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Vanshaj Jain

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*Vanshaj Jain**

Indian law provides a three-level safeguard against unfair self-dealing transactions between companies and their directors. The first consists of the requirement that a director disclose any personal interests that s/he may have in the transactions that the company enters into, and abstain from the subsequent proceedings on the transaction. The second level targets specific categories of transactions, mandating that they be carried out only with the prior approval of the Board of Directors and the Central Government. The final level of protection is aimed at a particularly dangerous transaction – loans to directors – which are regulated in a far more stringent manner than any other self-dealing transaction. This paper attempts to examine each of these three levels separately through a comparative study of the provisions of the 1956 and 2013 Companies Acts, and seeks to provide suggestions that could further the development of Indian law on the subject.

* Student of the V year of the B.A., LL.B. (Hons.) Degree at the National Law School of India University. The author can be contacted at vanshaj.j@nls.ac.in. The author is grateful to Ms. Anu Jain for her support.

Introduction

The No-Conflict rule mandates that a director, or any other fiduciary of a company, must not place himself in a position where his duties towards the company are in conflict with his own personal interests, or with his duty towards others.[1] One of the principal means by which a fiduciary can breach this duty is through 'self-dealing' – a process by which they engage in transactions with their own company, either directly or indirectly, whereby their personal, pecuniary interests conflict with the commercial interests of the company.[2] This is often problematic, as, in these circumstances, the fiduciary may give in to such personal interests, and use his position of influence within the company to ensure that it receives a deal whose outcome is less advantageous than if the transaction had been agreed to by a rational, well-informed decision maker who was independent and loyal.[3]

The above possibility may certainly lead one to believe that all self-dealing transactions ought to be prohibited. However, this would be an incorrect conclusion to draw, as it is not every form of self-dealing that harms the company. For example, a director may be the best source of a service or asset that the company wishes to acquire, and so a ban on self-dealing would cause great detriment to the company's interests. Similarly, the company may wish to avail the services that a director may offer in his professional capacity, so that he could use his experience and knowledge of the company's functioning to serve its interests better than any other professional in the field.[4] In every such case, one may observe that the possibility of self-dealing

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1 Gower & Davies' Principles of Modern Company Law 559 (9th ed. 2012).

2 Palmer's Company Law 652 (22nd ed. 1977).

3 Gore-Browne on Companies 1034 (45th ed. 2015). *Also see*, Lord Cranworth LC in Aberdeen Railway Co. v Blaikie Bros., (1843-60) All ER Rep 249 (HL): "...it is a rule of universal application that no one having such duties [fiduciary duties as an agent] to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which may possibly conflict with the interests of those whom he is bound to protect." Lord Herschell in Bray v Ford, 1896 AC 44 (HL): "It is an inflexible rule of a Court of Equity that a person in a fiduciary position, such as the respondent's, is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule."

4 Lord Herschell in *Bray* v Ford, 1896 AC 44 (HL): "But I am satisfied that it [the rule of No Conflict] might be departed from in many cases, without any breach of morality, without any wrong being inflicted, and without any consciousness of wrong-doing. Indeed, it is obvious that it might sometimes be to the advantage of the beneficiaries that their trustee should act for them professionally rather than a stranger, even though the trustee were paid for his services".

could actually provide unexpected advantages to the company. Thus, it is only when such self-dealing results in an unfair outcome that it ought to be curtailed. Consequently, the aspiration of any legal system should be to provide a procedure that prevents any conflicting interests from tainting the transaction, in order to ensure that a company receives equitable results even while engaging in transactions with its fiduciaries.[5]

In recent years, a number of writers have observed that abusive self-dealing is an important issue for corporate governance in Asian countries, and specifically, in India.[6] The reason for this can be attributed to two specific characteristics of the ownership structure in Indian companies. The first is the high concentration of shareholding in the hands of particular individuals or families, which grants them actual or effective control of the management of such a company.[7] As per a study conducted in 2007, the average BSE 100 Company had a promoter who owned more than 48% of its stake.[8] In fact, only ten of such BSE 100 companies had promoters who possessed a shareholding of less than 25%. Even if one were to observe the broader set of BSE 500 Companies, similar statistics would be found: the average promoter possesses a 49% stake, whereas less than 9% of them have a holding below 25%.[9] The second feature of Indian companies is that a large number of them are grouped together under the common control of a single shareholder or family.[10] Thus, not only are most companies effectively controlled by such promoter groups, but the same promoter group often controls a large number of firms.

Such a pattern of ownership and management creates a heightened potential for the promoter group to divert the company's profits away from the minority investors, into other companies where they possess a greater share of ownership, thereby capturing a higher share of the firm's profits than they are entitled to, while depriving the company and its shareholders of their due. Such a 'tunneling' of profits is achieved through numerous different self-dealing transactions between the promoters/directors and companies,

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5 SEALY'S CASES AND MATERIALS IN COMPANY LAW 339 (7th ed. 2010).

6 *See, generally*: Organization for Economic Co-operation & Development, *Guide on Fighting Abusive Related Party Transactions in Asia* (September 2009); Asian Corporate Governance Association, *ACGA White Paper on Corporate Governance in India* (January 2010).

7 A. Galani & N. Rehn, *Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses*, 20(2) NLSIR 134, 137 (2010).

8 S. Mathew, *Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities*, 3(1) COLUMBUS LR 800, 833 (2007).

9 *Supra*, note 8.

10 V. Umakanth, *A Cautionary Tale of the Transplant Effect on Indian Corporate Governance*, 21(1) NLSIR 1, 16 (2009).

for instance, through the provision of loans at low (or high) interest rates, or the sale of assets at prices far below (or above) market value.[11] In fact, several recent corporate scandals in India have witnessed the use of such self-dealing mechanisms, such as the ones involving Subhiksha Trading and Satyam Computer Services.[12]

Such a pervasive climate of unfair dealing between related parties, and an absence of transparency, also has harmful repercussions on the country's capital markets, by reinforcing investors' fears of potential abuse.[13] Hence, the issue of self-dealing transactions is certainly a pertinent one for the Indian legal system at present, while the nation seeks to expand its markets and attract foreign capital.

Indian law provides a three-level safeguard against unfair self-dealing transactions between companies and their directors. The first level consists of the requirement that a director disclose any personal interests that s/he may have in the transactions that the company enters into, and abstain from the subsequent proceedings on the transaction. The second level targets only specific types of transactions, and mandates the requirement of prior approval from the Board of Directors, and the Central Government. The final level of protection is aimed at a particularly dangerous transaction – that of loans to directors – which are regulated in a far more stringent manner than any other self-dealing transaction. Each of these levels is examined separately below through a comparative study of the provisions of the 1956 and 2013 Companies Acts. The paper then concludes with suggestions that could further the development of Indian law on self-dealing by examining provisions on this subject in other common law jurisdictions.

A. The Requirements of Disclosure & Abstention

The director of a company owes a fiduciary duty to the company, to act in its best interests, in a bona fide manner, and to avoid any conflict between his own interests and those of the company. When a director, acting on behalf

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11 M. Bertrand et al., *Ferreting Out Tunnelling: An Application to Indian Business Groups*, 117 QJE 121, 122 (2002).

