

Yes, Governance Matters.

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BALANCING PROCEDURE AND SUBSTANCE: THE LEGAL WEIGHT OF UNANIMOUS CONSENT

- Under Section 203, a board must pass a unanimous resolution, when appointing a managing director who already holds the position of a managing director in another company. Failure to explicitly document this unanimous approval can lead to regulatory penalties and potential invalidation of the appointment.
- The Registrar of Companies ruled that implied unanimity is insufficient—explicit documentation is required when appointing an MD under such circumstances. The company's failure to record a unanimous board resolution led to penalties, reinforcing strict compliance standards.
- Recent case law underscores the Companies Act's strict liability framework, highlighting that both substantive and procedural compliance are essential. Companies must ensure accurate record-keeping of board minutes and adherence to governance protocols to avoid financial and reputational risks.

BACKGROUND

In organizational management, the recording of board meeting minutes is a fundamental requirement to ensure transparency, compliance, and accountability. Accurate and comprehensive minutes serve as a legal record and provide an audit trail of the decision-making process. This becomes even more critical when the board is required to pass *unanimous decisions*, as these resolutions often have far-reaching implications on the company's governance, financial health, and strategic direction. Board minutes serve as *prima facie* evidence of decisions taken and discussions held during meetings. Under the Companies Act, 2013 in India and various governance codes across the world, well-maintained minutes of a board meeting are a legal necessity.

Section 203 of the Companies Act, 2013, is a crucial provision aimed at ensuring that certain class of companies appoint Key Managerial Personnel (**KMP**) to uphold these principles¹. Section 203 provides for the appointment/reappointment of the key managerial personnel in the company. To appoint a Managing Director, a company needs to inquire if the nominated person is already holding any position of managing director at any other company. The maximum already held position is one in order to be eligible for the position of managing director in any other company². Furthermore, appointing company needs to pass a board resolution *unanimously* as mentioned under sub-section 3 of the foregoing section. As established in multiple rulings of the Registrar of Companies (**RoC**), this condition is held to be mandatory, and a company cannot bypass this section. Otherwise, the appointment may be held to be unlawful. Resultantly, it can be rendered invalid by the RoC.

RECENT CASE ON COMPLIANCE OF SECTION 203:

In **Sastasundar Healthbuddy Limited³**, the RoC reinforced the mandatory nature of the unanimous requirement under Section 203 of the Companies Act, 2013. The purpose of requiring unanimous consent is to take the consent of all the directors in order to ensure that any shared interest would not hamper the functioning of the appointing company. The case arose from an inspection under Section 203(5) of the Companies Act, 2013, which revealed non-compliance in the nomination of a Managing Director. The specific issue concerned the appointment of Mr. Banwari Lal Mittal as the Managing Director of Sastasundar Healthbuddy Limited while he was simultaneously serving as the Managing Director of Sastasundar Ventures Limited. The core issue was that the company had failed to explicitly document a unanimous board resolution in its board meeting minutes authorizing this dual appointment, contrary to Section 203.

The company argued that although the word "*unanimously*" was not explicitly stated in the board resolution dated July 1, 2016, all board members present had accepted the appointment. The absence of any recorded opposition in the meeting minutes, it claimed, implied unanimous agreement. Further, the company contended that Secretarial Standard 1⁴ requires dissenting views to be explicitly recorded in board meeting minutes. Since no dissent was noted, the resolution should be deemed unanimously accepted. Lastly, the appointment had been approved by the Board, the Nomination and Remuneration Committee, and subsequently by shareholders at the Annual General Meeting. The company asserted that this multi-tiered approval process was sufficient to meet Section 203 compliance requirements.

The company distinguished between a *technical* and a *substantive* violation, arguing that any lapse in record-keeping should fall under Section 118 of the Companies Act 2013 (*which governs the maintenance of minutes*) rather than constituting a breach of Section 203. It maintained that the issue was procedural rather than substantive.

The adjudicating officer categorically rejected the company's arguments, emphasizing that Section 203 is a substantive compliance requirement aimed at ensuring transparent and unambiguous governance processes,

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stating:

- A unanimous board resolution is essential to ensure transparency and prevent conflicts of interest.
- The company could not retrospectively claim unanimity based on the absence of recorded dissent. The law requires explicit approval, and failing to formally document unanimous consent invalidates the compliance claim.
- The reliance on Secretarial Standard 1 was dismissed, as regulatory compliance demands express approval rather than merely inferring consensus.
- The violation was deemed a breach of Section 203, not merely a record-keeping lapse under Section 118. The ruling underscored that compliance must align with both the letter and spirit of the law to uphold corporate governance principles.

