ADMINISTRATIVE CONTROL

OF

COMPANIES IN INDIA

THESIS SUBMITTED BY A. M. VARKEY FOR THE
DEGREE OF DOCTOR OF PHILOSOPHY, FACULTY OF LAW
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DECLARATION

I do hereby declare that my thesis "Administrative Control of Companies in India" is the record of the original work carried out by me under the guidance and supervision of Dr.V.D. Sebastian, Reader, Department of Law, University of Cochin. This work has not been submitted either in whole, or in part, for any degree at any University.

(A.M. VARKEY)

Cochin 682022
2 March 1984

CERTIFICATE

This is to certify that this thesis "Administrative Control of Companies in India", submitted by Shri A.M. Varkey, for the Degree of Doctor of Philosophy is the record of bona fide research work carried out by him under my guidance and supervision from 1.1.1981 in the Department of Law, University of Cochin. This thesis or any part thereof, has not been submitted elsewhere for any other degree.

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PREFACE

The welfare ideals pursued by the modern State has necessitated greater regulation of the economic life of the citizens. It is through the legislative process, the administrative process and the judicial process that the State regulation is achieved. However, due to many inadequacies of the legislative and the judicial process, the administrative process has emerged as the principal device of State regulation. This is particularly true of the State regulation of economic activity. The incorporated company has been for a long time a standard form of organising economic activity. In the context of State regulation of economic activities, the administrative regulation of companies has become significant. An attempt has been made in the present study to analyse and present the various aspects of administrative control of companies in India with the aid of statutory provisions, case law and statistical data, and in the light of American and English case law in some respects. So far as the present writer understands there has been no such study till now.

This study is divided into six parts. Part I consisting four chapters deals with introductory matters.

Chapter 1 has traced the historical evolution of the administrative controls over companies. In Chapter 2 there is an outline of the present day controls. Chapter 3 analyses the machinery for administrative regulation. In Chapter 4, the all important concept of public interest, the principal justification of the administrative controls, is discussed. Part II is devoted to the control over formation and expansion of companies. This part consists of five chapters. In Chapter 5 the controls exercised at the stage of naming and licensing is considered. In the next Chapter, namely Chapter 6, the incorporation and the commencement of business and the impact of administrative regulation at these stages are discussed from a comparative and critical view point. The issue and the allotment of shares and the powers of the administrative authorities over these aspects are discussed in Chapter 7. In Chapter 8, the questions of forfeiture and surrender of shares and the related issues are considered. The next Chapter, namely Chapter 9 discusses the question of amalgamation, take over and mergers.

Part III is devoted to the control over management of companies. Chapter 10 considers the questions of appointment and removal of directors focussing attention on the powers exercised by the Central Government in this regard. The question of remuneration and other benefits to the directors and the administrative powers exercised by the Government

regarding these matters are examined in Chapter 11. Borrowing and lendings, accounts and audit and company meetings are considered in Chapters 12, 13 and 14 respectively. The next part namely Part IV, considers the most important powers of inspections and investigations exercised by the Government. The questions of inspection and investigation are considered in Chapters 15 and 16 respectively.

In Part V, styled "the miscellaneous aspects" are studied the remaining matters and the Government's powers in regard to them. These are, prevention of oppression and mismanagement in Chapter 17, winding up and dissolution in Chapter 18 and adjudication and prosecution in Chapter 19. In the next part, namely Part VI, under Chapter 20 are collected the conclusions that have emerged from this study.

I express my deep sense of gratitude to Dr.V.D. Sebastian, Reader, Department of Law, University of Cochin, for the care, concern and interest he has taken in guiding me at every stage of my work. The co-operation and help extended to me by Prof.(Dr.) P. Leelakrishnan, Head of the Department and other staff members of the Department of Law, University of Cochin is gratefully acknowledged. My sincere thanks are due to the Librarian and other staff of the Law Department Library and the Central Library of the University of Cochin, the Law College library, Ernakulam; the Indian Law Institute library, New Delhi and the library of the Institute of Company Secretaries of India, New Delhi for their

co-operation in making available to me the reports, books, periodicals and other materials on the subject. I acknowledge with thanks the help rendered to me by my colleagues in the Department of Law, University of Cochin, in comparing the scripts and verifying the authorities cited in the thesis.

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C O N T E N T S

PART - I

INTRODUCTORY

CHAPTER - 1

HISTORICAL EVOLUTION OF ADMINISTRATIVE CONTROLS

The joint stock company is an institution weilding immense socio-economic power over the ultimate progress and well-being of the nation. It is subjected to corresponding definable responsibilities towards all who depend on them, the shareholders, the employees, the suppliers of raw-materials, the consumers of its products and the society at large. The company law is changing and must change with time, and take note of the dynamics of trade and industry. Obviously it cannot be static and permanent while the basic economic and social philosophies and the techniques of production and investment in the industrial sector change.[1] It provides a legal framework for the corporate form of business in which the organisation, capital and labour are brought together in a particular form of relationship. The activities carried

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1. C.D. Deshmuk, Lok Sabha Debates, (Vol.5), dated 10.8.1954, No.13, Cl.9817-9818.

on within this corporate form is subjected to a gradual but steadily increasing control by the Government. A study of this control is undertaken to better understand the present law and to suggest the path for further change.

The Importance of Administrative Control in Company Law

The emergence of social welfare concept affected profoundly the relationship between the State and individual. The responsibility of the Government to manage the social and economic life of the people necessitated phenomenal increase in State-power. Among the three organs of the State, legislature, judiciary and executive - the executive or the administrative organ has got the lion share of this increased powers.[2] This extension in functions and powers of the administration is a must as most of the contemporary socio-economic problems could be efficiently tackled only by administrative process and not by normal legislative or judicial process. Administration of socio-economic legislation is a complicated job requiring a great deal of technical knowhow and expertise. The administration of company law, a fast developing socio-economic legislation, is all the more difficult. It is not possible for the legislature to lay down all the rules needed for efficient

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2. For a discussion on the reasons for growth of administrative power, See Julius Stone, Social Dimensions of Law and Justice, N.M. Tripathi, Bombay, (1966), Ch.14, Section III, pp.696-728 and Jain M.P. & S.N. Jain, Principles of Administrative Law, N.M. Tripathi Private Ltd., Bombay, (3rd edn., 1979), pp.1-8.

working of corporate sector. Individual variations is a must to harmonise industrial progress with social needs. The legislature can only lay down the policies to be followed by the administration. The administration should get a choice of possible courses of action or inaction[3] in dealing with individual cases. Then only the goal of industrial harmonisation would become possible. The judiciary which is more concerned with the application of legal principles to individual cases cannot efficiently discharge this function. Therefore to handle the complex problems of company law by evolving, within the limits set by the legislature, suitable policies, techniques and processes, administrative action would seem to be mostly called for.

Historical Evolution of Controls
Ancient & Medieval World

The credit for inventing the concept of corporate existence is bestowed on the Romans.[4] But evidence of the existence of such institutions as early as in 2075-2025 B.C. has been traced in the texts of title deeds engraved on tiles discovered during the excavations of ancient cities.[5]

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3. This choice of possible action is described as 'discretion.' See Davies, K.C., Discretionary Justice, Louisiana State University Press, (1969), p.4; de3mith S.A., Judicial Review of Administrative Action, Stevens, London, (1973), p.246.

4. William Blackstone, Commentaries on the Laws of England, Vol.I (15th ed., 1809), pp.467-68.

5. For example, Code of Hammurabi as cited in A.B. Levy, Private Corporations and Their Control, Routledge and Kegan Paul Ltd., London, (1950), p.3.

Trading associations existed in ancient Greece, usually in the nature of partnerships exercising the power to collect taxes and excise duties, the power being obtained on contract from the Greek City States on an yearly basis. The liability of contractors against the State was unlimited, while the liability of persons who contributed towards the capital was limited.[6] Under the Roman Law, there was societas formed either for profit or for some idealistic purposes, the relationship between the members being regulated by themselves.[7]

England

Power of Visitation by Bishop or Founder

The earliest business associations in England were the medieval guilds, which were bodies that regulated carrying on of particular trades by their members and preserved monopoly of that trade to its members,[8] though the concept of corporate personality was known to English law earlier.[9] The earliest ecclesiastical and eleemosynary corporations were liable to visitation by the Bishop or the founder and his heirs, as the case may be.[10] The

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6. Khorshed D.P. Madon, Management of Corporations, Progressive Corporation Pub.Ltd., Bombay, (1971), p.4.
7. A.S. Levy, op.cit., p.3.
8. Pennington Robert R., Company Law, Butterworths, London, (3rd edn., 1973), p.5.
9. See Holdsworth, William, A History of English Law, Vol.IX, Sweet & Maxwell Ltd., London, (3rd edn., 1944, Reprint 1966), pp.45-47.
10. Id., p.58.

powers of these visitors were very wide as stated in Philips v. Bury.[11] There Holt, C.J. said:

> "The office of visitor by common law is to judge according to the statutes of the college, to expel or deprive upon just occasions, and to hear appeals of course. And from him and him only, the party grieved ought to have redress; and in him the founder hath reposed so entire confidence that he will administer justice impartially, that his determinations are final, and examinable in no other court whatsoever."[12]

State Intervention

From the sixteenth century, the Court of Chancery was empowered to interfere when an eleemosynary corporation established a trust. Here the control of the visitor was supplemented by the control of the Court of Chancery.[13] The ordinances and rules made by guilds were controlled by Justices of Peace by a statute of 1437.[14] Another statute[15] made it obligatory to get the consent of the Chancellor, the Treasurer, the Chief Justice or Judges of Assize to the ordinances made by guilds, and other similar

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11. 1 Ld. Raym 5. As cited by Holdsworth, op.cit., p.58.
12. Ibid.
13. Holdsworth, William, op.cit., p.58.
14. 15 Henry VI c.6., as cited by Holdsworth, op.cit.,p.58.
15. 15 Henry VII c.7., as cited by Holdsworth, op.cit.,p.58.

associations. Those corporations which were not subject to any visitor were subjected to visitation by the King, exercisable only in the Court of Kings Bench.[16]

Statute Against Monopoly

Mining and banking companies also began to emerge in the first half of the seventeenth century. Statute against monopolies was enacted in 1623 considering public opinion against monopolies.[17] In 1698, law was enacted[18] making it compulsory to get Parliament's consent to create monopoly. During this time it was also established that a corporation must be established by lawful authority of incorporation i.e. either by the common law, by authority of Parliament, by Royal Charter or by prescription.[19]

Ecclesiastical and guild corporations were prevailing in other countries also. In India, Kautilya's Arthasastra contain rules regulating these guilds and co-operatives.[20]

Maritime Trade and Chartered Corporations

Further development of corporate law was closely connected with the advancement of trading corporations for

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16. William Blackstone, op.cit., pp.468-469.
17. Ibid.
18. Ibid.
19. Sutton's Hospital Case, (1613) 10 Co.Rep.23a., as cited by Holdsworth, op.cit., p.58.
20. Arthasastra, Chapter XIV; For a critical comment, See Dr.U.C. Sarkar, Epics in Hindu Legal History, Vishveshvaranand Vedic Research Institute, Hoshiarpur (1958), pp.90-91.

maritime trade. Thus in countries like Spain, Portugal and Holland, corporate law emerged to meet the growing needs of maritime trade and commerce.[21] Though these corporations were owned by private individuals, they were subjected to State control, and received aid from State to solve problems of maritime and capital risks. Later, to curb excessive competition between numerous trading corporations, State intervened and created a single company. The management and control of the company was in the hands of chief participants, and the State exercised only limited controls. In other companies established more for political or military purposes,[22] about fifty percent of the shares were provided by the State and some of the directors were nominated by the State's General.[23]

In Germany and France, mercantile class were almost prejudiced against joint stock enterprise.[24] Royal assent was necessary to create a company in Germany by virtue of the Napoleonic Code[25] which included provisions relating

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21. Khorshed D.P. Madon, op.cit., p.11.

22. Noordshe Company was established in 1616, and West India Company in 1621 for military purposes.

23. In the West India Company one out of nineteen directors were appointed by the States General.

24. When the first German company was established in 1765 by Frederic the Great, the State had to take major part of share capital. See A.B. Levy, op.cit., p.96. The response from mercantile class to the French East India Company and French West India Company was unsatisfactory and capital was mainly supplied by aristocrats and tax collectors. See A.B. Levy, op.cit., p.20.

25. Code de Commerce, 1807; In 1871, this Code was declared to be applicable to Germany. See E.J. Cohen, Manual of German Law, Vol.1, Oceana Publications, London, (2nd edn., 1968), p.25.

to joint stock companies.[26] In France, laissez faire principle was applied to joint stock companies, though during 1793-1795 the formation of new companies was prohibited and existing companies were ordered to be dissolved.[27]

In England, the East India Company was the earliest trading company chartered by the Crown. The management of the company was carried on as per the provisions of the charter, and there was little interference by the Government until a tax of 5 per cent on the value of the stock was imposed.[28] Later, more powers over management was taken by the Government.[29] This included the power of the King to remove the Governor General and Councillors of the company. During this period many other companies like Hudson Bay Company, South Sea Company, Bank of England etc. were formed with varying degrees of controls.

Period of Progressive Regulations

The fast developing trade and industry created a large number of trading associations in all countries. Failure of many such companies, speculations in stock market, limiting competition and other abuses that sprang up, created great public opinion every where. Legislation

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26. Ibid.
27. A.B. Levy, op.cit., pp.53-55.
28. Holdsworth, op.cit., p.206.
29. The Regulating Act 1773.

was introduced to regulate the management of these corporations.

Bubble Act

In England, the Bubble Act was passed in 1720 to control company promotion and speculations.[30] Unincorporated companies continued to be formed and the economic crisis of 1825 saw much speculation in shares of these companies. In 1837 Crown was empowered to grant the power to joint stock companies to sue or being sued in the name of one of its officers.

Gladstone Committee

As a result of the recommendations of the Gladstone Committee, in 1844, the first British Companies Act was enacted to ensure (1) proper regulations for the constitution of the companies at promotion, and publicity throughout the whole course of the proceedings.[31]

Registration under the Act was to be in two stages. An application had to be made to the Registry of Companies for provisional registration. On complying with the other

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30. The preamble to the Bubble Act 1720 (6 Geo I., C.11) reads, "... to supress the extravagant and unwarranted practice of raising money by voluntary subscriptions for carrying on trades dangerous to the trade and subjects of the Kingdom."

31. The Joint Stock Companies Registration and Regulation Act 1844 (7 & 8 Vic.C.110). The Preamble to the Bill states, "Whereas it is necessary that due publicity be given to the nature and constitution of companies, the names of their members, their capital and liabilities."

requirements of filing of returns, deeds of settlement etc. complete registration could be obtained. Appointment of auditor, and the filing of a full and fair balance sheet audited by them to the Registry was also insisted.

Concept of Limited Liability

The two stages required for registration and the absence of limited liability provision were greatly created difficulties for the business community. Later in 1855, limited liability was accorded to companies excluding those carrying on the business of banking or insurance.[32] These corporations were also given the benefit of limited liability later.[33] The directors were required to report to the Registrar if three quarters of the capital were lost. In such cases, the company was required to be wound up.[34] However, the principle of laissez faire was fully recognised by the Act of 1856 which granted full freedom of incorporation. The requirement of minimum share capital and minimum share value was removed. The memorandum of association was substituted for the deed of settlement in the earlier Acts. The provisions for registration and publicity and restrictions on payment of dividend continued. Though the

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32. The Limited Liability Act 1855, (25 & 26 Vic., C.91).

33. The Act of 1858 (19 & 20 Vic., C.47) conferred limited liability to banks except for notes issued, and the Consolidation Act 1862 conferred this right to insurance corporations.

34. A.B. Levy, op.cit., p.76.

Act did not restrict the powers of management, it empowered the minority shareholders to apply to the Board of Trade to appoint an inspector to investigate company's affairs. Reports had to be submitted to the Board of Trade, to the company and to those shareholders who requested for the investigation. In 1857, the Board of Trade was empowered to authorise companies to acquire land.[35] The requirement of registration of prospectus made under the 1844 Act was abolished by this Act.

The Consolidating Act of 1862

The Consolidating Act of 1862 (30 & 31 Vic., C.38) which is sometimes regarded as 'magna carta' of the English joint stock companies,[36] required the companies to keep a register of mortgages and charges. The Court was given power to investigate the affairs of a company on application of liquidator, shareholder or creditor. During this time the House of Lords laid down the doctrines of constructive notice[37] and indoor management,[38] which triggered a large volume of litigation by which exceptions to these rules were recognised.

The Companies (Consolidation) Act 1908 (8 Edw.7) officially recognised private company.[39] The Companies

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35. 10 & 11 Vic., C.78.
36. Palmer, Company Law, (21st Edn., 1968), p.1.
37. Ernest v. Nicholls, (1857) 6 H.L. Cas.401.
38. Royal British Bank v. Turquand, (1856) 119 E.R.886.
39. Private company was defined as a company which (a) limited its membership to 50., (b) restricted

(f.n. contd..)

(Consolidation) Act 1929 (19 & 20 Geo.V., C.23) introduced a provision for disclosure, in the balance sheet, of the particulars of loans and other payments made to any director or officer of the company.

Towards the Companies Act 1948

The Director of Public Prosecutions was empowered to initiate prosecutions when offences were committed by directors and other officers of a company. These restrictions did not extend to private companies. The dispersal of share ownership and the consequent separation of ownership from management and control of companies necessitated the enactment of the Prevention of Fraud (Investments) Act 1939.[40] Restrictions on raising of capital were imposed by the Defence (Finance) Regulations 1945 which was replaced by the Borrowing (Control and Guarantees) Act 1946 (10 & 11 Geo.6, C.47).

Based on the Cohen Committee recommendations, a comprehensive code, the Companies Act 1948 (11 & 12 Geo.6, C.38) was enacted. The Act contain provisions, ensuring effective control by shareholders,[41] and greater disclosure

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(f.n. 39 contd..)

the right to transfer shares and (c) prohibited any invitation to public for subscription.

40. The Anderson Committee Report on problems of Unit Trust, 1936, and the Bodkin Committee Report on share pushing 1937, were the inducement for this Act.

41. The 1948 Act, (11 & 12 Geo.6, C.38) contain provisions for calling extra-ordinary general meeting by members, circulation of members resolutions, removal of directors, voting rights etc. to ensure better shareholder control.

in prospectus and accounts on the lines of "best accountancy practice."

Later Changes

The Companies Act 1967, sought to make disclosure provisions more effective.[42] The Board of Trade was given power to make rules[43] in respect of insurance companies. The power of investigation was extended and a new system of licensing was introduced. By the Exchange Control Act 1947, consent of the Treasury was required for issue of shares in certain cases.[44] The European Economic Communities Act 1972 made the disclosure provisions more numerous.[45] This was with a view to give to the public a full picture of the company and its assets and liabilities in a compact form. Provision was also made for publication of such documents in the Official Gazette by the Registrar.[46] The Insolvency Act 1976, empowered the Secretary of State to make regulations for increasing the monetary limits relating to bankruptcy and winding up.[47] Wide discretionary powers were given to him in the matter of audit of accounts of trustees in bankruptcy and liquidators. By the Companies Act of 1976, revolutionary changes were made in accounting and auditing

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42. The main object of the Act was to require greater disclosure of information by limited companies about their trading and finance.
43. The Companies Act 1967 (15 & 16 Eliz.2, C.69), Ss. 119-121.
44. The Exchange Control Act 1947 (10 & 11 Geo.6,C.14), S.(8)(1).
45. European Economic Communities Act 1972 (21 Eliz.2, C.68), S.9(7).
46. Id., S.3.
47. The Insolvency Act 1976 (C.60), S.1(2).

procedure and also in the form and content of returns to be filed with the Registrar.[48] The Act empowered the Secretary of State to disqualify a person from becoming a director for persistent defaults in delivery of documents to the Registrar.[49] The Industries Act 1975, was enacted with the object of developing and assisting the economy of the United Kingdom, promoting industrial efficiency and international competitiveness and providing and safeguarding productive employment.[50] The Act established a National Enterprises Board and empowered the Secretary of State to intervene in the management of an industry to prevent the transfer of control of important manufacturing undertakings into foreign hands, initially by means of prohibition orders,[51] and if necessary by vesting the control of the undertaking in himself or in the National Enterprises Board.[52] In 1980 drastic changes were introduced in the matters of naming the company, insider trading, registration requirements, payment of dividends, loans to directors etc.[53] To harmonise the company law with the European Economic Community directives, the Companies Act 1981 was enacted making changes in the law relating to company names, accounts, disclosure

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48. The Companies Act 1976 (24 & 25 Eliz.2,C.69). See Buckley, The Companies Acts, Vol.II, 14th Edn., Betterworth & Co., London, (1981), pp.1354-1364; Schedule I to the Companies Act 1976.

49. Id., S.28.

50. See Tom Hadden, "Notes on Industries Act, 1975," (1979) 39 Mod.L.R. 319.

51. The Industry Act 1975 (23 & 24 Eliz.2, C.68) S.13(1).

52. Id., S.13(2).

53. See the Companies Act, 1980 (28 & 29 Eliz.2,C.22).

provisions, investigation etc.[54] In the Companies Acts of 1980[55] and 1981,[56] there is a trend to reduce the sphere of administrative power. For example, by the 1981 Act, the discretion of the Department of Trade to refuse to register a name, was abolished.[57] This reduction of administrative power is said to be made to save public expenditure by the reduction or redeployment of civil service manpower.[58]

In the U.S.A.

The American Corporate Law varies from State to State, to suit its federal concept of legislation, eventhough it was evolved from its original English concepts. The power to grant charters by the Federal Government was accepted by the Courts[59] and as a result the National Bank was incorporated in 1864.[60] The Federal Security Act 1933 (15 U.S.C.A. Art. 77a-77aa) was the first legislative measure adopted by congress to curb many of the abuses in company promotion and check concentration of economic power.[61] The Act required the registration of securities, disclosure of informations relating to the interests of directors, their remuneration

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54. See Editorial, "Companies Bill 1981," 1981 J.B.L. (March).

55. 28 & 29 Eliz. 2, C.22.

56. 29 & 30 Eliz. 2, C.62.

57. The Companies Act 1981 (29 & 30 Eliz.2, C.62), Schedule 4.

58. See Boyle A.J. and Richard Sykes (ed)., Gore-Browne on Companies, (43rd edn.), Jordan & Sons Ltd., Bristol, (1982) para 2.2, n.1.

59. See McCulloch v. Maryland, 4 Wheat U.S. 316 (1819).

60. National Bank Act 1864, See, Ballantine, On Corporations, Callaghan & Co., Chicago, (1959), p.47.

61. For a detailed description on the American Corporate (f.n. contd..)

etc., with the Securities Exchange Commission before public issue. The Securities Exchange Commission was given sweeping powers by the Securities Exchange Act 1934 (15 U.S.C.A. Art.78-78jj) including power to call for information, ordering investigations, and imposing heavy penalties. For protecting investors and imposing administrative checks on corporate management a number of other Acts were also passed.[62] The formation, incorporation etc. of corporations in the U.S.A. is controlled by State laws. Many matters which are regulated in other countries by Company Statutes are entrusted to the Securities and Exchange Commission in the U.S.A. Form and contents of corporate financial statements, solicitation of proxies, filing of returns etc. are regulated by the Securities and Exchange Commission. The control of monopoly and margers in the U.S.A. is effected by the Federal Trade Commission with the aid of the Sherman Act 1890 (15 U.S.C.A. Art.1-7), the Clayton Act 1914 (15 U.S.C.A. Art.17-27) and the Federal Commission Act 1914 (15 U.S.C.A. Art.41 et.seq).[63] The Industrial Reorganisation Act 1973, seeks to out-law the possession of monopoly power and establish an Industrial Reorganisation Commission with powers to reorganise many of the important industries and prosecute violations of the provisions.

(f.n.61 contd.)
law development. See Harry G. Henn, Law of Corporations, West Publishing Co., (2nd edn.1970), pp.11-25.