12 *See, generally:* R. Sriram, *Why Subhiksha Trading Services Collapsed*, ECONOMIC TIMES, 25 August, 2011; M.L. Bhasin, *Corporate Accounting Fraud: A Case Study of Satyam Computers Limited*, 2(1) OPEN JOURNAL OF ACCOUNTING 26 (2013).

13 A. Asharipour, *Corporate Governance Convergence: Lessons from the Indian Experience*, 29 NWJIL 335, 364 (2009). *See also*: A. Guha, *Ownership Pattern of the Indian Corporate Sector: Implications for Corporate Governance* 1, 11, INSTI. FOR STUD. IN INDUS. DEV., Working Paper No. 2006/09 (2006) *available at* http://isidev.nic.in/pdf/wp0609.pdf; Rajesh Chakrabarti, *Corporate Governance in India - Evolution and Challenges*, 11 (2005) *available at* http://ssrn.com/abstract=649857.

of the company, enters into any arrangement or transaction with himself or with a company or firm in which he is interested, it is a rule of common law that such a transaction can be set aside by the company, even without any inquiry as to the fairness of the deal, or the extent of loss suffered by the company.[14] However, one of the defenses that can be claimed against such avoidance is that the conflicting interest in question had been disclosed to the shareholders of the company, who have assented to the transaction.[15]

The Companies Act, 1956 adopted the aforementioned rule of common law, with certain important modifications. While it made disclosure of a director's interests mandatory, under Section 299, such disclosure was to be made to the Board of Directors, instead of the shareholders. Similarly, it was the assent of the Board of Directors, and not that of the shareholders, which was made compulsory under Section 297 – and that too for only certain types of transactions. This position was extremely problematic because, as mentioned above, the management of Indian companies is often under the control of a particular promoter group. As a consequence, disclosure to the Board of Directors served no purpose, as it allowed interested parties to approve their own transactions, while the shareholders of the company were kept in the dark.[16]

This was witnessed in several cases, such as *Globe Motors Ltd.* v *Mehta Teja Singh and Co.*,[17] *Ravi Raj Gupta* v *Hansraj Gupta & Co.*,[18] and *Suryakant Gupta* v *Rajaram Corn Products (Punjab) Ltd.*,[19] where transactions with promoters or directors were approved by a Board that was composed almost entirely of relatives or associates of the interested party. As a consequence, despite the possible inequity of the transaction, in each such case the Court's hands were tied as the provisions of Section 299 had not been violated. While the requirement of shareholder approval for every self-dealing transaction may be an impractical one,[20] it is the researcher's firm belief that disclosure to shareholders, or to some other body such as an audit committee (made up of independent directors), is essential for the more

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[14] Aberdeen Railway Co. v Blaikie Bros., (1843-60) All ER Rep 249 : 1854 UKHL 1 (HL); A.B. Cook v George S. Deeks, (1916) 1 AC 554 : 1916 UKPC 10; Regal (Hastings) Ltd. v Gulliver, (1967) 2 AC 134 : (1942) 1 All ER 378 : 1942 UKHL 1 (HL).

[15] *Id.*

[16] A. RAMAIYA, GUIDE TO COMPANIES ACT 2045 (17th ed. 2010).

[17] Globe Motors Ltd. v Mehta Teja Singh *and* Co., 1983 SCC OnLine Del 193 : (1984) 55 Comp Cas 445.

[18] Ravi Raj Gupta v Hansraj Gupta & Co., 2011 SCC OnLine Del 2608 : (2010) 94 CLA 1 (Del).

[19] Suryakant Gupta v Rajaram Corn Products (Punjab) Ltd., 2001 SCC OnLine CLB 5 : (2001) 2 Comp LJ 155.

[20] GOWER & DAVIES' PRINCIPLES OF MODERN COMPANY LAW 562 (9th ed. 2012).

risky transactions, involving large assets or amounts – in order to provide some form of oversight over the actions of the Board.

Another particularly troublesome aspect of this provision could be found under sub-clause (3) of Section 299, which permitted a director to simply provide a 'general notice', declaring that s/he was to be considered interested in transactions dealing with a particular company henceforth. The section specifically provided that such a general disclosure would be a sufficient alternative to specific disclosures, for the period of that financial year.[21] This provision is problematic for two reasons.

First, it permits a director to avoid any detailed disclosure on specific transactions, specifying the precise nature and extent of his interest in the company.[22] As Lord Cairns observed in *Imperial Mercantile Credit Assn.* v *Coleman*,[23] '*a man declares his interest, not when he states that he has an interest, but when he states* ***what his interest is*** [Emphasis added].'[24] Without such a detailed disclosure, which explains what the interest of the director is with respect to a specific transaction, it would be very difficult for the Board to make an informed choice and take precautions that would be appropriate for each individual transaction.[25] *Second*, following such a general notice, this provision places the burden on the Board to peruse the minutes of its prior meetings, and uncover any potential conflicts of interest, for each transaction, rather than on the director, who is better placed to disclose the same, but who can now keep silent without incurring any liability.[26]

The permissive manner in which the Indian judiciary has interpreted the requirement of disclosure is also problematic. For instance, in *A Sivasailam Tractors and Farm Equipment Ltd.* v *ROC*,[27] the Company Law Board noted that, when the daughter of the company's chairman-cum-managing director was to be appointed as the vice-president, there was no requirement

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21 Section 299(3)(a), The Companies Act (1956).

22 A. Galani & N. Rehn, *Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses*, 20(2) NLSIR 134, 137 (2010).

23 Imperial Mercantile Credit Assn. v Coleman, (1871) LR 6 Ch App 558 (CA).

24 Gray v New Augarita Porcupine Mines Ltd (1952) 3 DLR 1 PC.

25 A. Ramaiya, Guide to Companies Act 2078 (17th ed. 2010).

26 Admittedly, the Company Law Committee, in its report on this provision, acknowledged the issues outlined above. To overcome these problems, the Committee saw it fit to adopt certain recommendations that had been made earlier by the Millin Commission in South Africa, namely: to require that such general notices be renewed annually; and to place an obligation on the declaring director to take reasonable steps to bring up, read and discuss the notice at the next Board meeting. Nonetheless, such measures seem woefully inadequate in comparison to the problems outlined above, especially keeping in mind the gravity of harm that may be caused through such self-dealing transactions.

27 A Sivasailam, Tractors and Farm Equipment Ltd. v ROC, (1995) 83 Comp Cas 141.

of an explicit and formal disclosure at the meeting, as the other members of the Board were already cognizant of this fact. Several similar decisions have assisted in carving out such an exception against disclosure, for matters already known to the Board.[28] This type of an interpretation of the provision is dangerous, as it contradicts the specific wording of the provision, which mandates that a director explicitly '***disclose** the nature of his concern or interest **at a meeting of the Board*** [emphasis added].'[29] One must keep in mind that the purpose of this disclosure is not merely for the benefit of the directors in status quo, but also other individuals – such as future directors or auditors, who may require access to the minutes of the Board's meetings to determine when a fiduciary of the company is interested in a transaction. This was precisely why, in *Neptune (Vehicle Washing Equipment) Ltd.* v *Fitzgerald*,[30] the Court held that even in the case of a Company which possessed only one director, the sole director would be required to remind himself of his duties to make a disclosure and record it in the company's records and minutes book.

