

Appointment of Sole Selling Agent



Section 294 and 294AA of the Companies Act, 1956 regulate the appointment of sole selling agents. These sections provide, among other things, that no company shall appoint a sole selling agent for any areas for a term exceeding five years at a time and the term may be extended for another period but not exceeding five years on each occasion. [Section 294(1)]. The Board of Directors may appoint a sole selling agent but only subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made. In case, the company in general meeting, as aforesaid, disapproved the appointment, it shall cease to be valid with effect from the date of that general meeting [Section 294(2) and (2A)]. No company shall appoint any individual firm or body corporate, who or which has a substantial interest in the company as sole selling agent of that company unless such appointment has been previously approved by the Central Government. A company having a paid-up share capital of ₹50 lakh or more shall not appoint a sole selling agent except with the consent of the company accorded by a special resolution and the approval of the Central Government. Read on to know more...



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Sole Selling Agent

The term 'Sole Selling Agent' refers to a person who is given an exclusive right to sell the goods of the company in a particular area to the exclusion of all others, including the company.

The relationship between the company and the sole selling agent is that of principal and agent, and not that of employer and employee. If the proposed sole selling agent is to be appointed in a foreign country, the prior permission has to be obtained from the Reserve Bank of India.

Applicability: The provisions of Section 294 shall apply irrespective of the fact that –

- Appointment of sole selling agent is restricted to a particular area or extends to the whole of India;
- Sole selling agent is appointed in respect of some of the products or the entire range of products of the company.

Section 294 deals with Appointment of Sole Selling Agent

a. Requirements for appointment of sole selling agent:

(i) Appointment subject to approval in general meeting:

Where the Board of Directors of a company appoints a sole selling agent, such appointment shall be subject to the condition that the appointment shall cease to be valid if it is not approved by the shareholders in the first general meeting held after the date of the appointment. If the shareholders in the general meeting disapprove the appointment, the appointment shall cease to be valid with effect from the date of that general meeting. In the meantime, if the agent has done some work, he is entitled to remuneration there for (*Firestone Tyre & Rubber Company Vs. Synthetics & Chemicals Ltd (1971)41 Comp Cas 377*).

(ii) Disclosure of material facts to the shareholders:

The notice convening the meeting for approving the appointment of sole selling agent must give full information so that the shareholders can know the exact nature of the agreement. The mere mentioning in the notice that a copy of the agreement is available for inspection at the registered office of the company is not sufficient.

(iii) Appointment must be conditional:

The sole selling agreement must incorporate the condition that the appointment shall cease to be valid if not approved in the general meeting. If there is no such condition, the agreement will be void *ab initio* even if it is approved by the general meeting. As such provisions regarding incorporation of this condition are mandatory. (*Arantee Manufacturing Corporation Vs. Bright Bolts Pvt Ltd*)

b. Tenure of Office:

A company cannot appoint a sole selling agent of any area for a term exceeding five years at a time. But it

can re-appoint, or extend the term of office by further period not exceeding five years on each occasion.

Power of Central Government in Controlling the Appointment of Sole Selling Agent

Prohibition of Sole Selling Agent for Certain Goods:

The Central Government may, by Notification in Official Gazette, declare that sole selling agent shall not be appointed by a company for the sale of goods for specified period if the Central Government is of opinion that,

1. Demand for goods of any specified category is substantially in excess of the production or supply of such goods; and
2. Services of sole selling agents are not necessary to create a market for such goods.

Goods for which sole selling agents cannot be appointed:

The central government has issued notification prohibiting the appointment of sole selling agent for bulk drugs, Drugs and Formulations as defined in Drugs (Price Control) order, 1995 other than,

- a. Any bonafide preparation included in the Ayurvedic (including Siddha) or Unani systems of medicines, or
- b. Any preparation included in the Homoeopathic system of medicine.

Substantial interest of sole selling agent in the company:

Section 294AA (2): A company shall not appoint any person on having a substantial interest in the company as a sole selling agent, unless such appointment has been previously approved by the central government.

No retrospective effect: Where at the time of appointment, the sole selling agent has no substantial interest in the company but thereafter he acquires substantial interest in the company, the provisions of this section are not attracted. In other words acquisition of substantial interest subsequent to the appointment is not regulated by this section.

Substantial Interest

Now let's discuss Substantial Interest in the context of Sole Selling agent. Substantial interest means beneficial interest in the shares of the company exceeding ₹5 lakh or 5% of paid up share capital of the company, whichever is less.

An individual, firm or body corporate may be appointed as sole selling agent.

A company cannot appoint a sole selling agent of any area for a term exceeding five years at a time. But it can re-appoint, or extend the term of office by further period not exceeding five years on each occasion.