62. See the Public Utility Holding Company Act 1935, the Trust Indenture Act 1939, the Investment Company Act 1940, etc.

63. See Bharat B. Merchant, Monopoly Laws, N.M. Tripathi Private Ltd., Bombay, (1976), pp.67-74.

Developments in India

Registration and Inspection

The earliest Indian statute on joint stock companies, the Joint Stock Companies Act 1850 (43 of 1850), did not provide any regulation by the State on the affairs of a company. But the Joint Stock Companies Act 1857 (19 of 1857), imposed restrictions on the number of partners and empowered the Registry to levy fees on registration. Inspectors could be appointed by the Local Government to investigate the affairs of a company on application of one fifth of the members.[64] Copies of the reports were to be send to the registered office of the company. Expenses for the inspection were to be met by the shareholders on whose application the inspections were made. The powers of the Local Government were enlarged by the Act of 1866 whereby the Local Government could direct that the expenses for the inspection be met by the company in suitable cases.[65]

Appointment of Arbitrator

By the Act of 1857, the Government was empowered to appoint an arbitrator when one or more companies having agreeed to refer a dispute between them to arbitration failed to discharge that obligation. The Government could also appoint an umpire in the event of the failure of the arbitrator to appoint such umpire.

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64. The Companies Act 1857, (19 of 1857), S.48.
65. Id., S.59.

Changes brought about by the 1887 Act

By the Act of 1887 (6 of 1887), the Local Government was empowered to permit registration of an association as a company without the word 'Limited' as part of its name, if the intention of the association were that its profits and other income should not be distributed to its shareholders, but should be utilised for promoting the objects of the association.[66] Local Government could approve or disapprove a change of name.[67] Regarding inspection, the Local Government was empowered to require evidence to be produced for the purpose of showing that the applicant had good reasons for requiring an investigation. The power to demand security from the applicant for payment of costs was also conferred on the Local Government.[68]

The Companies Act 1913

The Companies Act 1913 (7 of 1913), substantially maintained the powers which had been conferred on the Local Government by the 1887 Act, with the modification that the power to approve alteration of name was conferred on the Registrar.[69] The power of the Local Government to order inspection was enlarged. The Registrar was empowered to call upon any company to supply information to him regarding the affairs of the company.[70] The Local Government could

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66. See S.K. Maitra, "Powers in the Changing Horizon of Corporate Law," 1973 C.S. 130.
67. The Companies Act 1887, S.36.
68. Id., S.83.
69. The Companies Act 1913 (7 of 1913), S.11(2).
70. Id., S.137(1).

order an inspection if the Registrar reports that the company failed to supply information when it was called upon or that the state of affairs disclosed by those documents was unsatisfactory.[71]

No one could act as an auditor of a company, excluding private company, without a certificate issued to him by the Government entitling him to act as such. The Governor General in Council could issue notification in the Gazette enabling persons to act as auditor. On failure of the company to appoint auditor in general meeting, the Local Government could appoint an auditor on an application of any member and could fix remuneration of such auditors.

The Amending Act of 1936

By the Companies (Amendment) Act 1936 (22 of 1936), the Local Government was empowered to refer matters requiring prosecution, to the Advocate General or to the Public Prosecutor. If on report made to it by the Registrar under Section 138, it appeared that any person connected with the management of the company was guilty of any offence, the Government could direct the Public Prosecutor to initiate criminal proceedings against those persons. All officers and other personnel of the company were bound to assist the Prosecutor. Any person convicted in such proceeding was debarred from holding positions in the management of companies for a period of five years.

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71. Ibid.

Transfer of Powers to the Central Government

The powers hitherto exercised by the Local Governments were transferred to the Central Government by the Act of 1938 (2 of 1938). The Companies Act 1952 gave more powers to it. The Central Government was empowered to direct that the restrictions contained in Section 91B of the Companies Act 1913, in relation to voting by a director in the matter of a contract or arrangement in which he was interested, should not apply to a private company or should apply thereto subject to such exemption or modification as might be specified in the notification. This could be done if the Central Government was of the opinion that having regard to the establishment or promotion of any trade, industry or business, it would not be necessary in the public interest to apply all or any of such prohibitions to that company.

The Companies Act 1956

The Companies Act 1956 (1 of 1956), enacted on the recommendation of the Company Law Committee,[72] which made comprehensive changes in the Companies Act 1913 (7 of 1913) is still in force in India, with a number of modifications by subsequent amendments.[73] The Act introduced

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72. Company Law Committee, (commonly known as Bhabha Committee) was appointed by the Government of India. Though the Committee submitted the report in March 1952 the bill was passed in the Parliament only in November 1955. Considerable changes were made in the Bill by the Joint Select Committee and the Act come into force from 1st April, 1956.

73. The Amending Acts of 1960, 1963, 1965, 1969 and 1974 brought about drastic changes.

provisions for filing a plethora of returns and forms, in addition to imposing governmental control in many matters.[74] The Central Government's power to direct special audit, if in its opinion the affairs of the company were not being managed in a sound and prudent way or were being conducted in a manner likely to cause injury or damage to the interests of the trade or business to which it pertained or the financial position of the company was such as to danger its solvency,[75] derives from the Amending Act of 1960 (65 of 1960).

The Company Tribunal

An independent Company Tribunal mooted[76] but rejected during the debates in the Parliament[77] while considering the

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74. Major areas of governmental control includes restriction on overall managerial remuneration (S.198) restrictions relating to appointment and retirement of directors (Ss.255, 256, 408), Government's approval for increasing number of directors (S.257), Government's approval for appointment of whole time or managing director, (S.269), loans to directors (S.295), Government approval for increase in remuneration of directors (S.310) etc. In addition to this, the powers of inspection, investigation etc. contained in the previous Acts were also increased.

75. See S.233A.

76. For example, See suggestions made by Shri Ayyanagar in the Lokh Sabha. He said, "the work of appointing inspectors must be entrusted to a competent body like the Board of Trade. I would suggest ... to make provision for a board of control for each province, consisting of representative men from shareholders and management with experts appointed by the Government." Lokh Sabha Debates dated 8.9.1956. Lokh Sabha Debates, Vol.VI, No.7, pp.17-18.

77. See the reply of the then Law Minister Shri C.D. Deshmukh, "It would be difficult to reconcile the conflicting aspirations and expectations of different sections of the public in the country which would like to have representation on such body. Considering the difficulty in selecting the representatives of the various contending interests, the joint committee

(f.n. contd..)

Companies Bill 1952, was constituted by the Companies (Amendment) Act 1963 (53 of 1963). The Tribunal was to exercise powers and functions delegated to it by the Central Government. The establishment of the Company Tribunal was intended to facilitate quick action against persons involved in cases of fraud, misfeasance and other malpractices and irregularities in the management of companies.[78] The Tribunal was empowered to exercise such powers and functions of the Court under the several Sections of the Companies Act as the Central Government might from time to time notify. The decisions of the Tribunal was subject to an appeal to the High Court on questions of law or on mixed questions of law and fact.[79] However the Tribunal faced a premature death[80] and the powers and functions of the Tribunal were vested in the Central Government or the Court according to the old scheme of jurisdiction.

Changes Brought About by Other Amendments

The Companies (Amendment) Act 1963 (53 of 1963)

(f.n. 77 contd..)

recommendation for establishing a Departmental authority seems to be more appropriate." Lok Sabha Debates Vol.VI, No.9, Cl.10525-26.

78. See the statement of objects and reasons to the Companies (Amendment) Bill, 1963.

79. See the Companies Act 1956, Ss.388B, 388C, 388E and 10 D.

80. The Tribunal was abolished by Company Tribunal Abolition Act 1967 (17 of 1967). The object and reasons to the Act states that the Tribunal was abolished since the main intention of securing quick justice was not fulfilled.

empowered the Central Government to appoint a Public Trustee to exercise voting rights in respect of shares held in trust. This change was made with a view to secure proper management of the company in the interests of the shareholders.[81] The Central Government was also empowered to give directions to companies to convert loans made, or debentures taken, by the Government into shares of the company.[82] To strengthen the provisions relating to investigation into the affairs of the companies and to provide for more effective audit in cases of dishonesty and fraud in the corporate sector,[83] the Companies (Amendment) Act 1965 (31 of 1965), was enacted. Managing agency system was abolished in India by the Companies (Amendment) Act 1969 (19 of 1969).[84]

The Amending Act of 1974

The Companies (Amendment) Act 1974 (41 of 1974), is considered as a landmark in the governmental control over companies. This amendment was made with a view to bring the corporate sector of commerce and industry within the fold of socialism. The Companies Act 1956 was amended in such a way as to confer enormous powers on the Central

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81. See the statement of objects and reasons to the Companies (Amendment) Bill 1963.

82. See Amendment to S.81.

83. See the Objects and Reasons to the Companies (Second Amendment) Bill 1964.

84. The Companies Act 1956, S.324A.

Government to enable it to exercise, in the public interest, an overall control over various aspects and activities of the company management.[85] Many of the powers and functions hitherto exercised by the Central Government and the Company Court were transferred to the Company Law Board.[86] Restrictions were imposed on the acquisition and transfer of shares. Approval of the Central Government was made necessary for acquisition or transfer of shares, in certain cases. The Amendment Act provide for automatic transfer of the shares either to the Central Government or to a corporation owned or controlled by it, under specified circumstances.[87] Deposits from public could be accepted only in accordance with the rules prescribed by the Central Government.[88] The Government was also empowered to conduct an investigation into the beneficial ownership of shares in a case where it has good reasons to do so.[89] Restrictions were placed on the payment of dividends,[90] Inspections of books and accounts of any company could be made without giving prior notice to the company, by the Registrar or any

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85. Shah S.M., Lecturers on Company Law, N.M. Tripathi Pvt.Ltd., Bombay, (18th Edn.1981), p.8. See also the Companies Act 1956, Ss.17,18,19,79,141 & 198.

86. Powers of the Court under above noted sections were transferred to the Company Law Board by the Act. For powers and functions delegated to Company Law Board See G.S.R.443(E) Gaz.Ind. dated 18.10.1972.

87. The Companies Act 1956, S.108A to H.

88. Id., S.58A & 58B.

89. Id., S.187-D.

90. Id., S.204-A & 205-B.

other officer authorised by the Government.[91] The Central Government could prohibit appointment of sole-selling agents for any category of goods under specified conditions.[92] Approval of the Central Government was made compulsory for appointment or reappointment of wholetime directors, additional directors, sole-selling agents etc. The Central Government was also empowered to limit the remuneration of managing director and other officers of a company.[93] These are the major changes in the field of administrative controls over companies envisaged in the Companies (Amendment) Act 1974 (41 of 1974).

Sometimes it is criticised that the true effect of the Companies (Amendment) Act 1974 (41 of 1974), is not so much to benefit either the company or its shareholders but to promote the process of state capitalism in the field of industry.[94] But this criticism does not sound good. It is true that the company law in India took a major departure from its english counterpart by this amendment. In the past, the Companies Acts in India were more or less a blind copying of the english provisions. There were only some minor changes, absolutely necessary to suit the Indian situation. The increased powers and responsibilities given

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91. Id., S.209-A.
92. Id., S.294AA.
93. Id., S.637AA.
94. Shah S.M., op.cit., p.8.

to the Company Law Board now, is a welcome sign towards the creation of an independent regulatory agency. The changes brought about in matters of share transfer, inspection, investigation etc. are the direct result of the experience gathered from the administration of the company law during the past years. It is a bold step towards an independent company jurisprudence for India. At best, it can be said that the prevalent social and political philosophy in India, a socialistic pattern of society, finds its expression in the new amendment, in a limited way.

The Amendment Act of 1977

The Companies (Amendment) Act 1977 (46 of 1977) prescribed the manner in which the orders of the Company Law Board is to be enforced.[95] Any order made by the Company Law Board can now be enforced in the same manner as a decree made by a Court. If the Company Law Board finds any difficulty in executing such order, it can seek the help of the Court having territorial jurisdiction over the company or the person on whom the order is sought to be executed.[96] The Central Government is empowered to exempt any company or any class of companies from the restrictions on acceptance of deposits.[97] Another change brought about by this amendment is that any notification proposed to be issued by

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95. See The Companies (Amendment) Act 1977, Ss. 8 & 9.

96. The Companies Act 1956, S.634A.

97. Id., S.58A regulates the acceptance of deposits by Companies.

the Central Government under Section 620 of the Companies Act 1956[98] should be approved by both Houses of Parliament.[99]

Enactments Closely Related to the Companies Act,1956

In addition to this general Act, there are a number of State Acts, prescribing or controlling the activities of non-trading companies.[100] There are other Central and State Acts also regulating certain categories of business.[101]

The Capital Issues Control Act 1947 (29 of 1947) gives wide discretionary powers to the Controller of C al Issues and the Central Government to regulate the issue of shares.[102] The Imports and Exports (Control) Act 1947 (18 of 1947), prescribes a system of licenses and permits for controlling the export and import of raw materials and products. The Industries (Development & Regulation) Act 1951 (65 of 1951) confers wide powers on the Government to regulate the business of companies for a planned development

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98. Id., S.620 empowers the Central Government to direct that any of the provisions of the Companies Act (other than Sections 618, 619 and 619A) shall not apply to any government company or shall apply to any government company, only with such exceptions, modifications and adaptations as may be specified.

99. See the Companies (Amendment) Act 1977(46 of 1977),S.7.

100. See the State Acts like the Andra Pradesh Non-Trading Companies Act 1962 (20 of 1962); the Assam Non-Trading Companies Act 1960 (32 of 1960); the Bihar Non-Trading Companies Act 1959 (2 of 1959);the Kerala Non-Trading Companies Act 1960 (5 of 1960);the Punjab Non-Trading Companies Act 1960 (25 of 1960); etc.

101. See the Banking Regulation Act 1949 (10 of 1949); the Chit Funds Act 1981 etc.

102. The Capital Issues Control Act 1947 (29 of 1947), Ss.3, 4, 5, 6 & 7.

of industry. The control measures include licensing,[103] registration[104] and investigation.[105] Control of production, distribution and sale[106] including the power to take over the management of the companies[107] under certain circumstances is also envisaged under this Act. The Securities Contracts (Regulation) Act 1956 (42 of 1956), empowers the Central Government to control the activities of stock exchanges to a great extent. The Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969) establishes a quasijudicial body, the Monopolies and Restrictive Trade Practices Commission, having administrative powers over companies. This Act confers wide powers on the Central Government also to check concentration of economic power. The Reserve Bank Act 1934 (2 of 1934), the Essential Commodities Act 1955 (10 of 1955), the Foreign Exchange Regulation Act 1973 (46 of 1973), and a large number of Rules and Regulations made under the above Acts also regulate the formation and management of companies in India. The present study concentrates on the administrative control under the Companies Act.

The Increasing Sphere of Administrative Control

The changing attitude towards the functions of State finds its practical manifestation in the involvement of State in commercial activities. Friedman enumerates three

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103. The Industries (Development and Regulation) Act 1951, (65 of 1951), Ss.11 & 13E.

104. Id., S.10.

105. Id., S.15.

106. Id., S.23.

107. Id., S.18G.

functions of a State in a mixed economy, viz. State as provider, as regulator and as entrepreneur.[108] This classification is appropriate to the modern trend of thinking. For the effective performance of these functions extensive application of regulatory powers is a must. Even when the concept of freedom from state intervention or laissez faire was prevalent, total absence of intervention in enterprises was not there. The old ecclesiastical and eleemosynary corporations were also subjected to visitation by Pope or the Founder. The controls developed with the development of trade and industry. Each time steps were taken to prevent the prevalent abuses of economic activities. The Security laws and antitrust laws of U.S.A., monopoly laws and investor protection laws of England and India are aimed at preventing abuses in the respective fields. Thus protective legislation has grown in all dimensions. Its content and form changed to meet the changing needs. With the growing awareness of the stake of all sections of the community in Industry, regulations were to be introduced to protect all these interests. The increasing need for a planned development of our country also contributed to the increase in control over companies. The abundance of regulations and its ever increasing trend necessitates the proper and efficient administration of these controls to avoid frustration of industrial growth. In the following chapters, an attempt is made to study these administrative controls over companies in India.

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108. See, Friedman, W. The State and the Rule of Law in a Mixed Economy, Stevens & Sons, London, (1971), pp.3-6.

CHAPTER - 2

A Brief Outline of Present-Day Controls

Two Contrasting Concepts of Control

Regulation of corporate activities is considered essential since they utilise public money as share capital, loan or deposits. The persons managing these funds owe social and moral obligation to the State, shareholders, workers and the community. The problem of control is to be considered in the context and against the background of two overcontending concepts underlying all legal and social phenomenon, namely the freedom of individual on the one hand and the social solidarity on the other. In their extreme forms the one which can be described as state of nature, the individual has supremacy over all claims of society. In the other, there is complete submergence of the individual in the amorphous mass of the society. In the capitalist system, it is considered that the ultimate responsibility to control the management should be vested on the investor who supplied the capital. But the socialists imagine that, the true function of the Government in relation to industry is to interfere in the existing relationship

between management, shareholders, workers, consumers and the community. The controls should be in between the two, the degree of preponderance of one over the other should be suited to the prevailing social and economical conditions. The role of an independent judiciary should be as peace maker between the confronting interests. It should be a third power controlling the situation. An independent regulatory body can play this role effectively. The analysis of the present day control over the management of companies is made with the above objective in mind.

Objectives of Control

The true purpose for which regulations are made in a country depends upon the economic and political policy followed by the Government and the goal that it aims to achieve. In India, the Directive Principles of State Policy visualise an economic and social order based on equality of opportunity, social justice, the right to work, the right to an adequate wage and a measure of social security for all citizens.[1] The Indian company law attempts to provide a legal framework for the corporate form of business in which organisation, capital, labour and community are brought together in a particular form of relationship. In the opinion of the Company Law Committee,

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1. The Constitution of India, Articles 39(f) & 43A.

> "Our objective will be to consider ... to what extent it is possible to adjust the structure and methods of working of the corporate form of business management with a view to weaving an integrated pattern of relationship as between promoters, investors and management so that (a) the efficiency of the corporate form of organisation may be increased as measured by accepted standards; (b) managerial efficiency is reconciled with the legitimate rights of investors; (c) the interests of labour, creditors and other partners of production and distribution may be duly safeguarded; and (d) the attainment of ultimate end of social policy is helped..."[2]

Thus, in India, the objective is not confined to the protection of investor and creditor only. It also aims to built up a socialistic pattern of society. The amendments to the Companies Act 1956 made in 1960, 1963, 1969 and 1974 are in tune with this objective.

Nature of Controls in Socialist Countries

In socialist countries like the Soviet Union, most of the business activities are carried on by the State or are largely controlled by the State. There, the function of control is to see whether the decisions and instructions are carried out and to find out the actual results of its

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2. See the Company Law Committee Report, 1952, Ch.1., as cited by Ginwala, F.R., Company Law and Problems of Corporate Enterprise, N.M. Tripathi Private Ltd., Bombay, (1958), p. xxxvii.

execution. This enables them to draw conclusions as to the expediency of such decisions and improvements to be made in the economic and administrative planning.[3] The control involves checking of activities of men responsible for proper performance of business and assessing the actual performance in keeping with the results planned.[4] This makes it possible to determine the reasons for the discrepancy and to decide whether the means employed were appropriate. The Supreme Soviet Edicts on Economic Enterprises lays down general principles of State control over production enterprises.[5]

Nature of Controls in Other Countries

In all legal systems, one of the main objective of corporate control is protection of investors. Another object is prevention of management abuses. Yet another object is prevention of concentration of economic power endangering public interest. It may also try to safeguard the interests of workers and other partners of production and distribution.

From the above discussion it can be seen that socialist countries give more importance to prevention of management

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3. See, Leon Boim, G.G. Morgan & A.W. Rudzinski, Legal Controls in Soviet Union, A.W. Sijthoff-Leyden, (1966), p.18.

4. Ibid.

5. William E. Butler, The Soviet Legal System, Selected Contemporary Legislation and Documents, Oceana Publications, INC., New York, (1978), p.169.

abuses and protection of the interests of workers and community.[6] There the investment is mostly made by the State. The State monopoly is not regarded as a menance to society. But in other countries, all these aspects need equal emphasis.[7]

Classification and Controls

The nature and extent of controls depend upon the nature of the company. Thus while public companies are subjected to stringent control, the private and government companies enjoy much exemptions.

In India at present, companies are classified based on a number of considerations. Thus there are national, multinational and foreign companies depending up on the country in which it is incorporated, and the field of its operation. Based on the liability of members, there are limited by share company, limited by guarantee company and unlimited company. Again considering the source of capital and the power to transfer shares and accept deposits, there are private, public and government companies. Among private companies also the extent of controls differ depending on whether it is a private company proper, private company which is a subsidiary of a public company or private company

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6. More than half of the Soviet Business Law is concerned with labour management relations.

7. In England, America, Japan and other capitalistic countries, the concept of free market competition determines the nature of corporate controls. There, the anti-monopoly laws tries to ensure free market competition. The security laws administered either by the State or by the Stock Exchanges help to protect the investors.

owned by the Government, the controls being stringent in the case of a private company which is subsidiary of public company. In the case of public company also there are deemed public companies, public companies owned by the Government and other public companies with different intensity of controls.[8] Government companies formed under the Companies Act 1956, and those incorporated under special statutes have different degrees of control. This variation in the intensity of controls necessitates a rethinking. There need be a rational basis for classification. The Sachar Committee has made specific recommendations in this regard.[9]

The Companies Act 1981, made salutary provisions relating to classification of companies in England.[10] The companies are classified into small, medium and large companies for the purpose of disclosure and accounting requirements and the extent of control differ considerably. The distinction between public and private companies in the matter of legal controls is much reduced.

In Germany, there are three forms of limited company 1) Public Limited Company (Aktiengesellschaft or AG);

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8. See Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holdings Ltd., A.I.R.1981 S.C.1298; (1981) 51 Com.Cas.743 (S.C).
9. The Sachar Committee Report, (1978), Chapter IV, para 4.5.
10. See the (English) Companies Act 1981, Schedule 8A.

(2) Private Limited Company or (Gesellschaft mit beschrankter Haftung) and (3) Limited Partnerships (Kommanditgesellschaft) which are regulated by separate statutes.[11] In the U.S.A., there are seven different forms of business enterprises, of which business corporation and professional corporations are the only two forms which have corporate existence.[12] In the case of public issue of securities, the controls are almost uniform for all corporations.

In determining the intensity of controls over different class of companies, influence of such company on the community, and the development of industry are to be considered. However, every form of company should be subjected only to so much controls as are necessary to achieve the objectives stated in the statute. The different kinds of controls like shareholder control, administrative controls and judicial controls are considered on this basis.

Shareholder Control

The board of directors and the shareholders in general meetings are the two organs of a company having power to manage the affairs of the company in all legal systems. But

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11. Cohn E.J., Manual of German Law, Vol.II, (2 edn., 1971) p.77.

12. See Henn, Law of Corporations, West Publishing Co., Minnesota, (1979), p.37.

the substantial part of the management of companies is vested on the board of directors[13] and the shareholders retain only nominal management powers. Thus, the executive board which may often contain non-members,[14] carry on the activities of the company subject to the restrictions contained in its constitution.[15] But powers in certain matters like alteration of memorandum and articles, appointment of directors and auditors, voluntary winding up etc. could be exercised only by members in general meeting. In addition to that, certain powers are deemed to be vested on shareholders as incidental to corporate membership.[16] The Companies Act contain special provisions for the protection of minority shareholders.[17]

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13. See the Companies Act 1956, S.291 which states "... the board of directors of a company shall be entitled to exercise all such powers and to do all such acts and things as the company is authorised to exercise and do..."

14. Id., S.408. This provision expressly authorises the Government to nominate such number of directors as it deems fit in certain conditions. In Germany the Supervisory Council contains representatives of various interests like shareholder, consumer, worker, community etc., See Cohn E.J., Manual of German Law, Vol.II, Oceana Publications INC., London, (2nd Edn., 1971), p.85. In other countries like U.S.A., U.K., Australia, Japan etc. there is no requirement that directors shall be shareholders.

15. The statutory incorporation documents, the memorandum of association and articles of association, are basic instruments of the company from which the different organs of the company derive it's powers and beyond which they cannot act.

16. These rights include right to get dividends, right to get certain documents of company, right to participate and vote in general meetings etc.

17. The Companies Act 1956, Ss.235-251, 397 & 398. (The right against oppression and mismanagement, preemption rights, right to get the companies affairs investigated etc.).

The right of shareholders to control management of companies may be classified into (1) Corporate Membership Rights; (2) Individual Shareholder Rights and (3) Minority Shareholder Rights. The distinction between individual and corporate membership rights is founded on various considerations. When a person acquires the share of a company he impliedly undertakes to bind himself by the articles of the company. It is a contract with the company to abide by the decisions of the majority shareholders in certain matters, if arrived at in accordance with the law and the articles. So the rights of a shareholder which can be exercised only through general meetings can be termed as corporate membership rights.[18] There are certain other rights which the shareholder can assert even without the help of other shareholders. The majority shareholders cannot take away these rights from him, without his consent. In the enjoyment of this right a single shareholder can defy even a majority consisting of all other shareholders.[19] The qualified minority right is a creation of statute. It is a right which can be exercised, not at the discretion

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18. See Pender v. Lushington, (1877) 6 Ch.D.70; Pulbrook v. Richmond Consolidated Mining Co., (1878) 9 Ch.D.610; Edwards v. Halliwell /1950/ 2 All E.R. 1064.