Another exception against the requirement of disclosure may be found under sub-clause (6) of Section 299, which states that if the interested director (or directors) in question did not possess a shareholding greater than 2% in the party with which the transaction took place, they would not be required to make known this interest to the Board of Directors. This clause has faced criticism from writers, for the use of the word "hold", which seems to suggest that only the concept of direct ownership would be capable of creating a conflict of interest, especially when contrasted with the wording used in other provisions of the Act, which speak of the broader conception of "beneficial ownership".[31] This criticism is supported by the narrow interpretation given to the term "hold" by the Supreme Court in *Howrah Trading Co. Ltd.* v *CIT*,[32] where it held that '*the expression "holder of a share" denotes, in so far as the company is concerned, **only a person who, as a shareholder, has his name entered on the register of members*** [Emphasis added]'. As a consequence, it can be argued that the phrasing of Section 299(6) may be capable of exempting a large number of transactions,

[28] Guntur Cotton Mills v Venkatachalapathy, AIR 1932 PC 244; Ramakrishna Rao (S.M.) v Bangalore Race Club Ltd., (1970) 40 Comp Cas 674. *See also* Lee Panavision Ltd. v Lee Lighting Ltd., (1992) BCLC 22 (CA); MacPherson v European Strategic Bureau, (1999) 2 BCLC 203 (Ch D); Runciman v Walter Runciman plc, (1992) BCLC 1084.

[29] Section 299(1), The Companies Act (1956).

[30] Neptune (Vehicle Washing Equipment) Ltd. v Fitzgerald, (1995) 1 BCLC 352 (Ch D).

[31] *See*: W. Megginson et al, *Corporate Governance in India*, 20(1) JOURNAL OF APPLIED CORPORATE FINANCE 59 (2008); E. Wahab, D*oes Corporate Governance Matter? Evidence from Related Party Transactions*, 14(1) ADVANCES IN FINANCIAL ECONOMICS 131 (2011).

[32] Howrah Trading Co. Ltd. v CIT, AIR 1959 SC 775.

in which a director may possess a great indirect interest, while owning less than 2% of the other company's shares.[33]

A failure to comply with the provisions of Section 299 would cause the vacation of the office of the director, under Section 283(1)(i), and also render him liable to pay a fine which could extend to fifty thousand rupees.[34] In addition, these provisions do not affect the common law remedy, which renders the self-dealing transaction or arrangement voidable, at the option of the company.[35] Finally, as observed by Vaughan Williams, L. J. in *Costa Rica Rail Co. Ltd.* v *Forwood*,[36] equity would also mandate that a Court deprive the directors of any profits they may derive, by entering into contracts in which they have a conflicting interest. This principle has also been applied in the Indian context.[37]

In addition to the requirement of disclosure, discussed above, the 1956 Act also mandated that an interested director abstain from any discussion or vote on the transaction in question.[38] Moreover, such director's presence on the Board was not to be counted for the purposes of determining quorum.[39] However, strangely, this provision was only made applicable to public companies.[40] Moreover, exemptions were made for transactions between a public holding company and its private subsidiary company,[41] as well as for contracts of indemnity, in which the director would serve as a surety on behalf of the company.[42] Finally, similar to the provisions on disclosure, directors whose only interest in the transacting company was a shareholding of 2% (or of the minimum stake required to qualify him to be a director) were also excluded from the scope of the provision.[43] A breach of the

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33 *See*: A. Galani & N. Rehn, *Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses*, 20(2) NLSIR 134 (2010). However, this argument is incorrect, as it fails to notice that Section 299 specifically accounts for both direct and indirect interests, under sub-clause (1). Moreover, the Indian judiciary has given a wide interpretation to the phrase 'indirect interest', mandating that a director make a disclosure, even if it is merely his relatives or his partnership firm, and not himself, who possesses an interest in the company with which the transaction is to take place. See: Fire Stone Tyre and Rubber Co. Ltd. v Synthetics & Chemicals Ltd., (1970) 2 Comp LJ 200; Needle Industries (India) Ltd. v Needle Industries Newey (India) Holding Ltd., (1981) 51 Comp Cas 743 at 815.

34 Section 299(4), The Companies Act (1956).

35 Amritsar Rayon & Silk Mills Ltd. v Amirchand Saideh, (1988) 64 Comp Cas 762 (P&H); Movitex Ltd. v Bulfield, 1988 BCLC 104 (Ch D).

36 Costa Rica Rail Co. Ltd. v Forwood, (1901) 1 Ch 746, 761).

37 See*:* Pandalai (K.C.) v S.I.G. Assurance Co. Ltd, (1941) 11 Comp Cas 327.

38 Section 300(1), The Companies Act (1956).

39 Section 300(1), The Companies Act (1956).

40 Section 300(2)(a), The Companies Act (1956).

41 Section 300(2)(b), The Companies Act (1956).

42 Section 300(2)(c), The Companies Act (1956).

43 Section 300(2)(d), The Companies Act (1956).

requirements under this provision warranted two consequences: *first*, any vote cast by such interested director would be rendered void;[44] and *second*, the director who contravened the provision would be liable for a fine which may extend to fifty thousand rupees.[45]

The Companies Act, 2013 provides for the requirement of disclosure of interests, and abstention in subsequent proceedings under Section 184 of the statute. This provision makes major advances over its equivalent in the 1956 Act (Section 299). As discussed above, one of the most important difficulties, with respect to the framework for disclosure under the 1956 Act, was the possibility of a director to simply provide a general notice of the companies in which he was interested at the start of each financial year, which would exempt him from making any detailed disclosures on the nature and extent of his interest, with respect to specific transactions. This was worrisome, as it made it very difficult for the Board of Directors to determine the character of his conflicting interest, and to account for it in their deliberations on the transaction.

This issue is resolved, quite effectively, by Section 184, which mandates that all directors '*disclose (their) concern or interest in any company or companies or bodies corporate, firms, or other association of individuals*', at the start of every financial year, and also whenever there is a change in their declared interests. However, in addition to this *mandatory* general notice, directors are also bound to make specific disclosures with respect to each transaction that the company enters into, in which they have an interest. By doing so, Section 184 ensures that the fact of the director's interest cannot be overlooked by the Board, as it places the burden on the concerned director to make such disclosure (rather than on the Board, to peruse the minutes of their meetings and uncover such interests, as was the case under the 1956 Act).[46] Moreover, it does not permit a director to substitute a specific disclosure with a general one, but mandates both, thereby ensuring that the Board possesses sufficient information, to enable them to safeguard the company against the conflict of interest.[47]

However, there is also, in the researcher's opinion, a defect in the drafting of Section 184. While Section 299 of the 1956 Act was phrased broadly, to bring within its ambit all transactions in which the director may have an interest, '*whether directly or indirectly*', the same cannot be said of Section

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44 Section 300(1), The Companies Act (1956).
45 Section 300(4), The Companies Act (1956).
46 A. RAMAIYA, GUIDE TO COMPANIES ACT 1389 (18th ed. 2014).
47 G. Vijay, *Corporate Governance Under the Companies Act, 2013: A More Responsive System of Governance*, 4(4) INDIAN JOURNAL OF APPLIED RESEARCH 7 (2014).

