking extension of time. The plaintiffs further claimed that notice dated September 2, 1991 and which was deemed to have been served on September 9, 1991 for convening the meeting on September 30, 1991 does not comply with the requirement of Section 171 of the Act as the duration of notice is less than 21 clear days. The plaintiffs further claimed that defendant No. 2 Santoshkumar Poddar ceased to be the Director of the Company as from January 1, 1991 and his appointment as Additional Director pursuant to the resolution of the Board of Directors was bad in law. The plaintiffs claimed that on retirement of defendant No. 2, the Board was not properly constituted as the minimum number of Directors required is 3 in number. The plaintiffs further claimed that the quorum required was two and defendant was 2 and 3 being real brothers and closely related, it was not open for defendant No. 3 to participate in the meeting for appointment of defendant No. 2. The plaintiffs claimed that the resolution appointing defendant No. 2 as additional Director was vitiated as there was no quorum required by the Act. The plaintiffs further claimed that if the appointment of defendant No. 2 was illegal and bad, the notice convening Annual General Meeting signed by defendant No. 2 is bad in law and inoperative. The plaintiffs further claimed that the company had deliberately circulated an abridged balance sheet so as to cover up the acts of misconduct, misfeasance and malfeasance indulged by defendants Nos. 2 to 4. The plaintiffs claimed that the perusal of the Auditor's report and Notes on accounts makes it clear that the substratum of defendant No. 1 has disappeared and defendants Nos. 2 to 4 are mismanaging the company".

Another suit was also instituted in respect of the 9th annual general meeting, on grounds set out in the earlier suit. The contentions were considered in detail in the light of the relevant legal precedents and the learned Judges had held:

"The Director is treated as an agent or a trustee by operation of law and not because the company or share-holders have entered into contractual relationship with the person proposed to be appointed as a Director. We are in agreement with the view expressed by the learned single Judge of Madras High Court that the appointment of Additional Director does not amount to a contract as contemplated by Section 300(1) of the Act".

They agreed with Rajagopala Ayyangar J., in *Public Prosecutor Vs. T.P. Khaitan and Others*, and observed :

"that the arrangement within the meaning of section must receive the interpretation that it must be of such a nature as would arise in the case of personal pecuniary nature in the context of the company is accurate and the expression "arrangement" must bear the meaning of it as in Sections 209 and 301 of the Act. Section 301 demands that every company shall keep one or more registers in which shall be entered separately particulars of all contracts or

arrangements and the particulars to be entered are the date of the contract or arrangement, the names of the parties thereto, the principal terms and conditions thereof etc. It is impossible to accept that the appointment of the Director amounts to an arrangement and it is required to be entered in the Register maintained by the company u/s 301 of the Act."

It was further held :

"What Section 300(1) prescribes is a contractual arrangement entered into by or on behalf of the company and it is impossible to suggest that the appointment of Additional Director is by and on behalf of the company. The section postulates that the contract or arrangement is by the company or on behalf of the company and that means that the company is one of the contracting party or party to the arrangement. The company is not a party for making appointment of a person as director, nor the appointment is on behalf of company. To accept the submission that the appointment of Additional Director amounts to contract or arrangement, it would be necessary to conclude that such a contract or arrangement is by or on behalf of the company, and it is not possible to do so. In our judgment, the contention that defendant No. 3 could not have participated in discussion or vote on the resolution to appoint defendant No. 2 as Additional Director in view of prohibition of Section 300(1), therefore, cannot be accepted."

9. In my view, the statement of law, is unexceptionable and I am in respectful agreement with the same. The decision taken to accord sanction for the transfer of shares in the names of relations of the fourth appellant did not attract the mischief of Section 299 of the Act to result in either his disqualification or of appellants 2 and 3. The contentions raised in this behalf in my view are untenable. Indeed, there was the required quorum of 3 directors when the impugned decision was taken. The court below has gone wrong in its conclusions. I am unable to sustain the impugned order and it is accordingly set aside. I. A. No. 4552 of 1994 shall stand dismissed.

10. The civil miscellaneous appeal is allowed.