19. See Schmitthoff, Clive M., Palmers Company Law, Stevens & Sons Limited, London, (21st edn., 1968), p.498.

of a single shareholder, but only by the co-operative act, within the body corporate, of a membership group of statutorily defined size.[20]

Corporate Membership Rights

The general body of shareholders retain control over the exercise of powers by the board of directors. The board derives its power from the articles of the company. But shareholders can amend the articles and take away any of these powers and vest them in general meeting. Appointment of directors is made normally in general meetings.[21] The general members can exercises control here by refusing to re-elect the directors. Another method available to the shareholders is to exercise management power by invoking the right to remove directors from office.

The directors have to exercise their powers for and on behalf of the company.[23] Certain powers specified in

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20. For example see the Companies Act 1956, Ss.236, 399, 408 etc. There, shareholders carrying one tenth voting rights or hundred members, is required to initiate proceedings.

21. In some cases it is permissible to appoint directors by articles of association. By Section 262, casual vacancies in the board may be filled by the board of directors. Under Section 408, the Central Government may appoint such number of directors as it deems fit in certain circumstances.

22. The Companies Act 1956, S.284.

23. See Gaiman v. National Association for Mental Health, [1970] 2 All. E.R. 362.

Section 292(1)[24] of the Companies Act 1956, could be exercised only in the manner stated therein. Even in these cases, general meeting may impose such conditions and restrictions as it may deem fit.[25] Consent of the company in general meeting is necessary to exercise certain powers by board of directors.[26]

But, it is only in law and theory that the 'risk-bearing' shareholders are considered as risk takes, top rulers and policy makers when they meet in general meeting. Until one or the other step is taken to exercise their rights as stated above, the directors, while exercising their powers under the articles can disregard the wishes of the shareholders in general meeting.[27]

The two organs of a company, the shareholders and the directors cannot usurp their respective powers as contained

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24. The Companies Act 1956, S.292(1) states, "The board of directors of a company shall exercise the following powers on behalf of the company and it shall do so only by means of resolutions passed at the meeting of the board:
    (a) The power to make calls on shareholders in respect of money unpaid on their shares.
    (b) The power to issue debentures.
    (c) The power to borrow money otherwise than on debenture.
    (d) The power to invest funds of the company; and
    (e) The power to make loans..."
25. Id., S.292(5).
26. Id., S.293.
27. Automatic Self Cleaning Filter Syndicate Co. Ltd. v. Cunninghame, [1906] 2 Ch.34; Gramophone and Typewriter Ltd. v. Stanley [1908] 2 K.B. 89. Salmon v. Quin and Axtens, [1909] 1 Ch. 311 (C.A).

in the articles.[28] The concept of corporate personality enables the dealing of the enterprise to be kept separate from its members.[29] In the case of private companies, the position is still worse. Voting rights of members in a private company could be varied by the memorandum and articles[30] so as to give a comfortable position to directors. The position of public companies is also not good. Since the shareholdings in it are widely dispersed, the members attending the general meeting would be very few, and members who are the controlling shareholders would be in a better position, inspite of the restrictions on proxy solicitations.

The board of directors has lesser power in France because of the fact that substantial powers are reserved by law to the shareholders.[31] They have the power to dismiss chairman of the board at any time. The person so dismissed cannot claim compensation even. In Japan, the proxy solicitation rule is made stringent to facilitate effective

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28. Shaw and Sons (Salford) Ltd. v. Shaw and Shaw, [1935] 2 K.B. 113; Scott v. Scott [1943] 1 All E.R.582, Suburban Bank v. Thariath, A.I.R. 1968 Ker.206. A.P. Pothan v. Hindustan Trading Corporation, [1967] 37 Com.Cas.266 (Ker.).

29. Tom Hadden, Company Law and Capitalism, World University, Weidenfeld and Nicolson, London, (1972), p.22.

30. Bushell v. Faith, (1970) A.C.1099. In India provisions against creation of unequal voting rights are not applicable to private companies by S.170(1), if there is provision in the article to the contrary.

31. The French Commercial Code, Art.153.

exercise of shareholder's rights in general meetings.[32] The Commercial Code prohibits general proxy. Proxy is allowed only with respect to a particular shareholder meeting.[33]

It can be seen that inspite of the wide powers conferred by the Companies Act, the shareholders in India are not in a position to exercise effective control over the company's affairs.

Individual Membership Rights

An individual shareholder can enjoy certain rights, which cannot be taken away from him by the majority shareholders. The individual rights of a member arises in part from the contract between the company and himself and in part from the general law. An enumeration of all such rights is hardly possible. The foremost among such rights is the one "to maintain (himself) in full membership with all rights and privileges appertaining to that status."[34] His contractual rights include the right to have his name and shareholding entered on the register of members, to vote at general meetings, to receive dividends when declared, to exercise pre-emption rights etc. Under the general law

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32. Makoto Yazova, 'The legal structure for Corporate Enterprise: Shareholder Management relations under Japanese Law,' Law in Japan, Harvard University Press, (1963), p.547 at p.550.

33. The Japan Commercial Code, Art.239(3) & (4).

34. Per Jenkin, L.J. in Edwards v. Halliwell, [1950] 2 All E.R. 1064, at p.1067.

he is entitled to restrain the company from doing ultra vires acts;[35] to have a reasonable opportunity to speak at the meeting of members,[36] to move amendments to resolutions proposed at such meetings,[37] to transfer his shares,[38] etc. Eventhough the individual rights appear to be very wide, there are many limitations.[39] For example, a person whom the shareholders had expressly refused to elect as director may be appointed as additional director of the company by the board of directors.[40] Like wise, the declaration of the Chairman of a general meeting that a resolution was validly carried cannot be challenged by a member unless fraud is proved.[41] A shareholder has only limited access to the books and other documents of a company. There are a number of instances showing the limitation of shareholder's power, some of which are discussed in the following chapters.

However the individual rights of shareholders like the right to inspect books and registers and obtain extracts,

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35. Davidson v. Illidge, (1883) 23 Ch.D.654.
36. Wall v. London and Northern Assets Corporation, /1898/ 2 Ch.469.
37. Henderson v. Bank of Australasia, (1890) 45 Ch.D.330.
38. Re Smith, Knight & Co., (1868) 4 Ch.App.20.
39. See Pennington, Robert R., Company Law, Butterworths, London, (3rd edn., 1973), p.562.
40. Our Prasad v. Rameshwar, A.I.R. 1933 All.344 (D.B.); For a discussion on this point see infra Chapter 10, n.55.
41. Kerr v. Mottram Ltd., /1940/ 2 All E.R.629; The Companies Act 1956, s.178.

and the right to approach the Courts, could be used to control management.[42] The right to approach the Central Government or the Courts in case of oppression and mismanagement, the right to get the affairs of the company investigated[43] etc. are powerful tools in the hands of shareholders.

Qualified Minority Rights

The exercise of qualified minority rights require the co-operation of a group of shareholders within the company. The size of this minority group vary according to the right they propose to exercise. For example, the size of minority group required for making an application for investigation under Section 235 of the Companies Act 1956 is different from the size of the group required for making an application to the Central Government for prevention of oppression and mismanagement under S.408 of the Companies Act.[44]

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42. See infra Chapter 15.

43. See infra Chapter 17.

44. The Companies Act 1956, S.235 reads,

> "The Central Government may appoint ... (a) in the case of a company having a share capital, on the application either of not less than two hundred members or of members holding not less than one-tenth of the total voting power therein; ..."

Id., S.408 reads,

> "Not withstanding anything contained in this Act, Central Government may appoint ... on the application of not less than one hundred members of the company ..." (emphasis added).

The purpose of qualified minority is normally to provide access to a competent forum in which a decision on the disputed measure can be obtained. Thus, if the dispute is with the management, a qualified minority may requisition an extra-ordinary general meeting of the shareholders;[45] if the dispute is between two rival groups, minority have access to the Court[46] or to the Central Government.[47]

A Critical Evaluation of Shareholder Controls

Shareholders, as the suppliers of capital are more interested in the returns in the form of dividends. So far as they get it, they are not much interested to take pains to keep the management under control. The demand of the society to get better quality of goods and services at reasonable cost would have little appeal to them. A planned and overall development of the country or the achievement of the goal of a socialistic pattern of society[48] are of no concern to shareholders. So the shareholder control in no way helps such stated objectives of the company law; even-though it may to a great extent restrict the mismanagement of company's funds by the management. Even for this limited

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45. Id., S.169.
46. Id., S.399.
47. Id., S.408.
48. The Industrial Policy Resolution, Government of India (1948).

purpose, the present system is inadequate.[49] Most of the control provisions applicable to public companies are exempted from application to private and government companies. The deemed public companies[50] also enjoy much previleges in this regard.[51] Even in the case of public companies due to restrictions imposed on members in the matter of inspections of books of account and other valuable records of the company, the rights conferred on shareholders could not be properly exercised.[52] It is necessary that while the intensity of legal controls, relating to formal disclosure and publicity requirement may be different according to the size of the organisation, the right of shareholders should be uniform in all type of companies in respect of voting rights, right to inspection etc. except perhaps the right to transfer shares to an outsider.[53]

Judicial Controls

So far as the judicial control is concerned, the aim is to keep the field free for the play of normal forces without the dice being loaded against one side or the other. The purpose is to see that the actions of companies

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49. See infra Chapter 6.

50. Private companies deemed to be public companies under Section 43A of the Companies Act 1956.

51. Only disclosure provisions are made applicable to those companies at par with public companies.

52. For a detailed discussion on the subject, see infra Chapter 15.

53. Since as per the Companies Act 1956, S.3(iii)(a), the restriction on the right to transfer shares is an essential condition for the creation of a private company.

are reasonable, just and proper and in the interest of everyone concerned with it.[54] The judiciary should pay heed not only to the interests of the capital suppliers but also the just needs of the community.

The Courts control the management and affairs of the company to a large extent. In addition to the extra-ordinary power and jurisdiction of the Supreme Court of India and the State High Courts for judicial review, certain statutory powers are entrusted with the High Courts. These powers cannot be transferred.[55] The joint stock companies which would have formerly gone into liquidation can now be preserved as national assets with the aid of judicial control, to tide over difficulties of management. The powers of Courts relating to the control of memorandum and articles, control over issue of share capital at a discount, control over meeting of companies etc. were taken out from the Courts and conferred on the Company Law Board.[56] But, the Court still exercise controls by controlling fradulent directors, preventing liquidation of companies in appropriate cases

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54. N. Rajagopala Ayyangar, J. in his speech in a seminar on "current problems of Corporate Law, Management and Practice," held at Delhi in November 1962; as reported in 'Proceedings of the Seminar on Current Problems of Corporate Law, Management and Practice, Indian Law Institute, New Delhi, (1962), p.111.

55. By S.10(2) of the Act, the powers under Sections 237, 391, 394, 395 and 397 to 407 shall be exercised by the High Court and cannot be transferred to any other Court. In respect of companies, having a paid up capital of rupees one lakhs, the powers under Sections 425-560 and other provisions of the Act relating to winding up of companies cannot be transferred from the High Courts.

56. The Companies (Amendment) Act 1974, (41 of 1974).

and preventing oppression of members by the management and controlling the conduct of liquidation of companies.

In England, the powers of the Courts are much greater compared to the Indian system. Many of the powers and functions exercised by the Central Government or the Company Law Board, in India are exercised by the Courts, in England. Thus, the power to hear petition on alteration of memorandum or articles, to rectify register of charges, to call general meetings etc. are still vested in the Courts. But in the U.S.A., the judicial control over company management is very much limited. Independent agencies like the Securities Exchange Commission and the Federal Trade Commission are entrusted with the adjudication of most of the matters.

It is submitted that the superiority of ordinary law courts in the matter of a specialised branch like company law is doubtful. To resolve a conflict arising out of company law it is not enough to be a well qualified lawyer but the knowledge of accountancy, management, economics and allied subjects are also essential. The French Commercial Courts consisting of Judges elected to represent different interests affected by the industries appear to be a good example, though lack comprehensiveness to enforce State objectives. A quasi-judicial authority free from governmental interference, the one that prevails in the U.S.A. with modifications suited to Indian conditions, would be a better

choice. Such agency should contain experts from profession of accountancy and economics and representatives of the Government, industry, workers and consumers in addition to experts in legal profession so as to blend all these interests.

Now the administrative controls may be considered. But before doing so, certain constitutional aspects of control may be briefly referred to in view of its intimate relation to administrative control.

Constitutional Aspects of Controls

The need to regulate private trade and business to subserve the needs of the community is recognised in all countries. In England, the power of parliament to make any law regulating business is supreme and not subject to any limitation by 'Fundamental Laws'[57] though subjected to certain practical limitations.[58] In the United States of America, the Federal Government enjoys no express power to control the formation and business activities of corporations; but by exercising the Federal Power over interstate commerce and the mails, taxation, bankruptcy, and procurement, many restraints are imposed on business corporations.[59] In

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57. See O.Hood Phillips, Constitutional and Administrative Law, Sweet & Maxwell, London, (5th edn., 1973) pp.45-53.

58. Id. at p.51.

59. See Harry G. Henn, Law of Corporations, West Publishing Co., New York, (1979), p.27.

Australia, the Federal power to legislate on corporate matters is contained in the Constitution of Australia.[60] In Soviet Union, the economic foundation being the socialist system of economy and socialist ownership of the instruments and means of production, the State's power over them is very wide.[61]

In India, the power to legislate on trading corporations is expressly conferred on the Central Government.[62] The Central Government could legislate on trading or non-trading corporations if the objects are not confined to one state.[63] However, the power to legislate on non-trading corporations is with the State.[64] The fundamental right to carry on any occupation, trade or profession[65] is subjected to reasonable restrictions contained in Article 19(6).[66] The test of reasonableness is to delimit the permitted extent of social control that can be imposed on a person in the enjoyment of this right.[67] The restrictions imposed for securing objects

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60. The Constitution of Australian, S.51(XX) empowers the Federation to make laws on "Foreign Corporations and Trading Corporations formed in any state or part of the Commonwealth." See P.H. Lane, Federal Control of Trading Corporations, (1974) 48 A.L.J. 233.

61. The Constitution of the U.S.S.R., Art.4.

62. The Constitution of India, Seventh Schedule, List I., Entry 43.

63. Id., Entry 44.

64. Id., List II, Entry 32.

65. Id., Art.19(1)g.

66. Id., Art.19(6) states "Nothing in subclause (g) of the said clause shall affect the operation of any existing law in so far as it imposes, or prevent the state from making any law imposing, in the interests of general public, reasonable restrictions on the exercise of the rights conferred by the said sub-clause..."

67. Pathumma v. State of Kerala, A.I.R. 1978 S.C.771.

declared in the Directive Principles of State Policy in Part-IV of the Constitution are considered to be reasonable restrictions especially under Article 19 and Article 31C.[68] The State policy towards trade and industry and economic system of the country is contained in Articles 38, 39, 41, 42, 43 and 43A of our Constitution. Article 39(b) & (c) states:

> "(b) - The State shall in particular direct its policy towards securing ... that the ownership and control of material resources of the community are so distributed as best to subserve the common good;
>
> (c) - that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment."

With the decision of the Supreme Court in the Keshavananda case[69] the Parliament is empowered to amend the Constitution to override or abrogate any of the Fundamental Rights in order to enable the State to implement the Directive Principles.[70] India, being a country wedded to the goal of socialist society,[71] can achieve those objects by exercise of legislative powers of Parliament without much hindrance by the Courts.

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68. The Constitution (42nd Amendment) Act, 1976.

69. Kesavananda Bharathi v. State of Kerala, (1973) 4 S.C.C. 225.

70. Id., para 715.

71. As disclosed in the Preamble and the Directive Principles of State Policy of the Constitution.

Administrative Controls

The administration of laws regulating company management in India is mainly entrusted with the executive Government. From the formative stage to the very last, removal of name from the register of companies, extensive regulatory powers are used to achieve the declared objectives of the company law. The Central Government determine the policy to be adopted in different matters and enforce it through the concerned Ministries,[72] by subordinate legislation and by issuing directions on various matters. Quasi-judicial functions are also entrusted with different agencies.[73] Different Advisory Commissions[74] are also set up for advising the Government in this matter. Regulation of the day-to-day activities of companies are also done by different agencies[75] like the Registrar of Companies, the Registrar of Monopolies & Restrictive Trade Practices, the Controller of Capital Issues,

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72. Administration of different aspects of company regulation are entrusted with different Ministries and Departments like the Department of Company Law Administration, the Department of Economic Development etc.

73. For example the Company Law Board, the Monopolies and Restrictive Trade Practices Commission, the Reserve Bank etc.

74. The Company Law Advisory Commission, Advisory Commission under Industries (Development and Regulation) Act 1951, etc.

75. See infra chapter 3.

the Reserve Bank etc. The inter-relations between these agencies are very limited.[76]

The methods employed in the administrative process for control of companies are (1) administrative legislation; (2) administrative adjudication and (3) exercise of administrative discretion. The Government and other subordinate agencies are empowered to make rules and regulations under company law. In addition to this, they can issue directions and clarifications on various matters arising out of the administration of company law.[77] Administrative adjudication is at different stages of company's life. For comprehensiveness administrative controls at different stages such as (1) formation, (2) expansion, (3) management, (4) issue and maintenance of share capital, (5) borrowing and lending, accounting and auditing, (6) amalgamation and (7) winding up are considered separately. Almost all known methods such as licensing, registration, approvals, sanctions, prosecution, settlement of disputes by adjudication, etc. are used during by the administrative authorities. The administration of a socio-economic legislation like company law needs large discretionary powers. Then only it can handle intricate

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76. See the Administrative Reforms Commission, "Report on Economic Administration, recommendations and conclusions," (1970), pp.89-98.

77. See <u>infra</u> n.79.

problems involving investigation of facts and making of choices effectively. The power to order investigation, inspection, amalgamation, etc. needs exercise of discretion before deciding what action is to be taken.

Administrative Legislation

The device of administrative legislation is widely employed in the company law for diverse purposes like the application of the Act to different territories with necessary conditions and modifications,[78] to elaborate and supplement the Act by working out the details of the principles laid down in the Act,[79] etc. A large number of forms are prescribed under these rules which are intended to solicit all necessary information on the basis of which the concerned authority can exercise his discretion in a judicious manner. In addition to these rules and forms, administrative directions and clarifications are issued for different purposes. With the aid of these directions, the policy decisions of the Government is made known to the public. It prescribes the procedure to be followed by the administrators and the public.

The agencies that exercise rule making powers are many in the field of company law. Thus, the Central

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78. The Companies Act, 1956, proviso to S.1(3).

79. See the Companies Regulations 1956; The Cost Audit Report Rules 1968; The Companies (Acceptance of Deposit) Rules 1975 etc.

Government represented by the Departments in charge of administration of these Acts,[80] the State Governments,[81] the Supreme Court of India,[82] the Company Law Board,[83] the Monopolies and Restrictive Trade Practices Commission,[84] and several other sub-ordinate administrative authorities are empowered to exercise rule making powers on different matters.

Under the Companies Act 1956, the Central Government is empowered to make rules and regulations to carry out the purposes of the Act.[85] Such rules may cover all or any of the matters which are to be carried out by the Central Government under the Act. Punishment upto a fine of five hundred rupees may be prescribed by such rules for contravention thereof. For a continuing contravention a further fine upto fifty rupees per day during the continuance of the contravention, can also be provided.[86] The Central Government is also empowered to alter any of the regulation, rules,

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80. See the Companies Act 1956; Sections 214, 273, 280, 437, 443, 507, 512, 642 etc., The Capital Issues (Control) Act 1947 S.12, the MRTP Act 1969, S.67, etc.

81. See the Constitution of India, Entry 32, List II of the Seventh Schedule. The State Governments are empowered to make laws regulating incorporation, winding up etc. of non-trading companies.

82. The Companies Act 1956, S.643.

83. Id., S.10E.

84. The Monopolies and Restrictive Trade Practices Act 1969, S.66.

85. The Companies Act 1956, S.642(1)(b).

86. Id., Sub-Section (2).

tables, forms and other provisions contained in the schedules[87] to the Companies Act 1956.[88] Such alterations have effect as if enacted in the Act itself.[89]

The rules or alterations made as aforesaid are to be laid before each House of Parliament while it is in session for a period of thirty days.[90] The Parliament may make modifications or annul the rules. But any action taken before the rule is modified or annulled shall have validity.[91] There is no provision in the Companies Act which insists that Central Government should consult affected interests before making any rules or alteration to the schedules.

In Shamdasani v. Central Bank of India,[92] the Bombay High Court considered the question whether the Central Government could introduce a new form or amend the substantive provisions of the Act. The Court's answer was in the negative.[93] But the Court observed that for amending a form in schedule III of the Act, it was a substantial compliance with the provision of the Act if the Central Government published a notification merely stating that the form should be amended in the manner specified therein.[94]

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87. Except Schedules XI & XII.
88. The Companies Act 1956, S.641(1).
89. Id., Sub-Section (3).
90. Id., Sub-Section (3); See also S.642(3).
91. Ibid.
92. A.I.R. 1944 Bom.107.
93. Id. at p.111 per Beaumont, C.J.
94. Id. at p.113 per Lokur, J.

Overlapping of Judicial and Administrative Controls

In a number of matters relating to companies, Judiciary and Administrative agencies are given concurrent powers. For example, if the board of directors refuses to register transfer of shares, the members can approach either the Central Government[95] or the Courts.[96] These two remedies are, alternative remedies.[97] The recourse to remedy under Section 111 is not a bar for the Court exercising its power under Section 155.[98] The reason is that the two remedies provided are not the same and as such the remedy provided under one section would not operate as a bar in pursuing the remedy provided under the other section.[99] In Harinagar Sugar Mills case[100] the Court held that the Central Government exercised judicial function under Section 111 and should therefore record reason for its decision.

In the case of a scheme for reconstruction or amalgamation of a company, the Court has power to sanction such scheme.[101] But notice of such proceedings ought to be

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95. The Companies Act 1956, S.111.

96. Id., S.155.

97. Harinagar Sugar Mills v. Shyam Sunder, A.I.R. 1961 S.C. 1669.

98. Joseph Michael v. South Indian Bank, (1978) Tax.L.R. 1717 (Ker.).

99. Moni Mohan Mukherjee v. Jalpaiguri Cinema Co. Ltd., (1975) Tax.L.R.1741 (Cal.).

100. Supra n.97.

101. The Companies Act 1956, S.394-A.

given to the Central Government. The Central Government may, in the public interest, cause amalgamation of two or more companies.[102] Likewise, for the reduction of share capital of a company, special resolution and confirmation by the Court is necessary.[103] The purpose of this requirement is preservation of share capital of company.[104] But, issue of shares at a discount, which also intends to preserve the capital of company is to be approved by the Company Law Board.[105] For the purpose of prevention of oppression and mis-management, the Court has power to give appropriate directions.[106] For the same purpose, the Central Government is also clothed with abundant powers.[107]

Such overlapping of powers is unnecessary and makes the legislation very lengthy,[108] and puts the affected party in dilemma as to the course of action to be taken. The area of administrative and judicial controls should be clearly demarcated considering all relevant factors and overlapping should be avoided as far as possible.

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102. Id., S.396.
103. Id., S.101.
104. Report of the Company Law Committee (1952), para 51.
105. The Companies Act 1956, S.79.
106. Id., Ss.397, 398 & 402.
107. Id., S.408.
108. One of the major criticism against the (Indian) Companies Act is that it is unduly lengthy and complicated; See Ginwala and Mazumdar, Company Law and Problems of Corporate Enterprise, Tripathi, Bombay, (1958), p.XXXIV.

An Evaluation

The idea of control arise because of the possibility of conflict between different interests and divorce of ownership from control. Management of the company is vested with the directors and so long as they are acting through a properly constituted board and within the powers given by the memorandum and articles of association, they can disregard even the interference by shareholders in general meeting. There are three conflicting view points on the role of the directors. Firstly, they represent shareholders. Secondly, they are appointed due to their professional competence. Thirdly, they have to safeguard the interests of labour, consumer, community and State. The legal framework for controls should be apt to persuade the directors to take a balanced attitude to all these interests.