184. Admittedly, Section 184 also uses similar phrasing, and mandates that a direct or indirect interest be disclosed. However, it qualifies this statement by specifying that only two specific forms of interest require disclosure: - first, if the director '*holds more than two per cent shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate*' with which the company transacts; and second, if the director '*is a partner, owner or member*' of a firm with which the company transacts.[48]

The issue with this provision, therefore, is the same issue pointed out above, for several provisions of the 1956 Act – it is far too specific, and thereby excludes from its ambit several types of transactions.[49] Thus, if a company were to enter into an agreement with another company, which was owned or controlled by a director's relatives, he would not be bound to make any disclosure under Section 184, although it would have been required under Section 299 of the 1956 Act. Although Section 184 desires to encompass such 'indirect' interests, as per the wording of sub-clause (2), by specifying precisely which interests mandate disclosure (all of which happen to be direct interests, in the form of a shareholding or position of management in the transacting company), the provision actually ends up having the effect of excluding all such indirect interests from its scope.[50] This is certainly a critical issue, which must be addressed to ensure an effective regulatory mechanism for self-dealing transactions. Although Section 184 has not yet come up for interpretation before our judiciary, it seems likely that the above-mentioned problem of excluding important transactions will occur, given the Supreme Court's narrow interpretation of the word "hold" in Howrah Trading Co., discussed above in relation to Section 299. However, there is a possible solution by which this issue could be mitigated – if our Courts were to interpret the word 'holding' to include equitable ownership, as has been done by Courts in other jurisdictions.[51] If this were done, then transactions where a director has an indirect interest in another company would also be hit by Section 184, as they would fall within the scope of the first qualification, mentioned above. This would also, perhaps, be the most effective interpretation of Section 184. Nonetheless, it is the opinion of the researcher that our legislators would do well to return to the phrasing found

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48 Section 184(2), The Companies Act (2013).

49 S. Jain & N. Nigam, *Companies Act 2013 – A New Wave in Corporate Governance*, 3(12) Indian Streams Research Journal 54 (2014).

50 Deloite & ASSOCHAM, *Report on Companies Act, 2013 – "New Rules of the Game"*, 24 (2013).

51 For instance, in the Australian case *Re Bennet* (decd), 1957 VR 113, at 116, Lowe J. stated that '*the word "hold" is not a term of art. The word must be construed in its ordinary English meaning. In my opinion it is a normal use of English to say that one holds shares when one possesses or owns them, and* ***that this is true whether the ownership is by means of a legal or an equitable title***' [emphasis added].

under Section 299 of the 1956 Act, and simply mandate disclosure for all interests that a director may possess in a company, whether direct or indirect – while deleting the list of specific interests, which they have inserted in Section 184.

The remedies available in case of non-disclosure remain the same under the 2013 Act except for a few minor changes. While any self-dealing contract entered into without disclosure to the Board would remain voidable at the option of the company,[52] it is the penal consequences that have been amended by Section 184. A director who fails to make a disclosure when required would be liable to pay a fine of at least Rupees Fifty Thousand, but up to Rupees One Lakh, and may also face a term of imprisonment for up to one year.[53] Moreover, while the 1956 Act limited the requirement that a director abstain from subsequent proceedings and voting only to public companies, the 2013 Act has now extended this obligation to all companies.[54]

B. The Requirement of Prior Approval

The Companies Act, 1956 provides for the requirement of prior approval for self-dealing transactions under Section 297. Although there is a considerable overlap between this provision and Section 299 of the Act, discussed above, there are some differences that must be noted. While the requirement of disclosure, under Section 299, applies to all existent and '*proposed contract(s) or arrangement(s)*' in which a director may have a direct or indirect interest, the requirement of prior approval is narrower, and governs only two specific types of contracts, namely - '*for the sale, purchase or supply of any goods, materials or services*' and '*for underwriting the subscription of any shares in, or debentures of, the company*' – which are brought before the Board.[55] Moreover, while self-dealing transactions between two public companies fall outside the ambit of Section 297, they are certainly subject to the disclosure requirements under Section 299.[56] Finally, Section 297 specifically details the parties with whom a contract would require prior approval – '*a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director*'. On the other hand, Section 299 used broader phrasing, and includes within its ambit all contracts in

52 Section 184(3), The Companies Act (2013).
53 Section 184(4), The Companies Act (2013).
54 Sections 174(3) & 184(2), The Companies Act (2013).
55 Rabindra Nath Mitra v Emperor, (1938) 8 Comp Cas 176.
56 Ministry of Corporate Affairs, *Circular No.* 8/299/56-PR (15th June, 1956).

which the director of a company is in '*any way, whether directly or indirectly, concerned or interested*'.

The primary defect that Section 297 suffers from, in the opinion of the researcher, is narrow drafting. By choosing to use specific rather than general phrasing, the section unintentionally excludes several forms of abusive self-dealing from within its ambit, creating lacunae that a dishonest director could exploit with ease.

For instance, although the provision attempts to specify parties with whom contracts would constitute self-dealing, it fails to account for several vital relationships. While the provision accounts for transactions with a private company in which a director may have a *direct* interest (by owning a stake in it or being placed on its Board), it overlooks similar agreements with companies in which only an *indirect* interest exists (companies which may be owned or controlled by the family members of the director).[57] It seems absurd for the drafters of the provision to have made such an error, considering that Section 299 specifically accounts for identical indirect interests. Moreover, the provision simply excludes all transactions between two public companies, even though the director of one may have a controlling stake in another, thereby enabling him to engage in transactions between the two, to further his own self-interest rather than that of either company.[58]

However, perhaps the more significant error made by the drafters of the provision was to restrict the scope of contracts for which approval must be sought to those for the sale or purchase of *goods*, materials or services.[59] As the Companies Act, 1956 does not provide a definition of "goods", one must resort to the definition under the Sale of Goods Act, 1930[60] which restricts the phrase 'goods' to only moveable property.[61] The difficulty that arises out of this is that all transactions in immoveable property, which almost always constitute the most valuable assets owned by a company, are not governed by the requirements of approval.[62] This fault in drafting permits

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[57] V. Khanna, *The Relation between Firm-Level Corporate Governance and Market Value: A Case Study of India*, 11(4) Emerging Markets Review 319 (2010).

[58] V. Umakanth, *India's Corporate Governance: Rhetoric or Reality?*, 21(1) NLSIR 132 (2010).

[59] Section 297(1)(a), The Companies Act (1956).