Sole selling agent

Individual	Firm	Body Corporate
Beneficial interest is held by Individual or his relatives, whether singly or taken together	Beneficial interest is held by one or more partners of the firm or Any relative of such partner, whether singly or taken together.	Body corporate or One or more of its Directors or their relatives, whether singly or taken together.
Shares of the company, the aggregate paid-up amount thereon exceeds the least of the following—		
<ul style="list-style-type: none"> • ₹5,00,000 or • 5% of the paid-up share capital of the company. 		

Companies having share capital of ₹50 lakh: Section 294AA(3)

A company having a paid up share capital of ₹50 lakh or more shall not appoint a sole selling agent except,

- (a) With the consent of the company accorded by a special resolution and
- (b) With the approval of the central government.

Time of passing special resolution and approval of Central Government. The special resolution may be passed in the first general meeting held after the appointment of sole selling agent. Similarly, the approval of central government may be obtained after the appointment of sole selling agent.

Effect of disapproval: The appointment of sole selling agent shall cease to be valid, if—

- (a) The central government disapproves the appointment; or
- (b) Special resolution approving the appointment is not passed in the first general meeting.

Summary

Case	Paid up Capital	Sole Selling Agents Substantial Interest	Procedural aspects for Sole Selling Agents Appointment		
			Board Resolution	Shareholders Approval	Central Government Approval
1.	< ₹50 Lakh	No	Yes	Ordinary Resolution	Not required
2.	₹50 Lakh or more	No	Yes	Special Resolution	Required
3.	< ₹50 Lakh	Yes	Yes	Ordinary Resolution	Prior approval required
4.	₹50 Lakh or more	Yes	Yes	Special Resolution	Prior approval required

No retrospective effect. Where the paid up capital of the company is increased to ₹50 lakh after the appointment of sole selling agent, the provisions of this section are not attracted. In other words, the appointments subsisting as on the date of increase in the paid up capital are not affected.

Illustration

The Board of directors of A Ltd having a paid-up share capital of ₹45 lakh appointed B Ltd as sole selling agent for a period of five years with effect from 1st April, 2011 and the said appointment was approved by the company in the next annual general meeting held on 30th September, 2011. The directors of B Ltd were holding fully paid-up shares of ₹4 lakh in A Ltd. Answer the following explaining the relevant provisions of the Companies Act:

- (i) Is the appointment of the sole selling agent in order?
- (ii) Will your answer be different if both are private companies or if the directors of B acquired the aforesaid shares in A Ltd., on 1st September, 2011?

Solution:

As per Section 294AA of the Companies Act, a company shall not appoint any person having a substantial interest in the company as a sole selling agent, unless such appointment has been previously approved by the central government.

Substantial interest means beneficial interest in the shares of the company exceeding ₹5 lakh or 5% of paid up share capital of the company, whichever is less. In case of a body corporate, beneficial interest may be held by such body corporate together with one or more of its directors and any of the relatives of directors.

Where at the time of appointment, the sole selling agent has no substantial interest in the company but thereafter he acquires substantial interest in the company, the approval of the central government is

not required (Department circular No.1/78, dated 7-3-1978).

All the provisions of the companies Act relating to sole selling agents apply to private companies as they apply to public companies.

- (i) In the given case B Ltd., along with its directors, holds more than 5% of the paid-up share capital of A Ltd. Thus, B Ltd can be appointed as sole selling agent of A Ltd. Only with the prior approval of the central government. Since, no prior approval has been obtained, the appointment of B Ltd. as a sole selling agent is not valid.
- (ii) Even if both the companies are private companies, Section 294AA would apply. As such the appointment will remain invalid.

If the shares were acquired on 1st September 2011, then the provisions of Section 294AA would not be attracted to the appointment of B Ltd. and therefore B Ltd. can continue as sole selling agents for a period of five years, i.e., up to 31st March, 2016.

Powers of the Central Government: Section 294

The powers of Central Government to investigate the terms of appointment of sole selling agent are as follows:

Investigation by the Central Government

(a) Where a company has appointed sole selling agent (Section 294(5))

- (i) Where the Central Government suspects that the terms and conditions of sole selling agent are prejudicial to the interest of the company, it may call the information from the company.
- (ii) If the company refuses or neglects to furnish the information, the central government may appoint an inspector to investigate into the terms and conditions of appointment of sole selling agent.
- (iii) If after perusal of the information furnished either by the company or by the investigator, if the central government is of the opinion that the terms and conditions of the appointment are prejudicial to the interest of the company, it may make necessary modifications so that they are not longer prejudicial to the interests of the company.
- (iv) The appointment of sole selling agent shall be regulated by the terms and conditions as varied by the central government from the date as may be specified by the Central Government.