The aim of company law administration, both in so far as the control by executive as well as judicial controls are concerned, is to ensure that there shall be secured an investment opportunity. It should also ensure that joint stock enterprise shall be a mechanism by which national economy is fostered as well as national savings garnered. By devising a system of more effective shareholder participation in management and administration of companies, State interference could be minimised. In a system where, at least theoretically 49% of the shareholders could go unrepresented in management, this minimising State intereference would not be possible.

The system of control based on classification according to social importance is a must for proper development of industries. The classification of companies in India and the differential regulation on this basis does not serve that purpose. For an effective administration of economic legislation like company law, the whole process of classification, control and adjudication should be on the basis of consultation of experts in the allied fields. Such a team of experts organised as an institution for controls, clothed with sufficient power, can administer company law better. Judiciary should remain as the authority to say the last word on company matters; but a judge specially qualified in corporate and economic matters shall be entrusted with that task. A reallocation of power, to control companies among the shareholder, judiciary and administration is necessary to achieve the stated objectives of company law.

CHAPTER - 3

MACHINERY FOR ADMINISTRATIVE REGULATION

Functions of Administrative Agencies

Indian Company Law assigns a large role to the executive Government for the supervision and control of company management. This is so, not only in respect of normal management of companies, but also for preventing arbitrary exercise of majority power. In the context of the severe restrictions imposed on the company management, there is a fundamental need for flexibility in individual cases.[1] For balancing the need for flexibility in individual cases with the need for maintaining strict restrictions on company behaviour, a strong and competent civil service is a must.[2]

The controls exercised by the administrative agencies over the corporate sector at present may be

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1. Restrictions are imposed on company management and company practices based on the average behaviour of companies in this country. Hence the need for accommodating individual deviances. See Administrative Reforms Commission, "Report of the Working Group on Company Law Administration," (1967), p.87.

2. See Lokh Sabha Debates Vol.IV., No.55, Column 5968.

grouped as under:

1. Regulations designed to facilitate planned economic development of our country.[3]

2. Control over issue and transactions of securities.[4]

3. Controls to prevent concentration of economic power and group dominance.[5]

4. Controls for promoting sound company management practice.[6]

and

5. Controls for ensuring compliance of social obligation by companies.[7]

Present System of Administration

At present the different aspects of company's activities are controlled by administrative agencies. Very often

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3. Industrial Licensing, capital issues control, control over imports & exports, foreign exchange regulation etc. comes under this group.

4. See the Companies Act 1956 (1 of 1956), provisions dealing with accounts and audit, annual returns, prospectus, company share and debenture, transfer of share; company deposit etc. The Capital Issue (Control) Act 1947 (29 of 1947), and the Foreign Exchange Regulations Act 1973 (46 of 1973), also regulate issue and sale of securities.

5. See the Companies Act 1956 (1 of 1956) provisions on amalgamation, take over and mergers, intercorporate investment and loans etc. See also, the Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969) and the Industries Development & Regulation) Act 1951 (65 of 1951).

6. The Companies Act 1956 provide for regulation of company meetings and procedure and lays down procedures for prevention of oppression of minority shareholders.

7. The concept of public interest is incorporated in the Companies Act 1956 and the Monopolies and Restrictive Trade Practices Act 1969. See the Companies Act 1956, Ss.89(4), 205(1), 211(3), 221, 396, 397 etc.

there is overlapping of controls, thereby making it cumbersome for the companies. Close co-operation of different Ministries and Departments dealing with company affairs is also lacking.[8] The need for an integrated administrative authority for efficient administration and co-ordination of controls was stressed by the Administrative Reforms Committee.[9] An analysis of the functions and powers exercised by different Ministries, Departments and other agencies is made here to evolve a pattern for an integrated administration of all the relevant laws.

Major part of the administration of the company law is entrusted to the Ministry of Law, Justice and Company Affairs. The Department of Company Affairs under this Ministry performs the following functions:[10]

1. Administers the Companies Act 1956, the Monopolies and Restrictive Trade Practices Act 1969, the Chartered Accountants Act 1949 and the Costs and Works Accountants Act 1959.

2. Exercises supervisory control over the functioning of the Institute of Company Secretaries of India.

3. Discharges the responsibilities of the Central Government relating to the administration of the Partnership Act 1932.

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8. Administrative Reforms Committee Report, op.cit., p.107.

9. Ibid.

10. See the Annual Report of the Working and Administration of the Companies Act 1956, 23rd Report (year ending March 31, 1979). The Company Law Board constituted under S.10E of the Companies Act 1956 is functioning under this Department. This statutory body is the main instrument through which powers and functions of the Central Government under the Act are exercised.

In addition to this, there are a number of Government Departments and organisations having vital role in regulating the growth of industries. The Ministry of Industry is responsible for the approval of import of capital goods, foreign collaboration agreements and allocation of foreign exchange and foreign credits to individual companies. The overall allocation of foreign exchange to the various sectors of economy is made by the Ministry of Finance, Department of Economic Affairs. This Department is responsible for the provision of adequate finances through the Industrial Finance Corporations, control over capital issues and participation of foreign capital in Indian industries. The Ministry of Labour is concerned with the overall co-ordination of industrial labour policies and the Ministry of Home Affairs controls the industrial management pool. Thus in the Ministries and Departments itself there is considerable overlapping of powers. This necessitates elaborate procedural formalities for administrative action.[11]

Company Law Board

Most of the powers and functions conferred on the Central Government under the Companies Act 1956 and related enactments are discharged by the Company Law Board, a statutory body constituted under the Companies Act.[12] The powers

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11. For eg., before issuing a licence under the Industries (Development and Regulation) Act 1951 (65 of 1951), the Ministry of Industry consults with other Ministries and Departments. The suggestions made by them are considered by the Advisory Council constituted under the Act.

12. The Companies Act 1956, S.10E provides for the creation of the Company Law Board. The constitution, powers and the mode of exercising the powers are prescribed in the Act.

of the Company Law Board were enlarged when some of the powers and functions previously exercised by the High Courts were transferred to it by the Company Law (Amendment) Act 1974 (41 of 1974).[13] These were in addition to the powers and functions earlier transferred to the Board by the Central Government[14] under the Act.[15] At present the Central Government

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13. The powers of the High Courts relating to confirmation of alteration in the memorandum of association, the issue of shares at a discount, the extention of time for filing of particulars relating to registration of charges and the calling general meeting in case of impracticability, are transferred to the Company Law Board by this Amendment.

14. By a notification No.G.S.R.443(E) of the Government of India, Department of Company Affairs published in Gazettee of India, 18.10.1972, Pt.II S(3)(i), Ext., P.204 9, all the powers and function of the Central Government other than those specified therein were delegated to the Company Law Board. The Notification reads as under: "G.S.R.443(E) - In exercise of the powers conferred by Clause (a) of Sub-Section (1) of Section 637, read with Sub-Section (1) of Section 10-E, of the Companies Act 1956 (1 of 1956), and in suppression of the notification of Government of India in the Department of Company Affairs No.GSR 686, dated 4th May 1971, the Central Government hereby delegates to the Company Law Board the powers and functions of the Central Government under the said Act other than those under the following provisions of the said Act, viz:

    Sections 1, 2nd proviso; 10E (4-A); 81(4),(5),(6); 198(4); 259, 268, 269, 274(2); 309(1),(3),(5-B); 310, 311, 316(4); 370, 372, 385(2); 386(4); 387, 388, 388B, 388C, 388E(1),(3),(5); 410, 488, 609;619-(A)(1), 620, 620-A, 620-B, 620-C, 624-A, 637(1)(6) & 638."

    The powers under Section 294AA was delegated to Company Law Board by the notification No.GSR.343(E) dated 24.6.1975 and those under S.58A and proviso to Sub-Section (1) of S.297 delegated to it vide notification No.GSR.477 dated 31.3.1978. See 1973 Tax.L.R.(Journal) 73-74.

15. The Companies Act 1956, Sections 10E and 637 permit the Central Government to delegate its powers to the Board. S.10E(1) reads:

(f.n. contd.)

exercises powers mainly with respect to policy matters. The Central Government through the Department of Company Affairs makes appointments to key positions like members of the Company Law Board and Public Trustee, Official Liquidator etc. The power, to make rules conferred on the Central Government cannot be delegated.[16] The approval for making intercorporate loans and investments,[17] increase in minimum remuneration to directors, holding managing directorship of more than two companies etc. is given by the Central Government. The power to remove disqualification of a person from holding directorship[20] or managing directorship[21] of a company is not delegated. The power of the Central Government in relation to appointment,[22] remuneration,[23]

(f.n.15 contd.)

> "As soon as may be after the commencement of the Companies (Amendment) Act, 1963, the Central Government shall by notification in the official gazette, constitute a Board to be called the Board of Company Law Administration to exercise and discharge such powers and functions conferred on the Central Government by or under this Act or any other law as may be delegated to it by that Government." Id., S.637(1) reads:
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> "The Central Government may, by notification in the official Gazettee and subject to such conditions, restrictions and limitations as may be specified therein, delegate - (a) any of its powers or functions under this Act (other than the power to appoint a person as public trustee under Section 153-d and the power to make rules) to the Company Law Board. (b)..."

16. Id., S.637 (1)(b).
17. Id., S.372.
18. Id., S.198 (4).
19. Id., S.275.
20. Id., S.269.
21. Id., S.274.
22. Id., S.266.
23. Id., S.310.

and removal of directors[24] and managing directors are also retained. The power to modify the Companies Act or exempt from specific provisions of the Act in relation to Government companies,[25] nighis[26] etc. are exercised by the Government.

The powers and functions conferred on the Central Government under the Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969) are also exercised by the Department of Company Affairs through the Company Law Board.[27] Every notice given or application made to the Central Government under any of the provisions of the Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969) need be sent to the Department of Company Affairs of the Government.

The Company Law Board consists of nine members appointed by the Central Government.[28] One of the members is appointed by the Government as the Chairman.[29] Nine Benches are functioning in addition to the head quarters of the Board at Delhi. The procedure followed by the Company Law Board is also prescribed.[30] The powers under Sections 17, 18 and 19 are exercised by the Company Law Board through

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24. Id., Chapter IV-A, Ss.388-B, 388-C, 388-E.
25. Id., S.619.
26. Id., S.620-A.
27. The Monopolies and Restrictive Trade Practices Rules 1970, Rule 3. (Notification No.G.S.R.1037 dated 9.7.1970).
28. The Companies Act 1956, S.10E(2).
29. Id., S.10-E(3).
30. The Company Law Board with the previous approval of the Central Government has prescribed the Company Law Board (Procedure) Rules 1964 and the Companies (Appeal to Central Government) Rules 1957.

a bench of two members, and those under Section 79 exercised by a single member.[31]

Regional Offices of the Company Law Board

Regional offices are intermediate non-statutory bodies exercising supervision over Registrars. The following functions are discharged by them:[32]

(i) Maintain close contact with the offices of Registrars and exercise supervision and control over them.

(ii) Advise and guide the Registrars on technical and administrative matters.

(iii) Report to the Government important events and trends in the Region in the sphere of trade and commerce in general and particularly on the activities and operations of companies and developments in capital market.

(iv) Look after the progress of investigations started by the Department and pursue prosecutions arising out of investigations and other breaches of the provisions of the Act.

(v) Function as a link between the Central Government and the State Governments in the Region.

(vi) Discharge functions of public relations officers and attend to complaints or difficulties put forward by joint stock companies, particularly small ones.[33]

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31. The Company Law Board (Bench) Rules 1975, Rule 4.

32. 1st Annual Report of the Working & Administration of the Companies Act 1956, for the year ending 31st March,1957, p.2.

33. Id., p.3.

In addition to this some of the powers and functions conferred on the Company Law Board are exercised by the Regional Directors. Thus the licence for registering a company droping the word 'Limited,' and the licence to drop the word 'Limited' from the name of an existing company is granted by the Regional Directors.[34]

Registrar of Companies

The Registrar is the pivotal agency in the arena of administrative control over companies. He performs mainly three functions[35] namely:

(1) acts as a repository of various documents filed by the companies.

(2) ensures that statutory documents and returns are filed in the prescribed manner. Eternal vigilence is taken to catch the defaulters, ask their explanation and prosecute them if necessary.

(3) scrutinises the contents of the returns to take necessary action if there is anything suspicious.

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34. The Companies Act 1956, S.25 provides for the grant of licence by the Central Government for the purpose. The Companies Regulations 1956 delegated this power to the Company Law Board by notification No. S.R.O. 432-B, dated 18.2.1956. The same was transferred to the Regional Director of the Company Law Board by notification No. G.S.R.1850 dated 1.12.1966. For a complete list of powers exercised by the Regional Directors, See Indian Investment Centre, Indian Company Law, (1967) p.120.

35. See S.D. Balsara, 'Killing the Ghoose that lays Golden Eggs,' paper presented in the Seminar on Company Law at Nandi Hills, Bangalore during May 11-16, 1970.

In addition to these functions certain powers conferred on the Central Government under other related statutes are also exercised by the Registrar of Companies.[36]

The Registrar is a statutory officer appointed by the Central Government.[37] Assistant Registrar or Deputy Registrar can also perform the functions of the Registrar under the Act.[38] In the exercise of his powers, the Registrar is under the control of the Central Government through the Regional Directors of the Company Law Board.

The nature of the powers exercised by the Registrar of Companies while recording documents was considered by the Gauhati High Court in Walford Transport (Eastern) India v. S.K. Mandal.[39] In this case the Registrar of Companies, Assam, entered in the register an intimation from a company regarding the satisfaction of a charge. After recording the same, the Registrar issued notice to the chargeholder to show cause why the satisfaction of the charge should not be registered. It was contended that the Registrar should have issued notice before entering the satisfaction of charge in the register. On this question, Justice Lahiri held that since the Registrar was a statutory authority and not an executive creature, he should observe principles of natural

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36. For example, every Registrar of Companies has been authorised by the Central Government to exercise within the limits of his jurisdiction the powers specified in the Capital Issue Control Act 1947, S.7, by notification S.O. No.2384 dated 14.11.1958.

37. The Companies Act 1956, S.609(2).

38. Id., S.2(4); See also, Ajitkumar Sarkar v. Assistant Registrar, (1979) 49 Com.Cas.911.

39. (1980) 50 Com.Cas.600.

justice in such proceedings.[40] However, the Court observed that if the Registrar had failed to hear the parties before taking a decision, he might rectify his mistake by taking a de novo proceeding.[41]

Other authorities under Companies Act

Public Trustees

Public Trustees appointed by the Central Government[42] discharge the functions and exercise the powers conferred on them by the Act. The rules regarding their powers, duties and conditions of service are prescribed.[43] The Public Trustee is under the administrative control of the Central Government. He may appoint proxy after duly considering whether such appointment will serve the best interests of the beneficiaries of the trust. He should also consider the views of the trustees of a trust, for whom he is acting, before making the appointment.[44] The Public Trustee is entitled to receive and

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40. Id. at p.607 per K. Lahiri, J. He said, "... the Registrar is a judicial authority and was bound to observe the principles of natural justice in making any order affecting any right of parties." See also D. Nagaraj v. State of Karnataka, A.I.R. 1977 S.C.876; J. Fernandes & Co. v. Deputy Chief Controller of Imports & Exports, A.I.R. 1975 S.C. 1208; Calcutta Gas Co. (Proprietory) Ltd. v. State of West Bengal, A.I.R. 1962 S.C.1044.

41. Id. at p.611, The Court held "... in the event of a breach of "natural justice," in the first instance the invalidity can be cured or insulated by a quasi-judicial authority by ex post facto hearing or a full and fair "de novo" hearing by the same authority or body, per K. Lahiri, J.

42. The Companies Act 1956, S.153-A empowers the Central Government to appoint a person as public trustee.

43. See the Companies (Public Trustee) Rules 1973.

44. Id., Rule 11(2).

inspect all books and papers which a shareholder is entitled to receive and inspect.[45]

Inspectors

The Inspectors appointed by the administrative agencies hold enormous powers.[46] Though they are not administrative authorities under the Act, in the strict sense of the term, but persons appointed to do a particular work, their reports have far reaching consequences. The Government can take various steps to cure any defect found by the inspectors. For example guilty persons may be prosecuted. The Government can apply to the Court for prevention of oppression and mismanagement.[47] Civil proceedings also could be taken to recover the misappropriated assets of the company or for recovering compensation.

What is the nature of duties of an Inspector appointed by the Central Government under Sections 235 or 237? This question was considered by the Madras High Court in Coimbatore Spinning and Weaving Co.Ltd. v. M.S. Srinivasan.[48] Here the Central Government appointed one chartered accountant, Shri M.S. Srinivasan, as Inspector to investigate the affairs of a company. The company contended that the duties of an

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45. The Companies Act 1956, S.187-B(6).

46. See infra Chapter 16 for powers and procedures of inspectors.

47. The Companies Act 1956, Ss.397 & 398.

48. A.I.R. 1959 Mad.229.

Inspector were of a quasijudicial nature and since Mr.Srinivasan was biased against the company, he was wholly disqualified from holding the enquiry. The Court held that the duty of the Inspector was purely ministerial and not quasi-judicial.[49] However it was felt that eventhough the duty of the Inspector was ministerial he ought to discharge his function fairly and without bias.[50]

Official Liquidators

Just like the Inspectors, Official Liquidators appointed by the Government for conducting winding up of a company also possess enormous powers. However, like the directors and managers of a company, they are under strict control by the High Court in relation to the affairs of the company and the conduct of winding up procedure.[50a]

Reserve Bank of India

The raising and maintenance of capital of a company is under constant surveillance of the Reserve Bank. Under

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49. The Court said, "... I am unable to take the view that the duties of an Inspector appointed by the Central Government under Section 235 or under Section 237 of the Act are quasijudicial in their nature.... His position is analogous to that of a Sub-Inspector of Police who goes out to investigate a crime which has been reported at his station." Id at p.234 per B. Ayyar, J.

50. The report of the Inspector is having great civil consequences to the officers of the company. In such cases the duty to act fairly cannot be dispensed with especially in the light of the decision in R.D. Shetty v. International Airport Authority, (1979) 3 S.C.C.489.

50a. See the Companies Act 1956, Ss.460,461 & 462. However, the Registrar of Companies exercises control over liquidators in voluntary winding up. See id., Ss.493-498.

the Reserve Bank of India Act 1934, (2 of 1934), the Reserve Bank is empowered to regulate all financial transactions in India.[51]

As addition or supplement to such powers, the Companies Act 1956 (1 of 1956) and Capital Issues Control Act 1947 (29 of 1974) also empower the Reserve Bank to regulate financial matters of companies. A number of directions have been issued by the Reserve Bank covering acceptance of deposits, issuing of shares etc. This general power is in addition to the special powers in relation to banking companies.[52] Under the Foreign Exchange Regulations Act 1973 (46 of 1973), the approval of the Reserve Bank is necessary for non-residents to acquire shares in Indian companies[53] or to hold certain post in Indian companies.[54]

The Monopolies and Restrictive Trade Practices Commission

The Monopolies and Restrictive Trade Practices Act 1969 provides for dual machinery for implimenting its provisions, viz. the Central Government and the Monopolies and Restrictive Trade Practices Commission.[55] The Commission is assisted by two statutory functionaries; namely the Director

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51. The Reserve Bank of India Act 1935, Ss.45H to 45O.

52. The Banking Regulations Act 1949, contains elaborate provisions for licencing, registration, filing of returns, investigation and inspection, control over managerial persons etc. by the Reserve Bank.

53. The Foreign Exchange Regulation Act 1973, S.19.

54. Id., S.28.

55. Report of the High powered Expert Committee on Companies Act and MRTP Act 1978, p.337 (para 22.1.).

of Investigations and the Registrar of Restrictive Trade Agreements. The Commission is vested with independent powers to inquire into restrictive trade practices. It performs adjudicative functions when it decides disputed questions relating to "group," "same management" and "interconnection."

The Commission consists of a chairman and such number of members not less than two, or more than eight, at a time.[56] At present there are three members including the Chairman. It is mandatory that the capability, competence and integrity of individuals, should be considered in making appointments.[57] The chairman should be person qualified to be appointed as a judge of the Supreme Court or of a High Court.[58]

The Commission's secretariat consists of two wings (1) Administrative and Technical wing headed by a secretary. The entire administrative work relating to the functioning of the Commission, co-ordination with the Government and various other authorities and other allied work pertaining to the Commission's statutory functions are looked after by this wing.[59] (2) A Research wing headed by a Director. This wing conducts studies and research in spheres like economic aspects of large sized corporations, impact of competitive

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56. The Monopolies and Restrictive Trade Practices Act 1969, S.5(1). (Hereafter referred to as MRTP Act 1969).

57. Id., S.5(2).

58. Ibid.

59. See the Annual Administrative Report on the Working of the Monopolies & Restrictive Trade Practices Commission for the period August 6, 1970, December 21, 1971, p.4.

and monopolistic market on costs, prices and quality of products, problems effecting concentration of economic power, industrial development plans, policies and programmes etc.[60]

Director of Investigation

The Director of Investigation is a statutory officer appointed by the Government in consultation with the Monopolies and Restrictive Trade Practices Commission. His independence is assured by providing that his conditions of service shall not be varied to his disadvantage after appointment.[61]

Under the rules framed by the Commission, the following duties are assigned to the Director of Investigation.[62]

1. The Commission may call upon the Director of Investigation to make any investigation as the Commission may desire in respect of any enquiry under the MRTP Act. It shall be his duty to submit a report to the Commission in respect of every such investigation.

2. The Director shall function in accordance with the instructions issued by the Commission from time to time.

3. The Director may authorise any officer subordinate to him to conduct any investigation on his behalf.

The work of the Director of Investigation does not end with the investigation report. He can participate in the

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60. Ibid.
61. MRTP Act 1969, S.8.
62. MRTP Commission Regulations 1974, Rule 25.

enquiry and help the Commission thereafter.[63]

Registrar of Restrictive Trade Agreements

Similar to the Registrar of Companies, the Registrar of Restrictive Trade Agreements is appointed by the Government to discharge the specified duties under the Act.[64] There is also provision for appointment of Additional, Joint, Deputy or Assistant Registrars.[65] The functions of the Registrar are (1) maintenance of a register under the Act and (2) discharge of other functions under the Act. He has to register agreements received by him under the Act. He can exclude certain portions of the agreements from being entered in the register. He can file a complaint with the Commission if his request to supply information regarding registerable agreements is not complied with. Eventhough there is much similarity between the duties of the Registrar of Companies and the Registrar of Restrictive Trade Practices, the powers of the latter are much limited.

Controller of Capital Issues

The administration of the Capital Issues Control Act 1947 is effected by the Central Government through the Controller of Capital Issues, Ministry of Finance. For issue of

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63. See Unreported decision of the MRTP Commission in Raymond Woollen Mills Ltd. v. M.R.T.P.C., (C.M.P. No.322 of 1975) as cited in A. Ramaiya, Guide to Monopolies & Restrictive Trade Practices Act, 2nd Edn., 1982, p.41.

64. MRTP Act 1969, S.34.

65. Id., S.34(2).

capital, the consent of the Government is necessary under the Act[66] unless exempted under the relevant rules.[67] Every application for consent is received by the Controller of Capital Issues.[68] After examining the application in the light of guidelines issued by the Government of India in this regard,[69] he takes a decision and conveys it to the company. Consent for issue of bonus shares is also considered by him in similar manner.[70] Companies exempted under the Act from obtaining consent of the Controller for issuing shares, have to make a return in the prescribed form which the Controller of Capital Issues acknowledges after verification.[71]

Authorities under other Related Laws

There are a number of specific laws, that are very much related to company law, administered by different authorities. They are concerned with particular aspects of business other than management of the affairs of a company. Hence they are not considered here in detail. The authorities entrusted with the administration of labour laws, taxation laws, Import

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66. The Capital Issues Control Act 1947, S.3.
67. See the Capital Issues (Exemption) Order 1969, issued under the Capital Issues Control Act 1947, S.6.
68. The Capital Issues (Application for Consent) Rules 1966, Rule-3.
69. Issued by the Bharat Chamber of Commerce, Circular No. BCC/Com/1/77-KCM/LL-13A dated 4.1.1977 as reproduced in A.Ramaiya, Op.Cit., p.1586.
70. Ibid.
71. The capital issues (Exemption) Order 1969, Cl.3 & 5.

and Export Control Act 1949 (1 of 1947), Essential Commodities Act 1955 (10 of 1955) etc. have considerable powers over company management.