[60] Hindustan Lever Employees' Union v Hindustan Lever Ltd., 1995 Supp (1) SCC 499 : 1994 Supp (4) SCR 723; Morgan Stanley Mutual Fund v Kartick Das, (1994) 4 SCC 225.

[61] Section 2(7), Sale of Goods Act (1930).

[62] This lacuna was specifically acknowledged by the Department of Corporate Affairs, when Sona Steering Systems Ltd., a joint venture of Maruti Udyog Ltd., made an application to the Department for approval under Section 297(1) of the Companies Act, 1956, for taking on rent office premises for the company from a firm in which directors of the company were interested. The Department responded through Clarification No.9/41/90—CL-X,

the most destructive form of self-dealing to occur without prior approval, the repercussions of which could be potentially fatal for the company in question. Moreover, due to such narrow drafting, the section does not apply to loans made by a director to a company, as such a transaction does not constitute a sale or purchase of goods, or a contract to render personal services.[63] In fact, the problematic nature of this provision's narrow drafting became evident in *Renuka Datla* v *Biological E. Ltd.*,[64] where the Andhra Pradesh High Court was forced to concede that, due to the specific wording of Section 297 requiring a *contract* for sale of *goods, materials or services*, the transfer of a company's shares by a director to his daughter did not require prior approval. Similarly, the Court found that the appointment of two other daughters as employees of the Company, in the same case, could also not be challenged under Section 297.

The provisions under Section 297 provide for a two-layer mechanism of approval. The *first* mandates that, for all transactions specified in the section, consent must be sought from the Board of Directors, and this approval is to be obtained only through a resolution passed at a meeting of the Board.[65] Such approval can be sought either prior to the contract, or within three months of the date on which it is signed.[66] However, if the company in question possesses a paid-up share capital of Rupees one crore or more, than a *second* level of approval must be sought – that of the Central Government.[67]

The problems associated with only requiring approval from the Board of Directors in the Indian environment, where the entire management of companies is often controlled by a single promoter group, are evident. In numerous cases, Courts have encountered Boards, where a majority of the members are related to one another, that have granted approval to the most grossly unfair transactions.[68] For instance, in A. *Jawahar Palaniappan* v *Kumudam Publications (P) Ltd.*,[69] a Board of Directors composed of the chairman's family members approved a purchase of LED panels worth Rs.8

dated 27–3–1990, stating that such transactions involving immoveable property fell outside the ambit of Section 279, and thus did not require prior approval.

63 R. Chakrabarti, *Corporate Governance in India – Evolution and Challenges* (2005) *available at* http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=649857 (Last visited on 14 May, 2015).

64 Renuka Datla v Biological E. Ltd, (2015) 193 Comp Cas 356.

65 Sections 297(1) & (4), The Companies Act (1956).

66 Section 297(4), The Companies Act (1956).

67 Proviso to Section 297(1), The Companies Act (1956).

68 *See*: Jai Surgicals Ltd. v CIT, (2014) 150 ITD 60 (Del); Yashovardhan Saboo v Groz-Beckert Saboo Ltd., (1995) 83 Comp Cas 371 (CLB); Subhash Chand Agarwal v Associated Limestone Ltd., (1998) 92 Comp Cas 525 (CLB); Francis Cleetus v Rashtra Deepika Ltd., (2013) 115 CLA 299 (CLB).

69 A. Jawahar Palaniappan v Kumudam Publications (P) Ltd., 2015 SCC OnLine CLB 83.

lacs from the chairman's company for a whopping price of Rs. 3 crores. Thus, *prima facie*, it may seem that the additional requirement of government approval in such transactions involving large-capital companies would be beneficial, as it would provide another layer of protection when the Board may fail to check an unfair self-dealing transaction. While this reasoning may make sense, theoretically, it has failed in practice, because the impracticality of examining and approving each such self-dealing transaction has forced the government to delegate this function to regional directors,[70] and to carve out numerous broad exceptions to this requirement,[71] which have severely diminished its effectiveness.

For instance, Circular No.13/75, which excludes agreements for employment in a professional capacity, waters down the regulations under Section 297, as it permits a director to appoint his relatives or friends as employees of the Company, or to hire them in any other professional capacity, without the approval of the Board. In fact, this was precisely what took place in *Shailesh Harilal Shah* v *Matushree Textiles Ltd.*,[72] in which the Bombay High Court was forced to uphold the appointment of a sitting director's relative as an employee, as such transactions had been excluded from the ambit of Section 297 and Section 300. This creates considerable difficulty, as there is great potential for abuse in such agreements of employment, whereby a director may allow his personal relations to motivate his selection of candidates, and hire his own family members, who may be unqualified and inefficient, against the best interests of the company – thereby breaching the No Conflict rule.

Section 297 also creates certain exceptions to the rule requiring prior approval. It exempts transactions in cash, which take place at prevailing market prices,[73] as well as transactions involving goods or services in which one of the parties regularly trades or does business, provided that the value of such a contract (or contracts) with a specific related party does not exceed Rupees Five Thousand for any given year.[74] The provision also excludes from its ambit any transactions entered into by a Banking or Insurance Company,

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70 Central Government has delegated to the Regional Directors at [Bombay, Calcutta, Madras and Kanpur], the powers and functions under the proviso to sub-section (1) through Notification No. GSR 563(E), dated 19–8–1993.

71 *See*: *Circular No.*13/75, dated 5–6–1975 (Excludes agreements for professional services); *Circular* No. 13/75, dated 5–6–1975 (Excludes contracts for the appointment of a director as a managing director or a whole-time director); *Notification* GSR 233, dated 31–1–1978 (Excludes transactions between Government Companies).

72 Shailesh Harilal Shah v Matushree Textiles Ltd., AIR 1994 Bom 20.

73 Section 297(2)(a), The Companies Act (1956).

74 Section 297(2)(b), The Companies Act (1956).

in the ordinary course of its business.[75] Finally, sub-section (3) also permits such self-dealing transactions to take place without prior approval, in circumstances of urgent necessity, provided that Board sanction is sought within three months of the transaction.

If the provisions of Section 297 are breached, and approval of the Board is not obtained prior to, or within three months of, the relevant related-party transaction, then the Company is granted the right to avoid the transaction.[76] On the other hand, if it is the Central Government's consent which has not been sought, then the contract is rendered void *ab initio*.[77] Moreover, although no penalty is prescribed under this provision, specifically, Section 629A would, nonetheless, be applicable to a director who has failed to acquire such approval under Section 297, and he would be liable to pay a fine of up to Rupees Five Thousand, as witnessed in Otto Burlingtons Mail Orders (P) Ltd., In re,[78] as well as Dintex Dyechem Ltd., In re.[79]

The provisions regulating prior approval of self-dealing transactions under the 2013 Act are, in the researcher's opinion, an excellent improvement on those under the 1956 regime. They overcome almost all the issues pointed out above, and even go further – providing additional checks and safeguards to ensure fair dealing among related parties. One of the foremost concerns, under the earlier Act, was that all self-dealing transactions merely required approval from the Board of Directors. However, as shown above, the management structure of Indian companies is such that most Boards are comprised of relatives and associates of the promoter group, who would gladly approve anything that they are required to – rendering the requirement of their consent a superficial and ineffective one. This was why the Act was amended,[80] to provide an additional means of oversight – that of the Central Government. However, as discussed above, this provision was also ineffective, due to the impracticality of obtaining government approval for such transactions.