(b) Where a company has appointed more than one selling agent (Section 294(6))

- (i) The Central Government may if it reasonably feels so, as the company to furnish particulars of the terms and conditions of appointment of all the selling agents.
- (ii) If the company refuses or neglects to furnish the information, the central government may appoint an inspector to investigate into the terms and conditions of the appointment of all the selling agents.
- (iii) On the basis of the information thus obtained directly or through the investigator, the central government may reasonably form an opinion that any of the selling agents is to all intents and purposes the sole selling agent for such area; it may order that such selling agent of the company shall be appointed as the sole selling agent.
- (iv) The Central Government may also make variations in the terms and conditions of such sole selling agent if these are prejudicial to the interests of the company. The variations will be effective from the date specified in the order.

Principles of natural justice to be followed: The proceeding undertaken by the Central Government must be guided by the principles of natural justice. The Central Government must give the sole selling agent an opportunity of being heard before making any order prejudicial to him. (*Nanavathi & Company Pvt.Ltd Vs. R.C.Dutt*)

Section 294 limits the powers of central government to make an order of variation in the terms of a sole selling agent. It does not authorise the central government to cancel the appointment of a sole selling agent.

Company Duties: Section 294(7)

It shall be the duty of the company

- a. To furnish to the Central Government all information regarding the terms and conditions of the appointment of the sole selling agent or all the selling agents, as the case may be.
- b. To produce the inspector all books and papers of the company which are in its custody or power.
- c. To give to the inspector all assistance in connection with the investigation.

The company and every officer of the company who is in default (by not fulfilling his duty) shall be punishable with fine up to ₹ 50000 plus ₹ 500 for every day till the default continues.

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The proceeding undertaken by the Central Government must be guided by the principles of natural justice. The Central Government must give the sole selling agent an opportunity of being heard before making any order prejudicial to him. (Nanavathi & Company Pvt.Ltd Vs. R.C.Dutt). Section 294 limits the powers of central government to make an order of variation in the terms of a sole selling agent. It does not authorise the Central Government to cancel the appointment of a sole selling agent.

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Prohibition of payment of compensation to a sole selling agent: (Section 294A):

Section 294A governs the determination of compensation payable to a sole selling agent in case of loss of office.

1. **Compensation not payable:** A sole selling agent shall not be entitled to any compensation for premature termination of the agency brought about in any of the following circumstances:
 - (a) Where his appointment is not approved in the first general meeting held after his appointment.
 - (b) Where the sole selling agent resigns because of the reconstruction or amalgamation of the company and is appointed as the sole selling agent of the reconstructed or amalgamated company.
 - (c) Where the sole selling agent resigns otherwise than on reconstruction or amalgamation of the company, i.e., where he resigns voluntarily.
 - (d) Where the sole selling agent is guilty of fraud or breach of trust or gross negligence in the conduct of his duties.
 - (e) Where the sole selling agent has instigated or is directly or indirectly responsible for the termination of the sole selling agency.
2. **Restriction on quantum of compensation:** Where a sole selling agency is terminated because of any reason other than the five circumstances mentioned above, the sole selling agent is entitled to compensation, as follows:
 - a. **Period:** The compensation shall be admissible only for the lower of the following periods:
 - (i) The unexpired period of the agency; or
 - (ii) Three years
 - b. **Basis:** The compensation shall be based on the “average remuneration”.
Average remuneration shall be calculated taking into account the remuneration actually

earned by the sole selling agent during three years immediately preceding the date of cessation of office. However, where he has held his office for a period shorter than three years, the average remuneration shall be based on such shorter period.

Example

Mr. Perfect was appointed as the sole selling agent of Q Ltd., for a period of five years in a general meeting of the company. Exactly after one and half years, Q Ltd was amalgamated with another company, R Ltd. Mr. Perfect was not appointed as the sole selling agent of R Ltd. Q Ltd paid p ₹6 lakh as selling agency commission during the said one and half years. Is Mr. Perfect entitled to any compensation and if yes, what is the quantum?

Solution:

As per Section 294A a sole selling agent shall not be entitled to any compensation for premature termination if he resigns because of the reconstruction or amalgamation of the company and is appointed as the sole selling agent of the reconstructed or amalgamated company.

In the given case Mr. Perfect was not appointed as a sole selling agent of R Ltd and so he is entitled to compensation.

Quantum of Compensation: The compensation shall be admissible only for the lower of the following periods;

- (i) The unexpired period of the agency; or
- (ii) three years

In the given case compensation payable to Mr. Perfect can be calculated as follows:

Unexpired period of the sole selling agency three and a half years

Lower of unexpired period of the agency or three years

Period of office = One and a half years

Remuneration earned by Mr. Perfect = ₹6 lakh

Average remuneration = ₹6 lakh/1.5years = ₹4 lakh

Maximum compensation payable = Average remuneration*3 years = ₹4 lakh*three years = ₹12 lakh.

Thus, a maximum of ₹12 lakh can be paid to Mr. Perfect as compensation for loss of office. ■