Non-trading companies with objects confined to a particular state only, are governed by relevant State Acts.[72] In certain states the Companies Act 1956 (1 of 1956) are not even applicable to them.[73] The administration of these State Acts is done by authorities other than those mentioned above. The provision relating to registration, returns etc. are almost in line with the corresponding provisions in the Central Act.

Advisory Committees

Company law gives wide and enormous powers to the administrative agencies. To check the abuse of such powers, provisions are made in Companies Act 1956[74] (1 of 1956), Industries (Development and Regulation) Act 1951[75] (65 of 1951) and the Capital Issue Control Act 1947[76] (29 of 1947) for the establishment of Advisory Committees. These Advisory Committees are not exercising any administrative controls over companies, but help the administrative authorities to evolve criteria for the exercise of discretion.

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72. See for example the Tamilnadu Non-trading Companies Act 1972, the Andra Pradesh Non-Trading Companies Act 1962 (2 of 1962), the Kerala Non-Trading Companies Act 1961 (42 of 1961).

73. For eg., See the Bombay Non-Trading Companies Act 1959, S.93, and the Madhya Pradesh Non-Trading Companies Act 1962, S.93.

74. The Companies Act 1956, S.410.

75. The Industries (Development & Regulations) Act 1951, Ss.5 & 6.

76. The Capital Issues Control Act 1947, S.11.

The present Advisory Committee under the Companies Act has no original powers[77] derived from the statute. They can deal with only such matters as may be referred to it by the Government.[78] Similar is the position with respect to the Advisory Committees constituted under the other Acts also.[79]

As pointed out by the Administrative Reforms Commission,[80] it is highly essential that the Advisory Committees should have power and responsibility in respect of those areas where the administration now exercises wide discretionary authority in regard to aspects of company management and practice. It should be obligatory for the Government to consult this Committee or Commission with regard to the formulation of these principles. The licensing of companies, permission to issue shares, appointment, remuneration and removal of managerial personnel, inspection and investigations, inter company investments and loans, cost audit and special audit etc. are areas where compulsory consultation ought to be made.

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77. For details relating to original powers, establishment and functions of the Company Law Advisory Committees, See Indian Investment Centre, op.cit., p.10.

78. The Companies Act 1956, S.410 reads, "(for) the purpose of advising the Central Government and the Company Law Board on such matters arising out of the administration of this Act as may be referred to it by that Government or Board, the Central Government may constitute an Advisory Committee consisting of not more than five persons with suitable qualifications" (emphasis added).

79. Under S.11 of the Capital Issues Control Act 1947, the Central Government need to refer only "... such matters arising out of the administration of the Act as the Central Government thinks fit." Under the Industries (Development & Regulation) Act 1951 also, the Council shall perform "such functions ... as may be assigned to it by the Central Government." See the Industries (Development and Regulation) Act 1951, S.6(4).

English Position

In England, the Department of Trade and Industry[81] which is technically a Committee of Privy Council, is responsible for governmental control over industry.[82] This Department also controls the imports and exports. The Secretary of State for Industry and concerned Ministers also exercise powers.[83] Anything required or authorised to be done by the Department may be done by the president of the Board, the Secretary or Assistant Secretary of the Department or any person authorised by the president of the Department. The Treasury exercises control over issue of shares and acceptance of deposits.[84] The Monopolies Commission constituted under the Monopolies and Restrictive Practices Commission Act 1953 (England), is an independent body exercising power to control economic concentration. The Commission consists of one chairman and such number of members, being not less than four or more than ten, appointed by the Department of Trade and Industry.[85] The Commission makes investigations on matters referred to it by the Department of Trade and Industry, and

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80. Administrative Reforms Commission, Report of the Working Group on Company Law Administration (1968),p.91.

81. Formerly the Board of Trade.

82. See Halbury's Laws of England, (3rd Edn), Vol.38, p.133.

83. See the (English) Companies Act 1976, S.38. See also the Companies Act 1948, S.455(1).

84. See the Borrowing (Control & Guarantees) Act 1946 (England). See also G. Brian Parker, Buckley on the Companies Act, (14th Edn.1981), p.114.

85. See Halsbury Laws of England, op.cit., p.83.

submits its report. Registrar of Companies is the pivotal agency in the administration of Companies Act, in England also. Broad powers for inspection of documents and investigation is vested in the Registrar. Stock Exchanges play an important role in administering the disclosure provision under the Companies Acts.

Position in the United States

In the U.S.A. two independent statutory commissions, the Securities Exchange Commission (SEC) and the Federal Trade Commission (FTC), control the two most important areas of corporate power via the security transactions and concentration of economic power.[86] The SEC administers the Federal Securities Act 1933, the Public Utility Holding Companies Act 1935, the Trust Indenture Act 1939, the Investment Company Act 1940, the Investment Advisors Act 1940, the Investor Protection Act 1970 and some of the provisions of the Bankruptcy Act.[87] All these Acts aim at the protection of investors. The SEC attains this goal by enforcing disclosure provisions, by adjudicating on inspections etc. The Federal Trade Commission (FTC) is a Federal regulatory agency clothed with sufficient powers to administer functions

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86. See 69 Am.Jr.2d, Securities Regulation - Federal, para 1.

87. Ibid. For a discussion of the function of the SEC under the Bankruptcy Act, See 9 Am.Jr.2d, Bankruptcy, para 1506.

committed to it under different Antitrust Acts. The FTC is composed of five commissioners appointed by the President with the advice and consent of Senate.[88] The FTC has power to make rules and regulations, to make investigations and inspections and to adjudicate on matters connected with prevention of monopoly. The other aspects of company affairs are dealt with by the States. The Model Business Corporation Act adopted by 39 States provides a uniform pattern of control over companies. Many of the functions of the Registrar of Companies under the Indian and the English law are carried out by Secretary of State in the U.S.A.[89] Thus incorporation, reservation of name, granting of permission to drop 'Limited' in the name of the company etc. are done by the Secretary of State of the concerned State.

Position in Other Countries

The growing influence of governmental action in the sphere of private corporations can be seen in other countries too. Especially the security laws, whose ultimate goal is investor protection, are stringent in all countries. The French Commission of Stock Exchange operations, Belgian Banking Commission, the Italian National Commission for Companies and Stock Exchanges etc. are similar or in line

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88. 55 Am.Jr.2d, Monopolies etc. para 807.
89. See the Model Business Corporation Act, para 8, 9 & 13.

with the American SEC and British Department of Trade and Industry. In Germany, the publicity function is exercised by the Commercial Register kept by the local courts at the seat of the company's office.[90] The 'land' can ask a court to order winding up of an illegally conducted company.[91] Japan follows American pattern of administrative control, having an independent regulatory agency, while Australia and Sweeden follows the English style.

Whether one can expect much from direct governmental control in general is a matter of opinion. There are academicians and legal writers holding opposite views.[92] They hold that governmental intervention may not necessarily guarantee professional competence and integrity.[93] However, considering the legal, social and economic conditions, every country is tightening governmental controls in the field of company laws.

The Distribution of Administrative Power - A Critique

For a satisfactory administration of Company laws, a strong and competent civil service is essential. Effective powers should be given to the executive for the above purpose.

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90. E.J. Cohn (Ed.), Manual of German Law, Vol.II, (1971), p.78.

91. Ibid.

92. For example, See Bernhard Grossfield & Werner Ebke, "Controlling Modern Corporations: A Comparative View of Corporate Power in the United States and Europe," (1978) 26 Am.J.Comp.L.427.

93. Ibid.

It is also true that a large measure of discretionary authority should be vested in the organisation responsible for the administration of the Companies Act.[94] But there should be a rational classification of different types of discretionary powers and a judicious allocation of these powers to the different units in the hierarchial level as envisaged by law. Administrative power includes inter alia the following:

(1) Framing of long range strategic policies on company management and ensuring efficiency in their operation.

(2) Inquisitional, advisory and promotional investigation by competent field staff.

(3) Safeguarding the interests of creditors, labour and other partners in production by the process of registration, licensing and publicity.

(4) Protection of social interest by preventing concentration of economic power and monopoly.

(5) Settling of disputes arising out of the management of the company, between shareholders and managing board.

(6) Ensuring proper accounting and the prevention of enjoyment of undue advantages by influential persons within the company.

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94. See Lok Sabha debates dated 28.4.1954, Vide, L.S.Debates, Vol.IV, No.55, Col.5968.

(7) Assuming direct control under certain conditions, or causing amalgamation or winding up of companies.

Each of the above noted activity should be entrusted only to those bodies having adequate competence. It is also necessary to see that these agencies take a uniform and unbiased, political or otherwise, stand in exercising their functions. The hierarchy of Government Departments may not be able to discharge these functions effectively.

At present there are a number of organisations and Departments of Government dealing with corporate sector. The Report of the Vivin Bose Commission of Enquiry pointed out the fallacy in entrusting the regulatory power over corporations to different independent agencies.[95] The Department of Company Affairs deals generally with the working of the Companies Act and ensures its compliance. It is the regulatory authority where the Central Government sanction is necessary under various provisions of the Act. But there are other Departments which deals with different aspects of the same matter. The control over capital issues, stock exchange regulation, industrial licensing etc. comes under a Ministry different from the Ministry under which the Department of Company Law functions.

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95. Report of the Vivin Bose Commission of Inquiry, (1962), pp.813, 814.

The effectiveness of administration of Company Law in helping to achieve the aims and objects of the legislation depends not merely on the efficiency of the administrative machinery entrusted with the responsibility for its administration. It depends on the scope, range and degree of co-ordination which this body can bring about between its work and the policies followed by other agencies in administering other related measures having a close bearing on the working of the corporate sector.[96] The Companies Act 1956 (1 of 1956), the Industrial (Development and Regulation) Act 1951 (65 of 1951), Securities Contract Act 1956 (42 of 1956), Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969), Banking Regulation Act 1949 (10 of 1949), Insurance Corporation Act, 1956, Financial Corporations Act 1961, Capital Issue Control Act 1947 (29 of 1947), Imports and Export Control Act 1947, (18 of 1947) etc. are closely related with the corporate sector. Administrative Reforms Commission recommended that one and the same Ministry should administer all these regulations.[97]

Government can never expect to produce any impact on corporate sector if different governmental and quasi-governmental agencies pull at each other and fail to evolve a co-ordinated and integrated policy. For achieving common objects and goals, such integration is a must. Again, haphazard distribution of

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96. See Administrative Reforms Commission, Report of the Working Group on Company Law Administration, (1968), p.107.

97. Ibid.

subjects among different agencies cause serious damages to the administrative effectiveness.

At present, the issue of capital by a company is controlled by the Companies Act 1956, (1 of 1956), the Capital Issues Control Act 1947 (29 of 1947) and the Foreign Exchange Regulation Act 1973 (46 of 1973). The combined effect of all these laws would control effectively the capital structure and terms of incorporation of companies. It helps to ensure a healthy and balanced capital structure for companies subject to the plan outline of industrial development. Stock exchanges provide easy means to acquire capital for investment in companies. They regulate the affairs of the companies by requirement as to registration, returns etc. In fact they are of vital importance to the extension and development of joint stock companies. Again, the Government owned financial corporations are major investors in many joint-stock companies. A detailed knowledge of the structure and mechanic of company management is necessary for these institutions to evolve wise investment policy. Sound and efficient working of these financial institutions will also be possible only if they possess this knowledge. Hence the need for bringing all these related subjects under one Ministry can not be overemphasised.

Similarly, the prevention of economic concentration is a common concern for the Companies Act 1956 (1 of 1956), and Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969).

Both these Acts provide safeguards against monopolisation. The Industries (Development and Regulation) Act 1951 aims at planned development of industries, preference being given to industries producing essential goods. The power to make investigations, similar to those provided under the Companies Act 1956 (1 of 1956) and Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969), is vested with the Central Government by the Industries (Developement & Regulation) Act also to ensure proper conduct of the affairs of the company.[98] There is urgent need for bringing all these powers under one authority.

Laws which deal with the organisation, structure and management of other institutions like Banks and Government investment corporation, Life Insurance Corporation etc. should be administered in close consultation and collaboration with the Ministry dealing with company matters. This would enable to reduce administrative delays.

The need for such an integrated department was realised in other countries also. In England, almost all matters connected with trade and industry is controlled by the Department of Trade and Industry. Treasury control financial matters. Similar situation prevails in other countries also.

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98. The Industries (Developement & Regulation) Act 1951, Ss.15-18.

Company law is a socio-economic legislation. The objective is to achieve the goals envisaged by our country in this regard. For the administration of such a law, mere legal expertise is insufficient. Knowledge of other related subjects like Accountancy, Management, Economics, Sociology etc. is essential. So it is necessary to have expert personnel under the integrated Department to administer different aspects. The Securities and Exchange Commission in the United States and the corresponding institutions in countries like Japan, Germany etc. provide a guide in this direction. It is also relevant to note that all committees and commissions which have studied the subject, have recommended the establishment of independent regulatory agencies.[99] The establishment of such an agency is of particular importance in India, where the exercise of the plethora of discretionary powers, vested in the executive under the present Departmental set up, can be influenced by the Ministers to suit political party purposes.

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99. For example, see the Report of the Company Law Committee, (1952); ARC Report on Company Law Administration, (1968) para 11.4 & 11.5; Report of the High Powered Committee on Companies & MRTP Acts, (1978), paras 16.3 et.seq.

CHAPTER - 4

Concept of Public Interest under Company Law

Administrative Functions

The Company Law of India confers wide range of ministerial and discretionary functions on the administration. A ministerial function is one where the law prescribes that the duty will be performed in certain and specific terms and leaves nothing to the discretion or judgement of the concerned authority.[1] There is no ascertainment of disputed facts or the making of any choices. But this type of functions are very few under company law. Because of the complexity of socio-economic problems dealt with by company law, the range of ministerial functions is very small and that of discretionary functions much larger.

In the case of discretionary functions, the administrative authorities have to make choices between alternative courses of action. Specific definition of the conditions or circumstances under which an action can be taken by them is rarely seen in company law. Very often, powers are conferred on the administrative authorities to act in a way it deems

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1. Griffith & Street, Principles of Administrative Law, (1973), p.145.

'necessary' or 'reasonable.' Similarly, the administrative authorities are empowered to take action when it is 'satisfied' or when it is 'of the opinion' that such actions should be taken. The restraints made in the exercise of administrative discretion are very often in terms of 'public interest,' 'public purpose' etc.

Incorporation of the concept of 'Public Interest' in Company Law

The Companies (Amendment) Act 1963 (53 of 1963) introduced express provisions in the Companies Act 1956, enabling the Government to regulate companies in the public interest. It is possible for the Government to take action against a company if its business is carried on in a manner "prejudicial to public interest."[2] Similarly, the Monopolies and Restrictive Trade Practices Act 1969, also contain provisions enabling the Government to take actions in the "public interest." The Monopolies Act prescribes the conditions under which a monopolistic trade practice would be deemed to be "prejudicial to public interest."[3] The Monopolies and Restrictive Trade Practices Commission can investigate any restrictive trade practice when it is of the opinion that the practice is 'prejudicial to the public interest.'[4] The Central Government may call upon a monopolistic undertaking to satisfy it that

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2. See the Companies Act 1956, Ss.235, 390-396, 397-408 etc.
3. The Monopolies and Restrictive Trade Practices Act 1969, S.32.
4. Id., S.37.

any proposed expansion of such undertaking is not likely to be 'prejudicial to the public interest.'[5] The Government can accord approval to such proposals if it is 'satisfied' that it is expedient in the "public interest" to do so.[6] Similarly, if the Central Government 'is of the opinion' that the working of a monopolistic undertaking is 'prejudicial to the public interest,' it can order the division of any trade of the undertaking.[7] The Industries (Development and Regulations) Act 1951 also empowers the Central Government to take drastic action against an industrial undertaking 'in the public interest.'[8] In most cases, the Central Government is treated as the guardian and advocate of public interest.

The Nature of the "Concept of Public Interest"

The idea of public interest is vague and elastic. What is considered as public interest yesterday may not be considered as the same today. It depends much on the prevailing social notions and cultural standards of the society. However, when an action is taken to preserve the general interest of the community as distinguished from the private interest of an individual, the action is considered to be taken in the

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5. Id., S.21.
6. Ibid.
7. Id., S.27.
8. The Industries (Development and Regulations) Act 1951, Ss.15, 16.

public interest.[9] In other words, the concept of public interest is based on majoritarian philosophy for judging private acts and conducts in the social context.[10] So the ideology and the social values entertained by a given society is the main determinant of public interest.

An action is said to be in the public interest where it is, or can be made to appear, to be contributive to the general welfare, rather than to the special privileges of a class, group or individual. However, individual interests[11] need not necessarily be opposed to public interest. If the individual interest is not opposed to the common good or general welfare of the community, it is not prejudicial to public interest.[12] In the sphere of company law, the idea emphasised is that the company is a social unit. The functioning of the company should also be for the public good or for the general welfare of the community. So when the working of a company is detrimental to the public good, it

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9. See State of Bihar v. Kameshwar Singh, A.I.R. 1952 S.C. 252 per Mahajan, C.J. at p.311.

10. See Ramaiya A. Guide to the Companies Act, 8th edn., Wadhwa & Co., Agra (1977), p.773.

11. Roscoe Pound classified 'interests' into (1) individual interests (2) social interests and (3) public interests. For a discussion on these interests, See Roscoe Pound, Jurisprudence, Vol.3, West Publishing Co., New York, (1959), p.16.

12. Eventhough most of the interests are individual in one sense, there may be conflicts of interests of a particular individual and the interest of the social group in which he is a member. In such cases, the State may have to step in. See Julius Stone, Social Dimensions of Law and Justice, N.M. Tripathi, Bombay, (1966), p.172.

should be treated as 'prejudicial to public interest.'[13] On many occassions, the Courts in India have examined whether a particular act of a company is detrimental to the public good or not. These situations are considered here.

Concept of Public Interest under the Companies Act 1956

Under the Companies Act 1956, the concept of public interest in an essential element in the operations of a company and any failure to take it into account may become the cause of action under the Act.[14] But no proper guideline is given in the Act to ascertain whether an action taken by the administrative authority is in the public interest or not. The following circumstances can be considered.

(1) Disproportionately excessive voting rights

A public company is prohibited from issuing shares with disproportionate voting rights.[15] If any shares of an existing company carry excessive voting rights, the company should reduce such voting rights.[16] But the Central Government may exempt a company from this requirement.[17] This is possible when in the opinion of the Central Government, the exemption is required either in the public interest or in the interests

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13. See N.R. Murthy v. Industrial Development Corporation of Orissa, (1977) 37 Com.Cas.389 (Orissa).
14. See the Companies Act 1956, Ss.89(4), 205(1), 211(3), 244(1), 250, 303, 326, 352, 396, 398 etc.
15. Id., S.88.
16. Id., S.89(1).
17. Id., S.89(4).

of the company, or of any class of shareholders therein or of the creditors or any class of creditors thereof."[18]

There is absolutely nothing in the provision suggesting the ingredients of public interest to guide the Government. In Vaishnava Dass v. Fagir Chand,[19] this concept was considered by the Delhi High Court. In this case, a news paper publishing company granted excessive voting rights to one of its shareholders, a public trust. The Government gave exemption to this company from applying the provisions of Section 89(1),(2) & (3) on the ground that it is in the public interest to see that the management of a news paper remains in the hands of the public trust. Later it was proved that the trust in question was not a public trust. Then the company contended that it was in the public interest to leave the management of the company in the hands of some disinterested public men. Another argument in support of this was that the mere fact that the managing agents had transferred their right of management to some responsible persons was itself a good ground for holding that it was in the public interest to grant the exemption prayed for.[20] The Court did not give any decision on this point. The Court said that since the Government had granted exemption asked for on the

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18. Ibid.
19. A.I.R. 1968 Delhi 6.
20. Id. at p.12.

sole basis that the shareholder having excessive voting right was a public trust and this was proved to be incorrect, the exemption could be revoked.[21]

The right conferred on ordinary shareholders to have equal voting rights is a valuable right. So if the excessive voting rights attached to a particular shareholder is reduced, the ordinary shareholders would get a greater voice in the affairs of the company. So it is necessary that before affecting such a right, the Government should give an opportunity to show cause against the proposed exemption. By doing this, the Government would be in a position to assess the position and take the action for the benefit of the community. An exemption under this section for retaining a public trust, public authority, professionally competent persons etc. in the management of a company appears to be reasonable. But there should be scope for judicial scrutiny at the instance of aggrieved shareholders.

(2) Payment of Dividends

A company can declare and pay dividends for any financial year only out of the profits of the company for that year arrived at after providing for depreciation.[22] But the Central Government can, in the public interest, allow a company to pay dividend for any financial year out of the

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21. Id. at p.12.

22. The Companies Act 1956, S.205(1).

profits of the company for that year or any previous year without providing for depreciation.[23] The purpose of regulating the payment of dividend is to prevent erosion of share capital. Public interest demands that the share capital of a company is maintained. The power of the Government in this regard is to provide for extra-ordinary cases requiring special treatment. But the circumstances in which the Government can accord approval under this section are not mentioned. Here the concept of public interest appears to be very limited. The Government should consider the interest of the shareholders, the creditors, and the community. The capability of the company to make sufficient profits in future, is another relevant factor. The special circumstances which made the company unable to make sufficient profits during the year should also be considered. An opportunity need be given to the creditors and other interested persons to represent before taking a decision in this regard.

(3) Restriction on Transfer of Shares and Debentures

Under Section 250(4) of the Companies Act 1956, the Central Government can impose restrictions on certain transfers of shares, when, in the opinion of the Central Government, it is in the public interest to do so.[24] Here the Central Governm

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23. Id., S.205(1)C.

24. The Companies Act 1956, S.250(4) reads:

"Where the Central Government has reasonable ground to believe that a transfer of shares in a company is likely to take place whereby a change -

(f.n. contd.)

can take action only when there is reasonable apprehension of a change of board of directors. Moreover the change, if occured, should be prejudicial to public interest. But when a change in board of directors would be prejudicial to public interest? For this, there is no guidance in this Act. Some situations may be considered here. When as a result of the transfer of shares the management of the company is transferred to foreign nationals or non-residents, it may be said that the change is prejudicial to the public interest. Similarly, when the effect of the transfer would be violation of any prevailing law, for example, the Foreign Exchange Regulation Act 1973, the Capital Issues Control Act 1947 or the Monopolies and Restrictive Trade Practices Act 1969; it can be said that the transfer is against public interest. It is desirable that the Government should hear the company and other affected parties before an action is taken in this regard.

Amalgamation & Take overs

Section 391 to 396 of the Companies Act 1956 contain provisions to be complied with in respect of amalgamation of companies. These Sections provide that, any scheme of

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(f.n.24 contd.)

(a) in the composition of board of directors, or

(b) where the managing agent is an individual, of the managing agent, or

(c) where the managing agent is a firm or a body corporate, in the constitution of the managing agent, of the company is likely to take place and the Central Government is of the opinion that any such change would be prejudicial to public interest, that Government may by order direct that any transfer of shares in the company during such period not exceeding three years as may be specified in the order shall be void."

compromise, arrangement or amalgamation should be approved by the statutory majority of shareholders of the company. Sanction of the High Court should be obtained before the implementation of the scheme. While granting the approval, the Court acts as the guardian of the interest of the minority as well as of public interest. The Court would not order for the dissolution of the amalgamating company unless the Official Liquidator, on the basis of the books and papers of the company, makes a report to the Court to the effect that the affairs of the company have not been conducted in a manner prejudicial to the public interest.[25] The Central Government can order for amalgamation of two or more companies if the Government is of the opinion that it is in the public interest to do so.[26] Here also, the answer to the question, what is public interest, is not clear.

The Gujarat High Court considered this question in the case Wood Polymer Ltd. In re.[27] In this case, the Court had to deal with a scheme of amalgamation which was intended mainly to take advantage of the benefit of tax exemption. Avoidance of tax liability by lawful means is not an offence under the Income Tax Act. The question was whether the

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25. Id., S.394(1).
26. Id., S.396.
27. (1977) 109 I.T.R. 1777.