Section 188 of the Companies Act, 2013 has found an innovative method to check abuse by the Board, and provide an additional means of supervision – through three different steps. *First*, for transactions whose value crosses 10% of the Company's net worth (or turnover, depending on the nature of the transaction), or exceeds Rupees One Hundred Crores (whichever is

[75] Section 297(2)(c), The Companies Act (1956).
[76] Section 297(5), The Companies Act (1956).
[77] A. RAMAIYA, GUIDE TO COMPANIES ACT 2103 (17th ed. 2010).
[78] Otto Burlingtons Mail Orders P. Ltd., In re, (1999) 96 Comp Cas 525.
[79] Dintex Dyechem Ltd. In re, (2001) 104 Comp Cas 735.
[80] Section 28, The Companies (Amendment) Act (1974).

lower), this provision mandates that the consent of the shareholders be taken, by means of a special resolution.[81] *Second*, while obtaining such consent, the provision bars any members who may be related parties to the transaction from voting on the special resolution.[82] *Third*, the section also creates an obligation for the Board to include, in its report to the shareholders, a list of all such related-party transactions, which the company has entered into, along with a justification for the same.[83] Through these three steps, Section 188 manages to significantly reduce the possibility of the Board abusing its powers, and granting consent to abusive self-dealing transactions, as supervisory powers are taken away from the central government, which has no direct interest in regulating such deals, and granted to the party that has the greatest stake in preventing them – the shareholders.[84]

In addition, Section 188 also accounts for several types of transactions that had been unwittingly excluded from within the ambit of Section 297 of the Companies Act, 1956. For instance, it explicitly brings within its scope all transactions involving the Company's immoveable property,[85] which had been excluded from the 1956 regime due to the use of the word 'goods'. Moreover, it also specifically includes within its scope agreements to appoint a related party to an office of profit within the company or a subsidiary or associate company, thereby putting an end to the trend of nepotism that was permitted under Section 297 of the earlier statute. This was witnessed in *Jagran Prakash Ltd.* v *Union of India*[86] and *Madhu Ashok Kapur* v *Rana Kapoor*,[87] where the Delhi and Bombay High Courts found that the appointment of a director's relative as an employee of the company would now require approval under Section 188 – in sharp contrast with the decisions in *Shailesh Harilal Shah* v *Matushree Textiles Ltd.* and *Renuka Datla* v *Biological E. Ltd.*, under Section 297 of the 1956 Act, discussed above. Further, by providing a broad definition for the word 'related party',[88] the section also accounts for several possible transactions in which the director may have possessed only an indirect interest, through his relatives, which were not governed by the 1956 Act's provisions on self-dealing.

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81 Proviso to Section 188(1), The Companies Act (2013) read with Rule 15, Companies (Meetings of Board and its Powers) Rules (2014).

82 Second Proviso to Section 188(1), The Companies Act (2013).

83 Section 188(2), The Companies Act (2013).

84 N.Kumar, *A Study of Corporate Governance under Companies Act, 2013*, 2(6) Asian Journal of Multidisciplinary Sciences 43 (2014).

85 Sections 188(1)(b) & (c), The Companies Act (2013).

86 Jagran Prakash Ltd. v Union of India, (2016) 131 CLA 27 (Del).

87 Madhu Ashok Kapur v Rana Kapoor, 2015 SCC OnLine Bom 5818.

88 Section 2(76), The Companies Act (2013).

Finally, the 2013 Act also streamlines the variety of different exceptions to the requirement of prior approval that were provided for under the 1956 Act – such as cash transactions at market price, contracts in areas of regular trade, and transactions in circumstances of urgent necessity – and replaces them with a singular, simplified exception. The section exempts all '*transactions entered into by the company in its ordinary course of business … on an arm's length basis*' from the requirement of prior approval.[89] Although the rationale for such an exception is easy to understand, and it does bring much needed clarity to the provisions, there are two points that must be noted with respect to this provision. *First*, it makes an unmistakable departure from a long history of common law rulings, which declare that a breach of the fiduciary duty to avoid conflicts is not determined by the fairness of the terms of a transaction, but rather by whether or not the procedural elements of disclosure and approval have been met.[90]

Second, the 2013 Act's definition of '*arm's length*' transactions - those conducted between two related parties as if they were unrelated – is an ambiguous one, and writers have observed that it is capable of different interpretations.[91] One may construe it as a procedural requirement, that neither the two related parties nor their agents participate in the negotiation and conclusion of the transaction. Alternatively, one may also interpret it as empowering courts to examine the terms of each agreement and evaluate their fairness by comparing them to the market value of such transactions.[92] Given the importance of this sole exception to Section 188, as well as its wide scope, it is essential that the legislature or the Courts clarify the means of ascertaining when a transaction has been conducted on an arm's length basis. The only case where the meaning of an '*arm's length*' transaction under Section 188 has come up for discussion is that of *Madhu Ashok Kapur* v *Rana Kapoor*,[93] in which the reappointment of the Managing Director of Yes Bank was argued to be a related party transaction that should have been carried out only with shareholder approval through a special resolution. The Bombay High Court, however, dismissed this objection on the ground that the transaction was conducted at arm's length. Although the objection is dealt with very briefly, and the Court sheds very little reasoning on the meaning of '*arm's length*' transaction, one can gather – from the

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89 3rd Proviso to Section 188(1), The Companies Act (2013).

90 Aberdeen Railway Co. v Blaikie Bros., (1843-60) All ER Rep 249; Hutchinson v Brayhead Ltd., (1967) 3 All ER 98 (CA).

91 N. Sharma, *Corporate Governance: Conceptualization in the Indian Context*, 3(5) INDIAN JOURNAL OF MANAGEMENT & SOCIAL SCIENCES RESEARCH 17 (2014).

92 N. Kumar, *A Study of Corporate Governance under Companies Act, 2013*, 2(6) ASIAN JOURNAL OF MULTIDISCIPLINARY SCIENCES 43 (2014).

93 Madhu Ashok Kapur v Rana Kapoor, 2015 SCC OnLine Bom 5818.

Court's discussion on the nature of perquisites that Managing Directors are ordinarily entitled to – that it opted for the second of the two interpretations outlined above, i.e. it chose to look at the substantive provisions of the transaction and compare them to those carried out in the market, rather than consider the test of '*arm's length*' transactions a mere procedural one. This is also the manner in which the Supreme Court has interpreted arm's length transactions in *Atic Industries Ltd.* v *H.H. Dewa*[94] and *A.K. Roy* v *Voltas Ltd.*,[95] in the context of Section 4 of the Central Excise Act, and in *Inder Singh* v *Union of India*,[96] in the context of Section 51A of the Land Acquisition Act. Thus it is fair to observe, provisionally, that the meaning of '*arm's length*' transactions under Section 188 is to be interpreted as a substantive test, and not a procedural one.