Given the non-compliance with Section 203, the adjudicating officer imposed a cumulative penalty of INR 6.5 lakhs (*approximately USD 7,500*), including fines of INR 1.5 lakhs (*approximately USD 1,750*), on three officers-in-default. The penalties reinforced the Companies Act, 2013's strict liability framework, holding companies and their officers accountable for governance lapses regardless of intent.

EVOLVING JURISPRUDENCE UNDER SECTION 203:

The jurisprudence surrounding Section 203 of the Companies Act, 2013, reflects a nuanced interpretation of the statutory requirements concerning the appointment and responsibilities of Key Managerial Personnel (KMP). Through a comparative analysis of judicial and regulatory orders, a clear pattern emerges regarding the enforcement of compliance with Section 203 and the penalties imposed for violations.

In the case of **Gwalior Smart City Development Corporation Limited⁵**, the RoC held that a chief financial officer cannot hold office in other company without prior approval of the board. Section 203(5)⁶ of the Act prescribes punishment for the violation. The penalty to the tune of INR 50,000 is imposed for its violation. On similar lines, **Landomus Realty Private Limited⁷**, the RoC decided that a company can't bypass this requirement by incorrect usage of designation without prior approval of the statute.

LSF10 Rose Investment S.A.R.L. v. Ratan India Finance Private Limited⁸, the National Company Law Tribunal underscored the importance of compliance of the key managerial personnel giving due regard to all the requirements under Section 203 of the Companies Act, 2013 and stated the importance of key managerial personnel to act independently. Otherwise, it would hamper the interest of the company. Due Diligence requirement must also be met.

In another landmark case of **Western Carrier (India) Limited⁹**, RoC underlined the importance of complying with the requirement before being appointed as a Whole Time Director of a Company. This requirement can't be avoided at any cost in order to get away with penalty.

Through these cases, the overarching principle emerges that compliance with Section 203 is not merely a statutory formality but a fundamental aspect of corporate governance. The judiciary and regulatory bodies have consistently held that violations, whether intentional or inadvertent, attract penalties to uphold corporate transparency and accountability. Further, these cases illustrate that companies cannot circumvent these obligations by delaying compliance or pleading ignorance, as the law imposes a strict liability framework on corporate officers and entities.

CONCLUSION:

The ruling in Sastasundar Healthbuddy Limited is a crucial decision reinforcing the necessity of explicit and precise compliance with Section 203. It establishes that even minor lapses, such as the omission of a single word in board minutes, can lead to significant financial and reputational consequences. For corporate boards and secretarial teams, this case serves as a crucial reminder: *governance is not just about substantive compliance but also about the meticulousness of procedural adherence*. To mitigate risks, organizations must prioritize transparent decision-making and detailed documentation in all governance processes.

Companies must recognize that regulatory bodies are moving towards a *zero-tolerance* approach for governance lapses. Future enforcement actions will likely focus on both substantive compliance and the accuracy of procedural documentation. Therefore, businesses must proactively revise their governance policies to ensure strict adherence to legal requirements, safeguarding themselves against regulatory scrutiny and potential financial liabilities.

Authors:

– Maulin Salvi

You can direct your queries or comments to the relevant member.

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¹Sec 203 of the Companies Act, 2013

²Third Proviso to sec 203(3) of the Companies Act, 2013

³In the matter of Sastasundar Healthbuddy Limited ROC/ADJ/55/160195/2023 (ROC, Kolkata, West Bengal)

⁴Secretarial Standard 1 issued by the Institute of Company Secretaries of India

⁵In the matter of M/s. Gwalior Smart City Development Corporation ROC-G/Adj. Pen./ Sec. 203/247,248 (Madhya Pradesh)

⁶Companies Act, 2013

⁷In the matter of Landomus Realty Private Limited, No. ROCB/Adj. Order/Sec.454/Section 170(2) r/w 203/Co.No.081640/2021/ 5818

⁸LSF10 Rose Investment S.A.R.L. Vs. Rattan India Finance Private Limited, NCLT Delhi, IA-19/ND/2022 in CP-76/ND/2021

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