Government could object to the scheme of amalgamation on the ground that avoidance of income tax through amalgamation was against public interest. The Court refused to confirm the scheme of amalgamation since the main purpose of amalgamation was to avoid tax liability which was prejudicial to public interest. The Court observed:

> "the expression public interest should take its colour and content from the context in which it is used. The context in which the expression 'public interest' is used should permit the court to find out why the transferor company came into existence, for what purpose it was set up, who were its promoters, who were controlling it, what object was sought to be achieved through the creation of the transferor company, and why it is being dissolved by merging it with another company. All these aspects will have to be examined in the context of satisfaction of the court whether its affairs have not been carried out in a manner, prejudicial to public interest."[28]

In Sakamari Steel & Alloy Ltd., In re.[29] the Bombay High Court considered a scheme of amalgamation. In this case the company aimed not to pay past and future interests to its secured creditors. The Court considered this as a confiscation of public money and hence detrimental to public interest.[30]

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28. Ibid.
29. 1980 Tax.L.R. 2055 (Bom.).
30. Id. at p.2062 per Aggarwal, J.

It said,[31]

> "Another point of great significance is the public interest. Public interest has to be born in mind in sanctioning a scheme of compromise or arrangement as in the case of a scheme of amalgamation or reconstruction. Court can take notice of public interest and it need not act only on a representation from the Central Government under Section 394-A, if facts and circumstances of the case show that the public interest is likely to be prejudiced."

In Bank of Baroda Ltd. v. Mahendra Ugvine Steel Company,[32] also the Gujarat High Court examined the concept of public interest. The Court held in this case that to satisfy the concept of public interest, a scheme of amalgamation should be for the benefit of the shareholders and the public at large. The concept of public interest is almost synonymous with national interest though not the same. But the concept is clearly distinct and distinguishable from the interest of a few identifiable persons or group of persons. The Court also held that the burden of proof was on the amalgamating company to show that the scheme was not prejudicial to the interests of the shareholders, employees and the public. Similar propositions were laid down in other cases also.[33]

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31. Ibid.
32. (1976) 46 Com.Cas.227.
33. See Union of India v. Asia Udyog (P) Ltd., (1974) 95 I.T.R.229; C.I.T. v. Express News Papers Ltd., (1964) 54 I.T.R. 250.

It appears that a scheme of amalgamation for using improved means of production, preventing unhealthy competition, facilitating research for producing goods of improved quality etc. could be considered as amalgamations in the public interest. But, if as a result of the amalgamation a large number of workers would be thrown out of employment the scheme should be considered as prejudicial to public interest.

Mismanagement

Members of a company can apply to the Court for prevention of mismanagement if "the affairs of the company are being managed" in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company."[34] Similarly, to safeguard the interests of the company or its shareholders or public interest, the Government may appoint such number of directors, as it deem necessary, on the management board of a company. This power should be exercised "to prevent the affairs of a company being conducted in a manner which is oppressive to any members of the company or in a manner prejudicial to public interest."[35] Here also the concept 'public interest' is not defined.

The Orissa High Court considered the meaning of the concept of public interest in this context in N.R. Murthy v. The Industrial Development Corporation of Orissa Ltd.[36] In

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34. The Companies Act 1956, S.398.
35. Id., S.408.
36. 1977 Tax.L.R.2268 (Orissa).

this case, the company had taken sizable amount of loan from financial institutions. The company was proposed to go into production in the first quarter of 1973. But this was delayed on account of non-availability of funds at the right time. Another reason for undue delay in starting production was some disputes raised over the right to manage the affairs of the company. In these circumstances some minority shareholders applied to the Court for prevention of oppression and mismanagement, on the ground that the affairs of the company were being conducted in a manner prejudicial to public interest. The Court accepted this contention[37] eventhough an order under Section 397 was not granted since the petitioners failed to establish that an order for winding up would have been appropriate on just and equitable grounds.[38] Regarding the concept of public interest, the Court observed,

> "It is the policy of the State today that the corporate sector must work with efficiency. The companies which face stalemate should be helped to overcome the same so that they may get into production and the production may be on the increase. With more of industrial and commercial activity, the scope of employment would be in the increase. The company in question has already taken a sizeable loan from financial institutions and it is in the public interest that the said capital is put to appropriate use without loss of time and optimum return is received."[39]

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37. Id. at p.2275 per Misra, J.
38. Id. at p.2276.
39. Id. at p.2275 per Misra, J.

It is clear that the object of incorporating the concept of public interest in company law is to safeguard public good or general welfare of the community. The management of the company should not be detrimental to public good. So if the management of a company were to close down some of its business without reasonable excuse, it may be considered as against public interest. Similarly, unreasonable fall in production of goods or supply of services, increases in prices of goods etc. can also be treated as matters against public interest. When internal disputes reach such a stage that there is the possibility of dissolution of the company, it appears to be a fit case for intervention by the court or the Central Government under these provisions. This is especially so, in the light of the recent decision of the Supreme Court.[40] In this case the Court held that eventhough, the Companies Act did not confer any special rights on the workers public interest would include the interest of workers and they should be given right to hearing in a winding up petition.

A critique on the Concept of Public Interest under Company Law

The concept of public interest endeavors to recognise the importance of law in every day life. It is intended to understand and develope legal rules to suit the changing

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40. National Textile Workers Union etc. v. P.R. Ramakrishnan, (1983) Comp.L.J.1 (S.C.).

concepts of society. Various relationships exists between individuals, between groups of individuals, between the legal community and the different parts of society and between the changing values of life. When the values entertained by a given society changes, the concept of public interest also changes. In the field outside private law, this public interest plays a decisive role. This concept is strongly emphasised in public law, the relative significance being different in different stages of development of community. In a society which is merely interested in maintaining peace and order, the public interest is minimum.[41] But with the development of society, the concept of public interest also developes. In a welfare State, the concept has wide meaning and includes the demand for decent livelihood, demand for employment, demand to get quality goods at reasonable prices etc. Public interest is thus a master concept in the administrative regulation of companies. It can be made to comprehend the expanding dimension of the social functions of companies in the modern era.

Since some of the specific circumstances that would attract public interest are mentioned in the Companies Act, it is easy to picture the breadth of the concept. The view expressed by Pendleton Herring that "public interest is a concept that leaves open the way to change, as general

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41. Magdalena Schoch (Ed), The Jurisprudence of Interests, Harvard University Press, Cambridge, (1948), p.132.

acceptance for new policies is won and officials remain accountable for their decisions"[42] seems to be acceptable. There is no meaning in insistence upon a precise definition of public interest. It is a value laden concept and it is difficult to define precisely the limit and substance of the term.

It can be seen that actions that are likely to endanger the general organisation of the State, the social or economic equilibrium of the country and the integrity and prosperity of the industry are considered to be against public interest. The need to protect the rights of large groups of small investors, the interests of consumers, company employees, creditors and the economic well being of the nation demand sound corporate management. So when there is delay in starting production or when there is the possibility of the company being wound up due to intre-faction rivalry, the public interest is affected. Similarly, when there is unreasonable rise in prices of the commodities or when there is disproportionate environmental pollution, the public interest suffers. The avoidance of tax liability and creation of unnecessary labour problems are against public interest. Limiting competition or reducing the quality of goods or services are prejudicial to public interest. In all these cases, the social and economic equilibrium of the country is disturbed.

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42. Pendleton Herring, 'Public Interest,' published in David L. Sills (ed.), International Encyclopedia of the Social Sciences, Crowell Collier and Mac-Millan Inc., U.S.A., (1968), p.174.

The inclusion of the concept of public interest in the company law enables the Government and the Courts to recognise more categories of actions as affecting public interest. What the Court has to do is to examine whether an action taken by the Government is for the furtherance of the social well being. If this be so, the mere fact that the parties had voluntarily put their property to the public use, itself would justify such governmental action.

What the U.S. Supreme Court said regarding the public regulation of private property may provide a useful parallel here. The Court said:

> "Property does become clothed with public interest when used in a manner to make it of public consequence, and affect the community at large, when one devotes his property to a use which the public has an interest, he submit to be controlled by the public for the common good."[43]

In a similar view, we may say that when corporate power primarily organised for private profit has its effect on social well being, it acquires a new dimension inviting control to promote public or common good. The concept would therefore remain progressive and open ended.

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43. Munn v. Illinois, 94 U.S.113 (126).

PART - II

CONTROLS OVER FORMATION AND EXPANSION OF COMPANIES

CHAPTER - 5

Naming and Licensing

Administrative controls over companies are provided under company law not only from its birth, but even from its inception. A company gets its life only on incorporation. But even prior to that a number of formalities are to be complied with. These formalities include not only matters arising from the Companies Act 1956 but also from other enactments and regulations[1] incidental to the working of a joint stock company.[2] System of licensing, permits, approvals, sanctions and registrations are the devices used by the Government to control companies at this stage. Penalties are also provided for non compliance.

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1. So, for the establishment of a new company, procedures prescribed under the Industries (Development and Regulation) Act 1951 (65 of 1951), (hereafter called IDRA), the Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969) (hereafter called MRTPA), the Capital Issues (Control) Act 1947 (29 of 1947), the Foreign Exchange Regulation Act 1973 (46 of 1973), (hereafter called FERA), the Securities Contracts Regulation Act 1956 (42 of 1956) (hereafter called SCRA) and rules and regulations made under these Acts are also to be complied with.

2. See Indian Investment Centre, Indian Company Law, Delhi, (1967), p.112.

Name of the Company

Choosing a few suitable names in order of preference is the preliminary thing for the formation of a company. Approval of the name by the Registrar of Companies of the State in which the registered office of the proposed company is to be situated is necessary. In order to protect the public from being deceived by the similarity of names, the Registrar has jurisdiction to refuse registration of a projected company under the Companies Act 1956 under a name which closely resembles the name of even an unregistered company carrying on the same business as that which is intended to be carried on by the projected company.[2a] A company cannot also be registered by an undesired name.[3] The Central Government may give direction to a company to change its name if the Government is of the opinion that the name of such company is identical to, or too nearly resembles, the name by which a company in existence has been previously registered.[4] Special resolution and approval of the Central Government is necessary to change the name of a company except where the change is only the addition or deletion of the word 'Private' consequent on conversion.[5] The Registrar may himself refuse to register a name if it

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2a. K.M. Multani v. Paramount Talkies, A.I.R. 1942 Bom.241 (244); U. Sreenivas Mallah v. Krishnakumar, A.I.R. 1952 Cal.804(806).

3. The Companies Act 1956, S.20(1).

4. Id., S.22.

5. Id., S.21.

contravenes the provisions of the Act.[6] In arriving at a decision, the Registrar or the Central Government, as the case may be, is guided by the Companies Act 1956, and also the Emblems and Names (Prevention of Improper use) Act 1950.[7] Guiding instructions are also issued by the Department of Company affairs in this regard.[8]

It is a notable feature of the Company Law that by registering a name, the company gains a monopoly of the use of that name.[9] The object is clear. When the same or similar name is allowed to be used by different companies, confusion may arise and people may believe that the two companies are connected in some way; or one is carrying on as a branch of the business of the other.[10]

A company has a Statutory right to change its name by passing special resolution and obtaining the approval of

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6. R. v. Registrar of Companies [1917] 3 K.B.23.
7. S.3 of the Emblems and Names (Prevention of Improper use) Act 1950, prohibits the use of any name specified in the schedule to the Act or colourable imitation thereof without the consent of the Central Government. S.4 reads, "no competent authority shall (a) register any company, firm or other body of persons which bears any name or ... the use of which name or emblem is in contravention of Section 3." Some 17 items are given in the schedule which include, among other things, the name or emblem of the United Nations Organisation (UNO), the World Health Organisation, the Government of India, the President, the Governor or the Prime Minister of India.
8. The 'Guiding instructions for deciding cases of making a name available for registration under the Companies Act 1956' issued by the Department of Company Affairs, Government of India, as cited by A. Ramaiya, Guide to the Companies Act, (8th edn. 1977), p.84.
9. K.M. Multani v. Paramount Talkies, Supra n.2a.
10. Ewing v. Buttercup Margarine Company, [1917] 2 Ch.1.

the Central Government.[11] But such change in the name of a company does not change the identity of the company[12] and therefore the outsiders are not prejudicially affected.

The duty of the Registrar of Companies, and of the Central Government, in relation to registration or approval of company names is not a matter of course. While refusing to register a name, or directing a company to change its name, the authorities should act judicially.[12a] But due to the large number of applications received,[12b] the Registrar

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11. The Companies Act 1956, S.21.

12. Kalipada v. Mahalakshmi Bank Ltd., A.I.R.1966, Cal.585.

12a. In R. v. Registrar of Companies, [1912] 3 K.B.23, the Court allowed a writ of mandamus against the Board of Trade on the basis that it had made an error of law in registering the name of a company. Similarly, in Jay's Ltd. v. Jacobi, [1933] 1 Ch.114, the Court held that where a company had carried on business under a particular name for a long period, the name cannot be objected to. Later, by the Companies Act 1981, the discretion of the Department of Trade to refuse to a register a name was abolished since it was considered undesirable. See Gore Browne, On Companies, 43rd edn., 3rd Supplement, (1982), para 2.2. All these developments shows that the powers of the Registrar in this regard is not of executive nature.

12b. The number of applications received by the Registrars enquiring the availability of names; yearwise was as follows:

Year	No. of applications received
1962-'63	4761
'65-'66	3610
'66-'67	3606
'67-'68	3457
'70-'71	8503
'71-'72	9932
'72-'73	11718
'74-'75	14120
'75-'76	13073
'76-'77	11092
'77-'78	11119
'79-'80	19305
'80-'81	31252
'81-'82	40155

Source: Annual Reports of the Working and Administration of the Companies Act 1956 for the years ending 31.3.1963 to 31.3.1982.

may not get time and patience to act fairly in all cases.

Licence to Drop the word 'Limited'

Normally, every public company, limited by shares, shall use a name with 'Limited' as the last word of the name.[13] In the case of a private company, limited by shares, the last words should be 'Private Limited.'[14] The object of such a requirement is to protect the interests of third parties dealing with the company. However, when it is proved to the satisfaction of the Government that an association, capable of being formed as a limited company, was formed for promoting commerce, arts, science, religion, charity or any other useful object and applied or intended to apply its profits in promotion of its objects, and prohibited the payment of any dividend to its members, the Government could, by licence direct that the association may be registered as a company with limited liability without the addition of the word 'Limited.'[15] Such licence is granted by the Central Government subject to certain conditions and regulation as the Government may deem fit. The memorandum and articles of such companies should contain these conditions and restrictions prescribed by the Government. A company licenced under this section cannot alter any provisions of its memorandum in respect of its objects except with the previous approval of the Central Government.[16]

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13. The Companies Act 1956, S.13.

14. Ibid.

15. Id., S.25(1) See also I.T. Commr. Madras v. Ootacamund Gymkhana Club, 1978 Tax L.R.74(Mad.).

16. Id., S.25(8).

The provisions of Section 17(1) must also be complied with if the alteration of memorandum comes within any of the clauses of that section. A partnership firm, eventhough not a legal entity, could be a member of a company licenced under Section 25, and enjoy all privileges of membership.[17] But when such partnership dissolves, the membership will not devolve among the partners, but would cease. The Central Government is empowered to revoke the licence or vary the conditions and restrictions contained therein at any time. However, before taking such actions, notice in writing of such an intention and an opportunity of being heard in opposition to such actions should be given. Upon revocation of a licence as aforesaid, the body shall change its name accordingly within three months, as otherwise penalty would follow.[18]

A company licenced under Section 25 enjoys a number of exemptions from the provisions of the Companies Act.[19] The power of the Central Government under this Section is a general power to exempt a licenced company from any provisions of the Act according to the need and exigencies. A licenced company, if by its articles have made provisions in relation to matters covered by exceptions granted by the Central Government, is not eligible to take advantage of such exemptions.

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17. Id., S.25(4).

18. Id., S.25(10) provides for a fine of rupees five hundred for every day for which the default continues.

19. Id., S.25(6); See also the order of the Government of India, Department of Company Law Administration, S.O. 1578 published in Gazette of India, Part II, Section 3(11) on 8th July, 1961.

Regional Directors of the Company Law Board are the prescribed authority to consider application for licence and related matters.[20] Application for licence should be accompanied by the memorandum and articles of association of the company, scrutinised and certified to be in conformity with the legal requirements, by an advocate of the Supreme Court or of a High Court or a chartered accountant. A copy of the application is to be sent to the Registrar. A notification to this effect should be published in newspapers also. The Regional Directors after considering the report of the Registrar and objections, if any, received from interested parties, and after consultation with the Ministries of the Central Government, would make the order granting or refusing licence.[21]

The exemptions and privileges enjoyed by companies licenced under Section 25 includes relaxation in matters of appointment of Secretary, periodicity of board meetings, increase in number of directors, inspection of books of accounts and a number of other matters.[22]

The procedure followed by the Regional Directors in granting or refusing a licence is adjudicatory in nature.

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20. The Central Government, on whom the powers under S.25 was conferred, delegated this power to the Regional Directors by the Companies Regulations 1956 as amended by the Companies (Amendment) Regulations 1965, 1966 and 1967.

21. See the Companies Regulations 1956, and the Department instructions as regards procedure for grant of licence under Section 25 of the Companies Act.

22. For the full list of exemptions, See order of the Central Government, Ministry of Law, Justice and Company Affairs, Department of Company Affairs, No. S.O.1578.

Granting or refusing licence, or imposing any condition in a licence requires consideration, as it might amount to restriction of civil rights of individuals. To protect the interests of members of the company, the Court has deviced certain methods. Thus if a company is registered under Section 25, the Company Law Board should not entertain an application for confirmation of the alteration of its memorandum except where approval of the Government for the alteration is obtained.[23] So also, the Civil Courts' jurisdiction to try a suit for the due administration of the company also remains.[24] The Court will take into account the method for protection of minority interests in the company. Thus in one case[25] a company was formed under Section 25 of the Companies Act, for promoting commerce. The articles of association of the company provided for the expulsion of its members in the event of their default in paying dues to other members. When the company sought to expel one member, the Court said that an expulsion from membership would prejudicially affect the interests of the members, and the company should observe certain standards for safeguarding the interests of those members. The company can of course ensure observance of discipline among members in the interest of commerce.[26]

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23. W.W. Chitley & V.B.Bakhale, The AIR Manual, Vol.6, (1979, 4th edn.), p.544.

24. Somathinarayanam v. Manthramoorthi High School Committee, A.I.R. 1963 Mad.387.

25. B.R.Kundra v. Motion Pictures Association, 1978 Tax.L.R. (MOC)9.

26. Ibid.

The British Position

In England, after the commencement of the Companies Act 1981, the promoters can choose any name so long as it does not infringe certain prohibitions set out in the Act.[27] The name choosen shall not be the same as any name appearing in the index of business names kept by the Registrar.[28] The discretion of the Department of Trade to refuse to register a name which is thought undesirable by him is abolished by the new Act.[29] But the Secretary of State can refuse to register a name, which, in his opinion, constitute a criminal offence or is offensive.[30] Moreover, except with the approval of the Secretary of State, a company may not be registered by a name which, in the opinion of the Secretary of State, would be likely to give the impression that the company is in any way connected with the Government or with any local authority.[31] The Act empowers the Government to make Regulations specifying the words and expressions for which approvals must be obtained. The Regulations should also contain the name of the Department or the public body to which request should be made.[32] Terms or expressions implying national or multinational pre-eminence, Government connection, business pre-eminence or representative status have to be

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27. The Companies Act 1981, Ss.22,23.

28. Id., S.23 requires the Registrar to keep an index of names of all companies including over seas companies if it has a place of business in Great Britan.

29. The Companies Act 1948, S.17 conferred such powers to the Department of Trade. But this power is abolished now. See id., Schedule 4.

30. Id., S.22(1)(d).

31. Id., S.22(2)(a).

32. Id., S.31.

considered as expressions requiring approval.

A private company limited by shares or by guarantee must use the word 'limited' as the last word of its name as stated in the memorandum.[33] Public companies limited by shares should use the words 'Public Limited Company.'[34] A guarantee company without share capital cannot be registered as a limited company.[35]

Compared with the Indian position, the procedure for omiting the word 'limited' from the name of a company is simple. Only a private company limited by guarantee and which meets certain requirements in its memorandum and articles can utilise this facility.[36] The object of the company must be the promotion of commerce, science, education, charity or any profession or anything incidental or conducive to those objects.[37] The memorandum or articles must require that its profits if any, or other income be applied in promoting its objects and prohibit the payment of dividends to members. On its winding up, all the assets of the company should be transferred to either a body with objects similar to its own or to another body whose objects are promotion of charity and anything incidental or conducive to such objects.[38]

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33. The Companies Act 1948, S.2.
34. See the Companies Act 1980, S.2(4)e, Schedule I.
35. Ibid.
36. The Companies Act 1981, S.25.
37. Id., S.25(2)(a).
38. Id., S.25(2)(b).

For enjoying this benefit, a statutory declaration should be made to the effect that the company is one to which Section 25 applies, by a solicitor engaged in the formation of the company or by a person named as director or secretary of the company. There is no need to seek the approval of the Department of Trade for this purpose. On the delivery of a declaration as stated above, the Registrar may accept it as sufficient evidence of compliance with Section 25.

A company exempt from using 'Limited' as part of its name need not send the list of members to the Registrar of Companies.[39] But such a company cannot alter its memorandum or articles so that it ceases to be a company to which Section 25 applies.[40] If it appears to the Secretary of State that a company exempt under Section 25 is in fact ignoring these requirements, he may, in writing, direct the company to change its name so that its name ends with the word 'limited'.[41] The directors must comply with such directions within such period as may be specified by the Secretary of State.[42] A company against which such an action is taken, may not there after be registered with a name which does not include the word 'limited' without the approval

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39. Id., S.25(3).
40. Id., S.25(9).
41. Id., S.25(6).
42. Ibid.

of the Secretary of State.[43] However, in all business letters and documents, the company should mention, in legible characters, that its liability is limited.[44]

The present procedure for changing company names is also very simple in England. This can be done by adopting a special resolution.[45] The change of name will take place from the date on which it is registered with the Registrar of Companies.[46] The Registrar will simply register the new name in place of the former name and issue a certificate of incorporation altered to meet the circumstance. The Secretary of State has power to direct a change of name where a company has been registered by a name which is the same as, or in the opinion of the Secretary of State resembles too much, a name appearing at the time of registration in the index kept by the Registrar. In such cases the Secretary of State may direct the company to change its name. He can exercise such power within twelve months of the time of registration. The company must comply to such direction within the time allowed by the Secretary of State.[47] The Secretary of State has the same power if he is of the opinion that the name to which the company has changed is too much like a name which is present in the index kept by the Registrar. Similarly, if it appears to the Secretary of State that a company has provided

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43. Id., S.25(7).
44. The European Communities Act 1972, S.9(7).
45. The Companies Act 1981, S.24.
46. Id., S.24(6).
47. Id., S.24(2).

misleading information for getting registered by a particular name or has given undertakings or assurances for that purpose which is not fulfilled, he may direct the company to change its name.[48] He can exercise this power within a period of five years of the date of its registration. He may extend the period within which a company, to which directions to change its name within a specified period is given, is to change its name.[49] By this method any abuse in the simplified procedure is checked.

A change of name does not change the legal character of the company. It will not affect its rights or obligations or render defective any legal proceeding by or against the company.[50] Any legal proceedings that might have been continued or commenced against the company by its former name may be continued or commenced by its new name.

The American Position

In the United States, the Model Business Corporation Act 1961, prescribes that a corporate name shall contain the word 'Corporation', 'Company', 'Incorporated' or 'Limited' or shall contain an abbreviation of one of such words.[51] The name cannot be same or 'deceptively' similar to the name of an existing corporation or a name registered under the Act.[52]

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48. Id., S.24(3).
49. Id., S.24(4).
50. Id., S.24(7).
51. The Model Business Corporation Act (Prepared by the Committee on Corporate Laws of the American Bar Association and adopted by 35 States), para 88(9).
52. The Model Business Corporation Act, provided for reservation of exclusive right to use a corporate name. See id., para 9.

The Secretary of State is the authority competent to register or reserve a name. For change of name similar procedure as for registration of the name is to be followed. The Act does not make any provision for droping the word signifying the limited liability clause.

The Administrative Process in Relation to Company Names - A Critique

The number of applications received by the Registrars for getting information regarding the availability of names are numerous.[53] So he will be not in a position to give prompt reply after duly considering all aspects relating to names of companies. So if a register of business names is made available in the office of the Registrar and the promoters of prospective companies are allowed to register company names after verification with the Register of Business Names, much work of the Registrar could be avoided. By this he will get sufficient time to look into complaints relating to similarity of names or undesirability of names and would be in a position to take a judicious decision in those matters. The question relating to the grant of licence to a company to drop the word 'Limited' or revocation or modification of licence involves complicated questions of fact and law. This could more efficiently be handled by an administrative tribunal. There seems to be no difficulty in experimenting the British

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53. See the table in note 12A supra.

procedure in this case also. Companies complying with certain rigid rules to be laid down in the Act itself, may be allowed to drop the word 'Limited' from its name without a licence. Then, of course, many of the exemptions given to the licenced companies may have to be taken away.