The remedies available for a violation of the requirement of prior approval have also been significantly altered by the 2013 Act. *First*, such a contract is rendered voidable, at the option of the Company, and the interested director, as well as any other director who authorized the transaction, are made liable to indemnify the Company for any loss it may have suffered as a consequence of the transaction.[97] *Second*, the Company can also initiate proceedings against any director or employee who entered into such a contract without approval, for the recovery of any loss suffered from the transaction.[98] *Third*, such directors and employees are also liable to penal sanctions – a fine that shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, as well as imprisonment that may extend to one year (in case of a listed company).[99] *Fourth*, the office of such a director may also be vacated, if he acts in contravention of Section 184 of the Act.[100] *Fifth*, any individual convicted for violating the provisions of Section 188 is also rendered ineligible to be appointed as the director of any company, for a period of five years.[101] Thus, we can conclude that the new regime, under the 2013 Act, provides for significant deterrence to directors who seek to engage in self-dealing transactions without appropriate prior approval.

[94] Atic Industries Ltd. v H.H. Dewa, (1979) 1 SCC 499 : AIR 1975 SC 960.
[95] A.K. Roy v Voltas Ltd., (1973) 3 SCC 503 : AIR 1973 SC 225.
[96] Inder Singh v Union of India, (1993) 3 SCC 240 : (1993) 3 SCR 371.
[97] Section 188(3), The Companies Act (2013).
[98] Section 188(4), The Companies Act (2013).
[99] Section 188(5), The Companies Act (2013).
[100] Section 167, The Companies Act (2013).
[101] Section 164(1)(g), The Companies Act (2013).

C. The Regulation of Loans

Loans are transactions which pose a special danger, in the realm of self-dealing. Loans constitute an easy method of avoiding the regulations that restrict the disposal of assets, and are capable of camouflaging transactions that, in reality, are nothing more than a gift – either because the loan in question is never expected to be returned, or because the terms on which the loan is granted are not of a commercially beneficial nature.[102] In fact, in 1945, the Cohen Committee in the UK recommended that the legislature ought to completely prohibit companies from granting loans to their directors, as they believed that such transactions were never justifiable.[103] Their reasoning was as follows: If the director desiring a loan was able to offer good security, it should not be difficult for him to borrow the amount he desires from other sources. If, on the other hand, he cannot offer good security, then it would not be in the best interests of the company to offer him credit, which he would not be able to obtain from elsewhere.[104]

The Companies Act, 1956 comes close to adopting the recommendations of the Cohen Committee, under Section 295. This provision prohibits the granting of any loans, directly or indirectly, to a director or his relatives, or to any shadow director, or to a company or firm in which such director is interested, without the prior consent of the Central Government. There are, however, two significant defects that this provision suffers from. The *first*, is that the provision limits its scope only to public companies (and private companies that are subsidiaries of public companies).[105] By doing so, the provision eliminates from its ambit a large number of private companies, for which there seems to be no easily discernible reason or policy concern. Consequently, a lacuna exists in the law, which permits directors of private companies to engage in unfair credit transactions with themselves, or other related parties.

The *second* problem with this provision is the use of the specific word 'loan', rather than a broader phrase – such as 'credit transactions' – which has resulted in the judiciary being forced to adopt a technical interpretation of this provision.[106] For instance, in *Fredie Ardeshir Mehta* v *Union*

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102 FARRAR'S COMPANY LAW 452 (4th ed. 1998).

103 Report of the Committee on Company Law Amendment, Cmnd. 6659, 1945, para 94. Interestingly, one of the corporate governance measures introduced in the USA, following the Enron affair, was the introduction of the Sarbanes-Oxley Act 2002, which contains an absolute prohibition on loans by companies to their directors, under Section 402(a).

104 GOWER & DAVIES PRINCIPLES OF MODERN COMPANY LAW 567 (9th ed. 2012).

105 Section 295(2)(a)(i), The Companies Act (1956).

106 N. Kumar & J. Singh, *Outside Directors, Corporate Governance and Firm Performance: Empirical Evidence from India*, 4(2) ASIAN JOURNAL OF FINANCE & ACCOUNTING 32

of India,[107] the Bombay High Court held that the provisions of Section 295 would only be attracted if a loan was granted to a director – the essential requirement of which was the grant of a sum of money, upon the understanding that it would have to be returned by a certain date, with or without interest. As a consequence, the transaction in that case – which was the sale of a company flat to a director, on part payment of the full amount, with the rest being due on credit – was not found to constitute a 'loan'.

This is quite clearly problematic, as it allows directors to achieve, through indirect means, what the law prohibits them from doing directly. Instead of directly taking a loan from the company to purchase a house, a director could, instead, use the company's funds to purchase the house in its name, and then sell it to himself on credit, without attracting the prohibition under Section 295.[108] A similar outcome was also seen in *M.R. Electronic Components Ltd.* v *Registrar of Companies*,[109] in which a managing director transferred sums to his wife, who was an employee of the company, under the guise of advance salaries, but whose actions were still considered to be consistent with Section 295, because they did not fall within the narrow definition of a loan.

A breach of the provisions under Section 295 makes any party which knowingly participated in the transaction liable to pay a fine of Rupees Fifty Thousand, or a term of simple imprisonment for six months.[110] However, if the loan amount is repaid in full, then the section mandates that no imprisonment should be awarded.[111] In addition to the above criminal sanctions, each such party is also jointly and severally liable to the lending company, for the amount of the loan so granted.[112] It would be important to note, however, that unlike the other remedies available for a breach of the No-Conflict rule, this remedy is a personal one, which renders only the director liable to pay the requisite amount, and not a proprietary one, which would make him a constructive trustee of the company with respect to the amount lent, as per the decision in *Ciro Citterio Menswear plc*.[113] Further, by making all parties with knowledge liable for this breach, the section extends sanction from merely the interested director, to the entire Board, if they were cognizant of the transaction. Finally, in addition to the above, the office of the

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107 Fredie Ardeshir Mehta v Union of India, (1991) 70 Comp Cas 210, 213.

108 A. Ramaiya, Guide to Companies Act 2089 (17th ed. 2010).

109 M.R. Electronic Components Ltd. v Registrar of Companies, (1987) 61 Comp Cas 8.

110 Section 295(4), The Companies Act (1956).

111 Proviso to Section 295(4), The Companies Act (1956).

112 Section 295(5), The Companies Act (1956).

113 Ciro Citterio Menswear plc. (in admn.) Re, (2002) 1 BCLC 672 (Ch D).

interested director shall also become vacant if he, or any firm in which he is a partner or any private company of which he is a director, accepts a loan or any guarantee or security for a loan, from the company in contravention of Section 295.[114]

The 2013 Act provides for the regulation of loans, under Section 185 of the 2013 Act. This provision is, largely, identical to the provisions under the 1956 Act. However, it has made *three* important changes, which have helped made such regulation more efficacious. *First*, Section 185 extends the scope of the prohibition of loans to directors from one that merely applied to public companies (under the 1956 Act), to one that now govern all companies.[115] *Second*, although the issues pointed out above, caused by the strictly technical use of the phrase 'loan' would still continue under the 2013 Act, Section 185 does seek to mitigate this effect, by '*including any loan represented by a book debt' within its scope*'.[116] The term 'book debt' is certainly a broader one than 'loan', and it includes within its ambit transactions such as the sale of goods on credit, or the provision of advances to employees,[117] which would earlier have been excluded. However, with respect to other types of credit transactions, it is likely that Courts will interpret the word 'loan' in Section 185 of the 2013 Act narrowly, as was done in Fredie Ardeshir Mehta case for Section 295 of the 1956 Act, discussed above. Although there is still much to be desired from the narrow drafting of this provision, it is still, definitely, an improvement from that of Section 295 of the 1956 Act.

Finally, the section also does away with the requirement of Central Government approval, which prevailed under the 1956 Act, and thereby completely prohibits all loans to a director or to persons in whom the director is interested. Thus, our jurisdiction has finally adopted, in full, the recommendations of the Cohen Committee.

Section 185 has also altered the remedies available for a breach of the provisions that regulate loans. It mandates that any director or related party who receives such a loan shall be liable to imprisonment for six months or with a fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.[118] It further provides that

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114 Section 283(1)(h), The Companies Act (1956).

115 Section 185(1), The Companies Act (2013).

116 Deloite & ASSOCHAM, *Report on Companies Act, 2013 – "New Rules of the Game"*, 24 (2013).

117 See: Independent Automatic Sales Ltd. v Knowles & Foster (1962) 3 All ER 27; Paul & Frank Ltd. v Discount Bank Overseas Ltd., (1966) 2 All ER 922; K.M. Mohommed Abdul Kadir Rowther v S. Muthich Chettiar, (1960) 2 Mad LJ 13 at 15; Raja of Venkatagiri v Krishnayya Rao Bahadur, AIR 1948 PC 150 at p. 155.

118 Section 185(2), The Companies Act (2013).

the company granting the loan shall also be punishable with a fine, which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees.[119]

Conclusion

The Companies Act, 2013 has successfully addressed numerous issues that were present under the 1956 Act's provisions on self-dealing. Nonetheless, the efficacy of the 2013 Act is a matter that cannot be predicted – it is only their implementation that will inform us of any further shortcomings that may need to be tackled. At the same time, it would be beneficial to outline the areas in which the 2013 Act could improve, and the lessons it could learn from the law on self-dealing transactions in other jurisdictions.

A. Enhancing Supervisory Mechanisms over the Board of Directors

As has been emphasized above, India's ownership and management structure renders it particularly vulnerable to unfair self-dealing transactions, at the hands of interested directors. As a consequence, leaving a majority of the task of regulating such transactions to the Board itself is a dangerous idea. Although the 2013 Act makes significant advances in this field, by introducing the original, common-law rule of shareholder approval, there are still means by which it could improve. For instance, Clause 49(VII)(D) of SEBI's Equity Listing Agreement mandates that each and every self-dealing transaction must be submitted to the Board's Audit Committee for verification and approval. This is certainly a novel idea, which ought to be extended to all companies. It should be noted, however, that this proposal could only be achieved if the mandatory requirement of independent directors were to be extended to *all* companies, instead of simply the public listed ones.

Furthermore, both Hong Kong and Singapore have developed an innovative method of providing an additional layer of oversight over the Board, by mandating that all material self-dealing transactions must be announced publicly, which allows investors as well as other members of the public to remain constantly informed and to investigate further, if need be.[120] In addition, while each of these jurisdictions has adopted a similar rule as the one in

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[119] *Id.*

[120] Stock Exchange of Hong Kong, Listing Rule 14A (2010); Singapore Exchange Listing Manual, Rule 9A06.

India, which requires shareholder approval for valuable related-party transactions, and only permits independent shareholders to vote, they go a step further in ensuring that such independent shareholders make an informed and educated choice. Both Hong Kong and Singapore mandate that in the event that such shareholder approval is required, the independent directors of the company must form a committee to advise them and, further, they must appoint an external financial advisor to issue an opinion on the fairness of the transaction.[121] It would certainly be beneficial to adopt similar requirements in India.

Moreover, it may also be beneficial to consider adopting the strategy used in the UK for determining when shareholder approval ought to be required. The UK's laws make such approval contingent on the nature of the transaction,[122] rather than the *quantum* or *value*, as is the case with the 2013 Act. This seems to be a more efficient strategy, as it enables the State to target only the particularly risky categories of transactions, while the others need not be put through the tedious process of obtaining shareholder approval.[123] Finally, it may also be beneficial to update the Accounting Standards that we follow. Accounting Standard 18, which regulates related party transactions, has significant loopholes in it: it does not apply to associate companies; it does not mandate the disclosure of important details, such as the pricing of the transaction, the reason it was chosen, the other available options, or why the choice was a fair one.[124] Addressing each of these concerns would be necessary, in order to ensure that we provide for a cohesive and exhaustive regulatory mechanism for self-dealing transactions.

B. Addressing Issues of Drafting in the Statute

As has been outlined, in the sections above, the 2013 Act is not without its flaws. However, it is pertinent to point out the two most important ones, that must be addressed. First, it is important to expand the scope of Section 185's prohibition against 'loans' to directors, which is excessively narrow

121 *Id.*

122 These categories include substantial property transactions, credit transactions, Directors' service contracts and gratuitous payments to directors, as well as donations and expenditure of a political nature. *See*: GOWER & DAVIES PRINCIPLES OF MODERN COMPANY LAW 563 (9th ed. 2012).

123 It would be pertinent to note that it was the very inefficiency and difficulty of obtaining shareholder approval for self-dealing transactions that had caused jurisdictions to abandon this common law rule in the first place, and to opt for simplified methods of disclosure and approval by the Board. *See*: GOWER & DAVIES' PRINCIPLES OF MODERN COMPANY LAW 564 (9th ed. 2012).

124 A. Galani & N. Rehn, *Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses*, 20(2) NLSIR 134 (2010).

and has been subjected to a very technical interpretation by the judiciary. It may be more appropriate to adopt the English position on this subject, by mandating that the prohibition apply not only to "loans", but also to "quasi-loans", "credit transactions" and other such "related arrangements", to ensure that directors do not use indirect means to circumvent the prohibition on taking direct loans.[125]

Second, it is also necessary to provide greater flexibility in the statute to determine when a particular party, with which a transaction is sought, is a related one or one in whom a director may have an indirect interest, thereby attracting the requirements of disclosure and/or approval. This issue is made evident by the phrasing of Section 184, which narrows the transactions it covers to such an extent, that it completely excludes any form of indirect interest a director may have in a contracting party. Jurisdictions such as the USA, Hong Kong and Singapore have sought to avoid such an outcome by using very broad definitions for related or associated parties, and also by avoiding any classification of transactions to which the requirements of disclosure and approval apply.[126] Perhaps it is time we do the same.

[125] Sections 197-203, UK Companies Act (2006).

[126] A. Galani & N. Rehn, *Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses*, 20(2) NLSIR 134 (2010).