Licensing Under Other Statutes*

Different statutes insists on taking licence or permission for carrying on certain trade activities. For example, under the Industries Act,[54] the establishment of a new industrial undertaking or the substantial expansion of an existing undertaking require an industrial licence.[55] The Central Government is empowered to revoke, modify or vary the conditions or lay down new conditions in the industrial licence[56] after providing an opportunity to the owner of being heard.[57] Similarly, under the Monopolies and Restrictive Trade Practices Act 1969, the proposals for setting up of a new undertaking, for substantial expansion of an undertaking, or for merger or take over of an undertaking cannot be given effect to without obtaining a licence from the Central Government, if such establishment, expansion or merger is

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* Elaborate procedures are prescribed under different statutes regulating the grant and revocation of licences. A comprehensive treatment of all these provisions is not considered necessary for the purpose of this thesis.

54. The Industries (Development and Regulation) Act 1951 (65 of 1951).

55. Id., S.10.

56. Id., S.12.

57. Id., S.10A & 12.

likely to lead to the concentration of economic power.[58] The Imports and Exports (Control) Act 1947 (18 of 1947), the Merchant Shipping Act 1958, the Banking Regulations Act 1948 etc. also contain provisions requiring companies to obtain a licence before engaging in certain trade activities.

Pre-Incorporation Formalities - A critique

There is a plethora of administrative process to be followed just at the inception of a company. In many cases applications for licence or permission are rejected without even giving an opportunity to the aggrieved person to make representation or to be heard. Often there is no right to appeal to higher administrative authorities or to the judiciary.

Since licensing is the commonly adopted method for controlling different aspects prior to incorporation of companies, the effect of refusal to grant licence and the effect of revocation of licence need consideration. If the party applying for a licence has 'sufficient interest' or right at stake, he is entitled to a trial type hearing, where the licence is not granted or is revoked.[59] When a person has sufficient interest,' he has a right to get licence. But if his interest is less than right, obtaining a licence is only a privilege or act of grace. Even when it is a privilege, substantive as well as procedural fairness do apply.[60] The

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58. The Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969), Ss.21-23.

59. See Davis K.C., Administrative Law Text, West Publishing Co., (3rd Ed.1972), para 7.03.

60. For example, see Maneka Gandhi v. Union of India, A.I.R. 1978 S.C.597.

idea is that the Government should be fair in granting licences, no matter what the nature of licence be.

Any licences under the company law may be considered as a right. It is a pre-requisite for starting a new industrial unit or for expanding an existing unit. It is not proper to allow administrative agencies to impose a death sentence on a lawful business or prohibit the birth of a lawful business without even giving the affected party a chance to be heard. The refusal of a licence to drop the word 'Limited' from the name of a company do not have such drastic effects. It can well be considered as a privilege available to some class of companies fulfilling the conditions laid down in the Act. Even here, before revoking a licence already granted, hearing need be given to the affected company. It is also a legally protected right so far as the company complies with the statutory requirements. In any case, it is not proper to take away the audi alteram partem rule from the field of corporate control.[61] However, there seems to be no danger to allow a company to drop the word 'limited' from its name if the company fulfil the conditions to be specified in the Act itself, with taking a licence, as is done in England.

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61. See also Lakshmi Swaminathan, 'Right to be Heard in Licencing Cases,' (1970) 12 J.I.L.I.657.

CHAPTER - 6

Incorporation and Commencement of Business

Adequately safeguarding the interests of investors, creditors and the public is one of the major objectives of the Companies Act.[1] Share holder militancy is perhaps the best method to increase managements' awareness of their duties to the shareholders as distinct from those to the company. But a shareholder in a large public company is becoming increasingly detached from any direct involvement in the affairs of the company, though in theory the shareholders have the ultimate right of control. Administrative authorities step in to see that the interests of shareholders and creditors are protected. This administrative intervention commences right from the time of incorporation.

Incorporation of Companies

Incorporation is the primary need for a company to get legal personality. The Registrar of Joint Stock Companies

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1. The Report of the Company Law Committee 1952, stated its objectives as under: "Our objective will be to consider, in the chapters that follow, to what extent it is possible to adjust the structure and methods of working of the corporate form of business management with a view to weaving an integrated pattern of relationships as between promoters and the management so that -
   a) efficiency of the corporate form of organisation may be increased as measured by accepted standards;
   b) managerial efficiency may be reconciled with legitimate right of investors;

   etc..."

is the authority to register a company. He will issue a certificate of incorporation after registration. For the purpose of registration the following documents should be presented to the Registrar of the State where the registered office of the company is to be situated.[2]

1) Memorandum of association, stating name of the company, place of registered office, company's objects and the state or states to whose territory the objects extend.

2) Articles of association prescribing the regulations of the company. In the case of unlimited companies and companies limited by shares, articles of association are compulsory. But in the case of public companies limited by shares, the company has the liberty to dispense with the requirement of articles. However articles of Table A contained in Schedule-I of the Companies Act 1956, will apply to such companies registered without articles or with articles but not excluding or modifying the application of the Table-A regulations; eventhough no article in Table-A is compulsory.[3]

3) A declaration to the effect that all requirements of the Act and Rules in regard to registration has been complied with.

4) In the case of public companies limited by shares, seperate written consent to act as director signed by the proposed directors.

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2. The Companies Act 1956, S.33.
3. Id., S.28.

5) Any agreement of the proposed company under the memorandum or articles of association of the company, which form part of the memorandum.

6) Registrar's letter intimating the availability of name.

7) Stamp duty and the prescribed registration fees depending upon the amount of authorised capital.

In addition to this, intimation letter stating the address of the registered office, and particulars of directors, managers or secretary should also be produced before the Registrar at the time of registration, even though these are required to be filed within 30 days after registration of the company. The Registrar will issue a certificate of formation after registering the company.

Registration of Companies - Registrar's Duty

While registering a company, the Registrar is not doing a ministerial duty.[4] In R v. The Registrar of Companies,[5] the Court of the Kings Bench considered this question. Here the Registrar refused to register a company on the plea that the proposed name of the company closely resembled an existing company. A writ of mandamus was sought to be issued against this order. The Court held that the duty of the Registrar is

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4. R. v. Registrar of Companies, [1912] 1 K.B. 23; See also Bowman v. Secular Society Ltd., [1917] A.C. 406 per Lord Parker. (H.L).

5. Ibid.

not purely ministerial but is discretionary.[6] The Court said,

> "I think that at the moment it is admitted that the registrar must exercise some discretion in the registration of a company, the name of which is suggested to be either identical with that of another company already registered or so nearly resembling it as to be calculated to deceive, then in order to displace the decision of registrar and justify this Court in interfering by mandamus it would be necessary for the applicants to show one or more of three things: either that the registrar had not in fact exercised any discretion in the particular case, or that he had exercised that upon some wrong principle of law, or that he had been influenced by extraneous considerations which he ought not to have taken into account."[7]

So the Registrar has to apply his mind and exercise discretion as the registration confers special status to companies. He should consider whether the requirements of the Companies Act have been complied with and refuse registration if he considers that it has not.[9]

However, there is no obligation on the part of the Registrar to enquire into the circumstances under which the

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6. Id. at p.34 per Avory, J.
7. Id. at p.34 per Avory, J.
8. Ibid.
9. Cotman v. Brougham, [1918] A.C.514. See also R v. Registrar of Joint Stock Companies, Exparte Moore, [1931] 2 K.B.197.

company was proposed to be formed. Not only is such an obligation not laid on the Registrar, but he would be exceeding his jurisdiction if he undertakes any such thing.[10]

In T.V. Krishna v. Andhra Prabha (P) Ltd.[11] the Andhra Pradesh High Court considered the question. A petition was brought in the Court for quashing the registration certificate granted to a company, namely Andhra Prabha Private Limited. The ground for such an action was that the new company was formed to deny some benefits to the workers, and the Registrar while granting the certificate had not enquired about these matters. Regarding this, the Court observed;

> "We cannot also see our way to accede to the theory that the Registrar before functioning under Section 33 of the Act should enquire into the circumstances under which the company was proposed to be formed. In our considered judgement, not only is such an obligation not laid down on him but he would be exceeding his jurisdiction if he should undertake any such thing."[12]

Payment of prescribed fee is a condition precedent and such fee is payable on presentation of the documents for registration.[13] For example, in Ratanshi Panchan Tank v. Registrar,[14] the petitioner claimed the refund of fees paid

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10. T.V. Krishna v. Andhra Prabha Pvt.Ltd., A.I.R. 1960 A.P.123.
11. Ibid.
12. Id. at p.128 per P. Chandra Reddy, C.J.
13. Ratanshi Panchan Tank v. Registrar of Companies, 1969 K.L.T.858.
14. Ibid.

to the Registrar for registration of a company since the petitioner did not proceed with the matter. He argued that he had not been rendered the services for which he paid the fee, he was entitled to get the fees back. The Court refused to give any relief in this regard on the ground that a person paying a fee under a statute had no right to get the fees back because he no longer wanted the services for which the fee was paid.[15] Here the Court said,

> "Although there would appear to be no express provision as in Section 80 of the Indian Registration Act that, "all fees for the registration of documents shall be payable on the presentation of such documents," it seems to us obvious that the fee payable for registration of a company, ...is payable on the presentation for registration of the documents."[16]

Effect of Registration

A certificate of incorporation is conclusive evidence to prove that all requirements of the Act in respect of registration have been complied with and that the association is a company authorised to be registered and duly registered under the Act.[17] This also proves that the corporation thus formed have the statutory number of persons, and that the association is a complete person in law having satisfied all

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15. Id. at p.860.

16. Ibid., per Raman Nayar, Ag.C.J.

17. In re Nassau Phosphate Company, (1876) 2 Ch.D.610. See also Hammond v. Prentice Brothers Ltd., [1920] 1 Ch.D.201.

the requirements of law as prescribed by the Act.[18] The conclusiveness of the certificate of registration extend not only to corporate structure,[19] but also to matters precedent and incidental thereto.[20]

Since the certificate of registration is of such importance, the Registrar can refuse to register an article or memoranda which introduces an illegal object.[21] It is essential for the validity of an incorporated company to have the prescribed number of persons and should have been associated for a lawful purpose.[22] So if the purpose appears *exfacie* illegal or prohibited by statute, the Registrar should refuse registration.[23]

However any purpose not prohibited by law is a lawful purpose[24] and a company may validly be incorporated with such objects. The fact that one person, because of his preponderating number of shares, is in a position to out-vote all other members will not make the company illegal if the memorandum has been signed by the requisite number.[25]

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18. Bowman v. Secular Society, [1917] L.R. A.C.406.
19. The Companies Act 1956, S.35; See also Ariff v. Ariff, I.L.R.1913 Cal.1.
20. T.V. Krishna v. Andhra Prabha, Supra n.10.
21. Pioneer M.B. Society v. Assistant Registrar, A.I.R. 1933 Mad.129.
22. The Companies Act 1956, S.12.
23. T.V. Krishna v. Andhra Prabha, Supra n.10.
24. In re Indian Iron and Steel Co.Ltd., A.I.R.1957 Cal.234 per P.B. Mukherjee, J.
25. Salomon v. Salomon & Company, (1897) L.R.A.C.22.

Similarly it was held that an infant signing a memorandum is a person and unless he has repudiated the contract, the Registrar could not object registration.[26] But when a person has not signed the declaration contained in the memorandum of association of a private company, he is not a subscriber to the memorandum eventhough his signature appears elsewhere, and cannot be considered for registration.[27]

In Sri Arthanari Transports v. Swami Gounder,[28] the plaintiff had signed some papers relating to the company in which he has alleged to have agreed to take 50 shares. But he had not signed the declaration attached to the memorandum and claimed that since he had not signed the declaration he could not be considered as a member. Allowing this arguement, the Court observed,

> "It is plain that those who do not subscribe their signature to the declaration in token of their desire to form themselves into a company and do not agree to take shares as required in the declaration, cannot be considered to be subscribers to the memorandum of association."[29]

When the Registrar grants a certificate of incorporation, the memorandum of association would be deemed to have duly subscribed by the required number of persons even when

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26. In re Nassau Phosphate Co., Supra n.76. See also In re Lenon & Co.(2), /1892/ 3 Ch.D.555.
27. Sri Arthanari Transports v. Swami Gounder, A.I.R.1966 Mad.231.
28. Ibid.
29. Id. at p.234 per Veeraswami, J.

that is not so in fact.[30] On this basis it was held that a certificate of incorporation conclusively proved that each subscriber wrote the number of shares he took opposite his name and hence no subscriber would be allowed to prove the contrary.[31] In Collector of Moradabad v. Equity Insurance Co.,[32] the number of shares noted opposite to the name of one promoter, Raja Jagat, was 1500. Though no money was paid, he signed the articles and memorandum of the company before incorporation. No shares were formally allotted to him also. But the certificate of incorporation was given to the company. In this circumstances the Court said,

> "Admittedly a certificate of registration was given by the Registrar in respect of Equity Insurance Co.Ltd. The certificate is, therefore, conclusive evidence of the fact that each subscriber wrote opposite his name the number of shares he took."[33]

Statutory Documents

Among the documents to be delivered to the Registrar at the time of registration, the memorandum of association and the articles of association are the basic documents. They are often treated as the constitution of the company. These two documents, when registered, bind the company and the members thereof as if there had been a binding contract.[34]

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30. Moosa Goolam Ariff v. Ebrahim Goolam Ariff, 1 L.R.1913 Cal.1.
31. Collector of Moradabad v. Equity Insurance Co., A.I.R. 1948 Oudh.197.
32. Ibid.
33. Id. at p.200 per Kaul and Misra, JJ.
34. The Companies Act 1956, S.36.

Object and Powers

The directors or managers of a company cannot do anything beyond the scope of the memorandum.[35] The object of the company and the powers of the company to be exercised in carrying out the objects would be contained in the memorandum and articles respectively.[36] The exercise of powers should be to attain the objects stated in the memorandum. The powers are not required to be and ought not be stated in the memorandum. They are usually contained in the articles of association.

The object clause

The object clause contained in the memorandum of association is of great practical importance and not a mere legal technicality.[37] The objects stated therein are those which the company intends to carryout.[38] The purposes of stating the objects in the memorandum are:

1) The intending corporator should know in what field he is going to invest; and

2) Anyone dealing with the corporation should know whether the contractual relation, he is entering into, relates to a matter within the company's corporate object.[39]

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35. Ashbury Railway Carriage Co. v. Riche, (1875) L.R. 7 H.L. 653.
36. Cotman v. Brougham, [1918] A.C. 514.
37. In re Bhutoria Brothers, A.I.R. 1957 Cal.593.
38. Ibid.
39. Ibid.

Since the object clause of the memorandum is of such importance to the investors and creditors, the English Courts have taken the view that when the Act says that memorandum should 'State the objects', the meaning is that it must delimit and identify the objects in such plain and unambiguous manner as that the reader can identify the field of industry within which the corporate activities are to be confined.[40]

Doctrine of 'ultra vires'[41]

The object clause in the memorandum of association affords an important protection to the investors and creditors. The Companies Act 1956 (1 of 1956) provides that every company should specify in its memorandum, the objects for which it is incorporated.[42] In the case of companies to be registered after the commencement of the Companies (Amendment) Act 1965 (31 of 1965), its object clause should be divided into three parts stating the main objects, other objects and the states to which objects extends.[43] This

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40. Cotman v. Brougham, [1918] A.C.514 at p.522.

41. The discussion here is limited and is intended to bring forth only the importance of administrative control in relation to object clause of the memorandum. For a fuller discussion see Gower, L.C.B., Modern Company Law, Stevens & Sons Ltd., London (6th Ed.1981), Chapter 6.

42. The Companies Act 1956, S.13(1).

43. Id., S.13(1) c, d & e reads: "(c) In the case of a company in existence immediately before the commencement of the Companies (Amendment) Act 1965, the objects of the company; (d) in the case of a company formed after such amendment -

    (i) the main objects of the company to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the special objects;

(f.n. contd.)

confines the activities of the company within a defined field and prevents diversification of company's activities in directions not closely connected with the business for which the company may have been initially established.[44] The shareholders and creditors can also ensure that the funds they invested for one undertaking is not going to be risked in another undertaking.[45] Any action done by the company beyond the powers given under its memorandum would be ultravires of the company and hence null and void.[46] However, anything done to promote some objects which are fair, reasonable and incidental to the objects authorised by the memorandum would not become void by virtue of this doctrine.[47]

But a company cannot devote any part of its funds to an object which is neither essential nor incidental to the fulfilment of its objects, even if that object is likely to prove to be beneficial.[48]

(f.n.43 contd.)

(ii) other objects of the company not included in sub-clause (i);
and (c) in the case of companies (other than trading corporations) with objects not confined to one state, the state to whose territories the object extend."

44. D.L. Mazumdar, Towards a Philosophy of the Modern Corporation, (1967), p.119.

45. Waman Lal v. Scindia Steam Navigation Co., A.I.R.1944 Bom.131.

46. Ashbury Railway Carriage and Iron Company Ltd. v. Riche, (1875) L.R. 7 H.L.653. See also Cotman v. Brougham, [1918] A.C. 514.

47. Attorney General v. The Great Eastern Railway Co., (1880) 5 A.C.473. See also Lakshmana Swami Mudaliar v. L.I.C., A.I.R. 1963 S.C.1185.

48. London County Council v. Attorney General, [1902] A.C.165. See also Imperial Bank of India v. Bengal

(f.n.contd.)

So it can be seen that memorandum of association is the charter of a company and it defines and limits its powers.[49] The object stated should be those which the company intends to carry out in near and reasonable future. It should not be too remote and intended for a too remote future. The mere possibilities in carrying out the objects in some distant and uncertain time is not sufficient.[50]

The proper test for determining the validity of an action taken by a company is to see whether the power to do that thing arises by necessary implication from the expressed objects.[51] Even a private limited company cannot exceed the powers conferred by the memorandum of association. A company cannot engage in a business which is not fairly incidental to or consequential upon the business, the carrying of which constitute its object.[52] However, the doctrine will not be allowed to be carried to an unreasonable extent so as to benefit a company from an ultra vires transaction.[53]

(f.n. 48 contd.)

National Bank, A.I.R.1930 Cal.536; Wamanlal v. Scindia Steam Navigation Co., A.I.R.1944 Bom.131; Iron Traders v. Hiralal Mittal, A.I.R. 1962 Punj.277.

49. In re Kingsbury Collieries Ltd. and Moore's Contract, /1907/ 2 Ch.259.

50. In re Bhatoria Brothers, A.I.R.1957 Cal.593 (597).

51. In re Kingsbury's Collieries Ltd. and Moore's Contract, /1907/ 2 Ch.259. See also In re Bilasari Juharmal, A.I.R. 1962 Bom.133.

52. Turner Morrison and Co.Ltd. v. Hungerford Investment Trust Ltd., A.I.R. 1972 S.C.131.

53. See the European Communities Act 1972, S.9; Kumar Krishna Rohatgi v. State Bank of India, (1980) 50 Com. Cas.722 (Pat.). International Sales and Agencies Ltd. v. Marcus, /1982/ 3 All E.R.551 (Q.B.D).

The Alteration of Object Clause

To preserve the sanctity of these propositions relating to object clause, administrative intervention is envisaged in the Act. So for any alteration of the objects, passing of special resolution and confirmation by the Company Law Board is necessary.[54] The Company Law Board is clothed with such discretion in approving confirmation of alteration of memorandum. However, an alteration permitted by the Act and not prohibited by the memorandum will have to be allowed by the Company Law Board. The powers of the Company Law Board in imposing terms and conditions while confirming the amendment of memorandum are unlimited.[55] In so allowing the Company Law Board can impose terms and conditions. Till the Companies (Amendment) Act 1974, the Court was exercising power to confirm alteration of memorandum. So the power of the Court in this regard applies to the Company Law Board also. In In re Indian Iron and Steel Co.Ltd.,[57] the company sought confirmation by the Court of the alteration of memorandum. Here the question whether the alteration should be sanctioned and confirmed by the Court unconditionally or upon certain terms and conditions was considered. The Court held that it could impose some terms and conditions while confirming an alteration.[58] Regarding the extent of such power, the Court said,

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54. The Companies Act 1956, S.17.

55. See In re Indian Iron and Steel Co.Ltd., A.I.R.1957 Cal.234.

56. In re Indian Iron and Steel Co.Ltd., A.I.R.1957 Cal.234.

57. Ibid.

58. Id. at p.239.

> "I do not think that there can be a set pattern in which all the conditions that the Court may impose can be limited. The Courts' hands in this respect are in my view free and unfettered."[59]

The Company Law Board may confirm the alteration either wholly or in part or on such terms and conditions as it may deem necessary.[60] Thus in Jayantilal v. Tata Iron & Steel Co.,[61] the Bombay High Court considered the question whether the Court, while confirming an alteration of memorandum, can confirm it partly. Regarding this, the Court said,

> "The order that the Court makes is a discretionary order and wide power is given to the Court to confirm the alteration either wholly or in part ..."[62]

Though loss of substratum of the company is not by itself a ground on which the Company Law Board may decline to confirm an alteration in the memorandum of association of a company, the Company Law Board may decline an alteration if conditions mentioned in the Act are not satisfied.[63] It is necessary that the Company Law Board should give due weight to the judgement of the directors and shareholders.

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59. Ibid. per P.B. Mukharji, J.

60. Jayantilal v. Tata Iron and Steel Co.Ltd., A.I.R.1958 Bom.153(156).

61. Ibid.

62. Id. at p.156, per Chagla, C.J.

63. See In re Standard General Assurance Co., A.I.R.1965 Cal.16.

The English Position

Under the English Law also, company's objects as stated in the memorandum cannot be departed from unless and until altered under the Companies Act 1948. This rule is, however, subject to the exception in favour of a person dealing with the company in good faith.[64] A company can alter the provisions of its memorandum of association with respect to company's objects by a special resolution.[65] But if an application is made to the Company Court for cancellation of the alteration, then alterations will not have any effect except in so far as confirmed by the Court.[66] The application can be made by the holders of not less than 15 per cent shares in the aggregate of the nominal value of company's issued capital or, if the company is not limited by shares, not less than 15 per cent of the company's members; or by holders of not less than 15 per cent of the company's debentures entitling the holders to object to alteration of its objects.[67] However, an application cannot be made by a person who has consented to or voted in favour of the alteration.[68] While considering the application, the Court may make an order confirming the alteration wholly or in part and on such terms and conditions as it may think fit.[69]

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64. See Halsbury's Laws of England, Vol.7, (4 Edn), para 701.
65. See the Companies Act 1948, S.5(1); See also Halsbury's Laws of England, op.cit., para 780.
66. Id., proviso to S.5(1).
67. In re Hampstead Garden Suburb Trust, [1962] 1 Ch.806.
68. The Companies Act 1948, S.5(2).
69. Ibid.

In the United States

In the U.S.A., all State Acts require the articles of incorporation to set forth the corporate purpose.[70] This purpose clause should express the nature and scope of the business and the risk as agreed upon among the shareholders. The purpose clause is supposed to protect shareholders, management and the public by defining the line between intra-vires and ultravires corporate activity.[71]

The Australian Position

In Australia, the object clause of the company must be fully and completely be stated as it defines the limits within which the company is intended to operate. The company's powers consists of stated objects, powers necessarily ancilliary to these objects, and powers conferred by the statute.[72] For alteration of the objects, special resolution is necessary. A copy of the altered memorandum is required to be lodged with the Registrar of Companies within fourteen days of its passing.[73] But the shareholders may approach the Court for cancellation of an alteration. The holders of at least 10 per cent of nominal value of shares should combine to move such an application.[74]

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70. See the Model Business Corporation Act, S.48(c).

71. See Harry G. Henn, Law of Corporations, (2nd Edn.1979), West Publishing Co., p.202; See also 18 Am.Jur.2d, Corporations, S.397.

72. The Companies Act 1961 (Australia), S.20.

73. Id., S.28.

74. Cf. English provision. The Companies Act 1948 requires that holders of at least 15 per cent nominal value of share capital should combine to make an application to the Court.

It can be seen that administrative intervention in matters relating to object clause is more rigourous in India. Here the Company Law Board exercises the power to confirm the alteration of memorandum in place of Courts in other countries. Moreover, confirmation by the Company Law Board is necessary even when the alteration is effected by a unanimous resolution in general meeting. This seems to be burdensome in the commercial sense. There seems to be no need to retain the requirement of confirmation by the Company Law Board and the same may be dispensed with unless at least members holding 10 per cent of nominal value of shares raises objection to such alteration. When the confirmation is necessary, the order of the Company Law Board in this respect should be made appealable.

Registration of Alteration

Registration of alteration of the memorandum with the Registrar of Companies is a condition precedent for its validity.[75] A certified copy of the order of the Company Law Board confirming the alteration and a printed copy of the memorandum as altered, should be submitted to the Registrar within three months from the date of the order.[76] If the alteration has the effect of changing the registered office of the company from one State to another, registration should be made in both the States.[77] The Registrar of Companie is under an obligation to certify registration within one month from the date of filing the documents.[78]

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75. The Companies Act 1956, S.19.
76. Id., S.18(1).
77. Id., S.18(3).
78. Id., S.18(1).

The Company Law Board is empowered to extend time for filing documents or for registration of alteration at its discretion.[79] But if the documents are not filed within the time limit under the section or as extended by the Company Law Board, all the proceedings in connection with the alteration would become void and inoperative.[80] Here again the Company Law Board may revive the order on an application made to it within a further period of one month.[81]

Till the Companies (Amendment) Act 1974 (41 of 1974), the power to confirm the alteration of memorandum was with the Courts. Hence the scope and extent of the discretion of the Company Law Board in relation to the confirmation of memorandum or extention of time for registration of the alteration should be treated as similar to those of the Court. Since the power of the Company Law Board has been expressly declared to be of judicial nature, it should follow the principles evolved by the Courts.

In the matter of registration of alteration of memorandum, the Registrar has to use his discretion. It was held that the Registrar has a discretion to refuse registration of the alteration of memorandum to the same extent as he has with regard to the original memorandum.[82] In

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79. Id., 18(4). See also Project Engineers (Pvt.) Ltd. v. Registrar of Companies, Madras, (1967) 2 Comp.L.J.103.

80. Id., S.19(2).

81. Id., Proviso to S.19(2).

82. Pioneer M.B. Society v. Assistant Registrar, A.I.R.1933 Mad.129.

Pioneer M.B. Society v. Assistant Registrar,[83] the Madras High Court considered the question whether the Assistant Registrar had power to decline the registration of alteration of any part of the articles or memorandum. The Court said,

> "If he can exercise his discretion with regard to articles, he must obviously be able to exercise a discretion with regard to the alteration of articles."[84]

There is no necessity to follow all the procedural formalities contained in Section 17 for alteration of the particulars contained in the memorandum except those conditions which are required to be stated in it under Section 13 of the Act. So anything else contained in the memorandum can be altered by passing a special resolution.[85]

Alteration of Articles

Section 31 of the Companies Act 1956 empowers the company to alter its articles of association by a special resolution. But if such alteration has the effect of converting a public company into a private company, approval of the Central Government is necessary. When such approval of the Central Government is necessary, printed copy of the articles,

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83. Ibid.
84. Id. at p.129 per Stone, J.
85. Venkataramana Aiyar v. Coimbatore Mercantile Bank, A.I.R.1924 Mad.126.

as altered, should be filed with the Registrar within one month of the date of receipt of the order of approval.[86]

The power of the company to alter its articles need be exercised bonafide for the benefit of the company as a whole[87] and should not be used to oppress or defraud minority shareholders.[88] The Registrar can refuse to register an alteration of the articles if contravention is made in this regard.[89] In Pioneer M.B. Society v. Assistant Registrar,[90] the object of the company included a scheme which offended Section 294A of the Indian Penal Code. The Registrar refused registration which was challenged by the company. The Court said,

> "In my opinion, it does offend Section 294A (of the Indian Penal Code) and the Assistant Registrar of Joint Stock Companies was right in refusing to register the articles as presented to him."[91]

Incorporation and Related matters:
A Comparative Analysis:

In England also, registration under Companies Act 1948 is compulsory for any association or partnership having a membership of more than ten in the case of banking business or twenty in the case of any other business, unless formed

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86. The Companies Act 1956, S.31(2A).
87. All India Railway Men's Benefit Fund v. Baharvarnath, A.I.R. 1945 Nag.187. See also National Industrial Corporation v. Registrar of Companies, A.I.R.1963 Pun.239.
88. Shuttle Worth v. Cox Brothers and Co., [1927] 2 K.B.9.
89. Pioneers M.B. Society v. Assistant Registrar, supra n.82.
90. Ibid.
91. Id. at p.130 per Stone, J.

under some other Acts of Parliament or of Letters of Patent.[92] For the purpose of such registrations, the Department of Trade and Industry has established registration offices. The procedure for registration is almost similar to the Indian practice.

The power of the Registrar as to registration is held to be of not purely a ministerial type.[93] He should consider whether the requirements of the Companies Acts have been complied with and refuse registration if he conceives that they have not.[94] The Courts will not interfere with the decision of the Registrar unless it is shown either that the Registrar had not in fact exercised his discretion or that he has exercised that upon some wrong principles of law, or that he had been influenced by extraneous conditions which he ought not to have taken into account.[95] On the registration of the memorandum of a company, the Registrar should certify that the company is incorporated, and in case of a limited company, that the company is limited. The duty of the Registrar can be enforced by a writ of mandamus.[96]

From the date of Registration, the company becomes a body corporate by name contained in the memorandum, separate

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92. The Companies Act 1948, S.429.

93. R. v. Registrar of Companies, [1912] 3 K.B.23; Bowman v. Secular Society Ltd., [1917] A.C.406.

94. R. v. Registrar of Joint Stock Companies, Exparte More, [1931] 2 K.B. 197.

95. R. v. Registrar of Companies, supra n.93.

96. R. v. Whitmarsh, (1850) 15 Q.B.600; R. v. Registrar of Companies, (1847) 10 Q.B.839.

and distinct from the individual members of the company.[97]

Being the basic documents of a company, which are also public documents, regulating the relations of the company and others like directors, members and outsiders, the conditions contained in the memorandum and articles cannot be altered except in the cases, in the mode and to the extent, for which express provision is made in the Act. The alterations which may be made in the memorandum without the confirmation of the Court are change of name, alteration of objects, alteration of conditions in the memorandum which could have been contained in the articles, increase of capital, cancellation of capital not issued or agreed to be issued, conversion of fully paid up shares into stock, reconversion of stock into shares, consolidation of shares into shares of larger amount, sub-division of capital into shares of smaller amount and rendering of the liability of officers unlimited. However, confirmation by the Court is necessary to reduce paid or unpaid capital, reorganisation of the capital or any other alteration under a scheme of arrangement.[98]

The documents relating to incorporation, the memorandum and articles, are open and accessible to all.[99] So even if any person make some dealings with the company without knowing the contents of these documents, the doctrine of constructive

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97. Salomon v. Salomon & Company, [1897] L.R.A.C.22.

98. Halsburys Laws of England 4th Edn.(1974) Butterworths, London, Vol.VII, para 88.

99. The Companies Act 1956, S.610 expressly guarantee right of inspection of these documents.

notice.[100] stands against him. The powers and duties of all organs of the company are also determined with respect of these documents.[101] So utmost diligence is required in the registration of these documents. But, the right to form a company could not be unduly restricted by administrative authorities. Since the number of new company registrations is fairly large,[101A] it is difficult for the Registrar of

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100. For detailed treatment of the doctrine, See Halsburys Laws of England, Op.Cit., para 748.

101. Doctrine of ultra vires, See Moshir Alam, Doctrine of ultra vires in Company Law, 1979 C.U.L.R. p.305.

101A. The new registration from 1964-65 to 1981-82 were as follows:

Year	New Registrations		Total
	Govt. Companies	Non-Govt. Companies	
1964-65	15	1350	1365
65-66	28	1313	1341
66-67	18	1021	1039
67-68	9	1035	1044
68-69	13	1102	1115
69-70	23	1487	1510
70-71	32	1895	1927
71-72	31	2493	2524
72-73	40	2820	2860
73-74	64	3346	3410
74-75	97	3599	3696
75-76	75	2913	2988
76-77	54	2595	2649
77-78	44	2624	2668
78-79	33	3455	3488
79-80	33	4953	4986
80-81	38	6578	6611
81-82	41	9978	10019

Source: Annual Reports of the Working and Administration of the Companies Act 1956 (for the years 1964-65 to 1981-82).

Companies to apply his mind to each individual cases. This apart, a fairly large number of documents relating to alteration of memorandum and articles are also to be registered. This necessitate a review of the procedure. On the receipt of application for registration of a new company or registration of alteration to the articles or memorandum, the Registrar should give a provisional registration after satisfying himself that all the provisions of the Companies Act and related Acts are complied with. He should then cause to make notification in the Gazette and one or more news papers about the matters, inviting objections, if any, for such registration. Final registration shall be made only after considering the objections, if any, received from the interested parties. Sufficient number of trained staff should be provided for effective administration of these provisions. Right of appeal by the aggrieved party to an administrative tribunal and a second appeal to the High Court should be provided for.

Commencement of Business

In the case of public company, a certificate of commencement of business issued by the Registrar is a necessary to commence business. Such a certificate will be issued by the Registrar to a company issuing prospectus, after filing a declaration by a director or secretary of the company stating that the company has collected the minimum subscription stated in the prospectus and that the directors have taken the qualification shares, if so provided by the articles.[102] If the

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102. The Companies Act 1956, S.149(1).

company does not issue a prospectus, the certificate would be issued when a declaration is filed with the Registrar to the effect that a statement in lieu of prospectus has been filed and that the directors have taken the requisite qualification shares.[103] A private company can commence business right from the date of incorporation.[104]

The certificate granted by the Registrar is conclusive proof of the fact that the company is entitled to commence business.[105] A company is not liable for costs and expenses incurred in respect of its formation and promotion. In the case of a company which never commenced its business, the company is not liable for the expenses such as stamp and registration fee, postal and other charges and publicity and travelling expenses incurred even after incorporation.[106] So the certificate of commencement of business becomes an essential document.

The company can commence its business like raising of capital by issuing shares etc. before the certificate is obtained. The prohibition is against the commencement of any business which means that it cannot enter into any agreement for sale or purchase of property, borrow money etc.[107] Such

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103. Id., S.149(2).
104. The Companies Act, S.149.
105. Id., S.149(3).
106. In re Ambica Textiles, A.I.R. 1950 Cal.491 (493).
107. Kishangarh Electric Supply Co. v. United States of Rajasthan, A.I.R. 1960 Raj.49.

prohibition applies to all contracts of a company whether preliminary or final or in the course of carrying on its business.[108]

The requirement of taking prior permission or certificate of commencement of business is a protection to the investors. When the business is commenced, they can assure that the company has a sound financial position as stated in the prospectus. This does not cause much difficulty to the company as the Registrar is under a duty to issue the certificate when a statutory declaration is made.

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108. In re Otto Electrical Manufacturing Co.Ltd., [1906] 2 Ch.390.

CHAPTER - 7

Issue and Allotment of Shares

Pattern of Company Finance

The principal sources of company finances are the share capital, borrowed capital, governmental aids and undistributed trading profits. One of the major benefits of joint stock trading, is the provision for a formal mechanism of raising finance by issuing securities and stocks, and collecting deposits. The capital of a company is the share capital of it as stated in the memorandum of association, as nominal or authorised capital and does not include borrowed money or deposits.[1] In the case of private companies and small companies, the finances include either the personal investments of those who run the business only or may be supplemented by bank loans or debentures secured under personal guarantee or on company's assets. Thus the company funds may be classified into:

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1. Lee v. Neuchatel Asphalte Co., (1889) 41 Ch.D.1; Verner v. General and Commercial Investment Trust, [1894] 2 Ch.239. The company may not have collected the whole of the nominal capital but collected a substantial amount by issuing debenture or by accepting deposits. Here also the company is a debtor to the borrowed money. The Kerala High Court has in In re S.N.D.P. Yogam, Quilon, (1970) 40 Com.Cas.60, held that capital and share capital are synonymous.

1) Direct issue of shares in the business which in turn form a capital contribution entitling the holder to participate in future profits.

2) Raising repayable loans, with or without interest, from outside sources or from those directly involved. This include bank loans, deposits, debentures etc.

3) By operating on credit, by avoiding the need for capital either by not paying for supplies or services until the operating profit on them has been realised, or by obtaining plant and machinery on hire or hire-purchase terms.[2]

The essential difference between a share capital and loan capital in a company lies in the rights and liabilities attached to the shares.[3] A share capital is repayable only on winding up of the company or through a formal scheme of reduction of capital. But loan capital is to be repaid according to the contractual terms, or in the absence of such specific terms, that ranks along with other debts of the company in the event of winding up or insolvency.

Need for Government Control over Capital Raising

Large public companies, whether Government or non-Government, rely on public market for their money requirements.

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2. See Tom.Hadden, Company Law and Capitalism, (Ed.) Robert Stevenson, (1972), p.168.

3. Lee v. Neuchatel Asphalte Co. Supra n.3; See also Verner v. General and Commercial Investment Trust, [1894] 2 Ch.239.

by issue of share or loan capital. Small and medium sized companies also depend much on capital market, but they raise money mostly by issue of ordinary or preference shares. The companies often get substantial part of its capital from various governmental agencies like banks, Life Insurance Corporation, International Bank of Reconstruction and Development, Industrial Finance Corporation, etc. Since the working and prosperity of companies depend on public money, the Government exercises strict controls over issue of shares and acceptance of deposits. The stock market mechanism of financial control over companies is not at all satisfactory in India. However, when a company lists its securities in a recognised stock exchange, they should observe all procedural formalities especially relating to accounts and audit. The functioning of the stock exchanges are in turn subject to the control of the Central Government.[4]

Share Capital: Types of Controls

The promoters or directors of a company have first to decide how much capital is required and how it should be raised. Then they should take into account how much response would they get from the public for a particular type of shares or security. In the case of a public company or a private company which is a subsidiary of a public company,

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4. See the Securities Contracts (Regulation) Act 1956.

they can issue only two type of shares namely preference shares and equity shares.[5] There is no stipulation as to any specific proportion, between different classes of share capital. But issue of shares with disproportionate voting rights is prohibited.[6] Private companies may, however, issue shares with disproportionate voting rights if authorised by its articles.[7] In any case, the consent of the Controller of Capital Issues must be obtained by the company intending to raise capital from the general public, unless exempted.[8]

Detailed procedural formalities are prescribed under the Companies Act 1956 in relation to raising of capital.[9] The memorandum of association of the company must invariably state the authorised capital, or the maximum amount of share capital, a company is authorised to issue.[10] This authorised capital may be increased or reduced by the company by following the procedures prescribed under the Act.[11]

Share Capital: An Analysis

That portion of the capital which is issued for public subscription is the issued capital of the company.

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5. The Companies Act 1956, S.86.
6. Ibid.
7. Bushell v. Faith, [1970] 1 All.ER.53.
8. See the Capital Issues (Exemption) Order 1966.
9. See infra n.15.
10. The Companies Act 1956, S.13(4).
11. Id., S.94.

The actual shares taken up or subscribed by public out of the issued capital is the subscribed capital. The paid up capital is that portion of the subscribed capital which has been actually paid by the shareholders. In a limited liability company, the liability of the shareholders to contribute to the assets of the company on winding up extends only to the unpaid portion of the subscribed share capital. Some times the uncalled portion of the capital of a company may be reserved or the company may by special resolution determine not to call such portion of the capital except in the event and for the purpose of winding up.[12] This portion of the capital is called reserve capital. As already stated, after the commencement of the Companies Act, there is only two class of shares, the equity shares and preference shares. Only equity shares carry voting rights in matters of company administration and such voting rights will be in proportion to the amount paid up. The other group of shareholders or creditors will have voting rights only in matters directly affecting their interests. The preference shares itself may be classified into cumulative or noncumulative, participating or non-participating and redeemable or non-redeemable, depending upon the rights attached to it.

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12. Id., S.99.

The Principle of Shareholder's Democracy

The principle of shareholders democracy envisaged in the Act[13] is available only to equity shareholders. Even in this class of shareholders, the shareholders of a private company which is not a subsidiary of a public company is excluded.[14] The preference shareholders are excluded from the ambit of this principle on the ground that they have a preferential right in respect of dividends at a fixed rate and also in regard to repayment of capital in the event of winding up. Private companies are treated for this purpose as an extension of family business or partnership and they are given much discretion in these matters. Both these reasonings do not sound good. The preference shareholders are entitled to get dividend only if the company makes profit. It is their interest also to see that the company flourishes. So they should have a say in the matters of administration of the company. Most of the private companies are not a matter of individual concern now. Society has certainly a stake in its prosperity. It is hightime that a change is effected in

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13. The principle of federalism is applied in company administration also. The different organs of the company viz. the board of directors, shareholders in general meeting; etc. take their power from the constitution of the company - the memoranda and articles. The principle of majority rule is also adopted in the Act.

14. Bushell v. Faith, supra n.9.

any company carrying proportional voting rights, unless specifically permitted by competent authority on a petition by the company.

Issue of Shares

(a) Requirements under the Capital Issues (Control) Act 1947.

The Capital Issues (Control) Act 1947, (29 of 1947), regulates the issue of capital by companies. Companies are prohibited from making a public offer for subscription of securities unless consent or acknowledgement has been obtained from the Central Government.[15] No person can accept or give any consideration for any securities in respect of any issue of capital in India without the consent or recognition of the Government. Similarly, selling, purchasing, transferring or accepting transfers of securities require such consent.[16]

Exemptions

However, extensive exemptions dispensing with the need for such consent or acknowledgement have been issued from time to time.[17] The following undertakings are exempted from the provisions of the Act regardless of the amount of capital issued by them.[18]

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15. The Capital Issues Control Act 1947, S.5.
16. Ibid.
17. See the Capital Issues (Exemption) Order 1969, Clause 4 and the Capital Issues (Exemption) (Amendment) Order 1972.
18. The Capital Issues (Exemption) Order 1969, Clause 3.

1. A private company not registered under Section 26 of the Monopolies and Restrictive Trade Practices Act 1969.

2. A government company as defined in Section 617 of the Companies Act 1956, which does not issue any portion of the securities to the general public.

3. A banking company or an insurance company or a provident society incorporated as a company.

However, these companies should submit a report to the Controller of Capital Issues if the issue of any of the above companies exceed Rs.50 lakhs in a period of 365 days. The Government's approval would become necessary for these companies also if there is (1) an issue of bonus shares, (2) an issue of securities by a private company in which 20% of the subscribed capital is held by a public company, (3) an issue of preference shares carrying participating or conversion rights,[19] (4) an issue of debentures carrying conversion rights other than debentures issued by financial institutions or (5) an issue of securities at a premium or discount.[20]

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19. A public company cannot issue preference shares carrying voting rights except as provided under the Companies Act 1956, S.86.

20. The Capital Issues (Exemption) Order 1969, Clause 9.

Certain issues of securities are totally exempted from the order.[21] Similarly, a private company registered under the MRTP Act and a public company not registered under the MRTP Act can issue shares without obtaining the approval of the Government, if the value of the issue including any value of issue of securities made by the company in the preceding twleve months do not exceed Rs.50 lakhs.[22] Similarly, a public company not registered under the MRTP Act, may issue securities worth over Rs.50 lakhs provided it satisfied the several conditions mentioned in Clause 5 of the Exemption Order.[23]

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21. Id., Clause 10. The issue of securities as a result of division, consolidation etc. issue of securities where the Government by order provides for amalgamation, conversion of debentures or loans taken up by the Government or the financial institution etc. are totally exempted from taking approvals from the Government.

22. Id., Clause 4.

23. The conditions mentioned in Clause 5 include the following matters :

    1) The issue does not comprise or include preference shares carrying rights of participation over and above the fixed amount.

    2) As a result of the proposed issue, the equity of the capital is not less than one half of its debt.

    3) As a result of the proposed issue the total paid up preference share capital will not become more than one third of the total paid up equity share capital.

    4) Where the securities issued by the company or part thereof is for the purpose of taking over an existing business or asset, the take over is effected at the book value of such business or asset.

    5) No securities are issued in consideration of revaluation of assets, or creation of any intangible or fictitious assets.

(f.n.contd..)

When the application for consent of the Central Government is refused, the Central Government should, on the request of the applicant, communicate to him in writing the reasons for such refusal.[24] The power of the Central Government to revoke the consent given or alter any condition with which such consent is given[25] is a quasi judicial power.[26] The

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(f.n.contd...

6. The issue price of securities to be issued is at par and not at a premium or discount.

7. Any offer of securities for public subscription is such as to make the securities eligible for listing on a recognised stock exchange.

8. The rate of dividend in preference shares shall not exceed prescribed limit.

9. No reservation made in favour of any person if it is public offer, without the approval of the Controller of Capital Issues.

10. Calls on the securities are made on a uniform basis on all securities of the same class.

11. Private holding of the promoters, directors, or their relatives do not exceed 15 percent of the total issued equity share capital.

12. When a public company is formed for taking over the business of a private company or partnership, the consideration for such take over does not exceed the book value of the net assets of the private company or the partnership.)

24. The Capital Issues (Control) Act 1947, S.5.

25. Id., S.6.

26. The proviso to S.6 id., reads, "Provided that before an order under this sub section is made the company concerned shall be given a reasonable opportunity of showing cause why such an order should not be made."

Ministry of Finance has issued various guidelines for giving consent or acknowledgement under the Act.[27]

The application for consent should contain copies of approval of the Central Government under the MRTP Act and the approval of the Reserve Bank of India under the Foreign Exchange Regulations Act 1973, wherever necessary. More over there should be a ceiling on the dividend payable to preference shares. An equity-preference share ratio 3:1 should be maintained. There are other requirements also like prohibition in allowing premium to first issue of shares. All these requirements are primarily intended to protect the interests of the investing public.

(b) Requirements under the Foreign Exchange Regulation Act 1973

The Foreign Exchange Regulation Act 1973 (46 of 1973)[28] prohibits aquisition or transfer of shares in a company registered in India by or to persons resident outside India, except with the permission of the Reserve Bank. General permission has been granted by the Reserve Bank for the issue of Indian securities to persons resident in Nepal.[30]

Application for permission to issue shares to foreign

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27. Press note issued by the Ministry of Finance (Department of Economic Affairs), Office of the Controller of Capital Issues, dated 14th May 1975 and revised by a similar press note dated 13.8.1976 as contained in Tax.L.R.1975 & 1976.

28. Hereafter referred to as 'FERA'.

29. FERA, S.19(1).

30. See D.J.Ganatra, Foreign Exchange Regulation Act, (1976), p.436.

collaborators in industrial ventures in India should be sent to the Foreign Investments Board in the Ministry of Industrial Development & Internal Trade, irrespective of whether the foreign investment is for the establishment of a new industrial unit or for the expansion of the existing units. Same is the procedure for initial issue of capital to non-residents or for additional issue of capital to them.

After the application is approved by the Government, the Reserve Bank will issue its formal authorisation. According to the Indian Investment Policy adopted in September 1967,[31] the Government of India decided that non-residents of Indian origin should be allowed to engage in any industrial activity in India subject to certain conditions. But if the non-residents do not take Indian citizenship, all amounts due to him would be creditied to his non-resident blocked account. To avoid this difficulty, the non-residents floating an Indian joint stock company, preferably a public limited company, should give a voluntary undertaking that neither the capital invested nor the profits earned therefrom would be repatriated abroad. They should associate progressively resident Indian participation in the company at least upto 49% of the equity capital, within a reasonable period.

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31. See the policies adopted by the Government of India on investments in India by non-residents of Indian origin as cited by D.J. Ganatra, op.cit., p.439.

The restriction in the FERA against the issue of shares to non-residents is intended to stop flow of Indian capital abroad. Eventhough it is essential to facilitate investment to the maximum possible extent, it does not seem wise to allow foreign nationals or non-residents to hold substantial shareholding.

The English Position

In England, the Treasury may make orders for regulating capital raising by companies.[32] There, the following transaction need prior sanction of the Treasury.

1) Borrowing of money in Great Britan where the aggregate of the amount of money borrowed under the transaction and of any other amounts so borrowed by the same person in the previous twelve months exceeds £10,000.[33]

2) The raising of money in Great Britan by the issue of shares or debentures whether in Great Britan or elsewhere by any body corporate.[34]

3) The issue, for any purpose, by any body corporate of any shares in, or debentures or other securities of, that body corporate if either the body corporate is incorporated under the law of England or Scotland, or its shares, debentures or other securities are to be registered in England or Scotland.[35]

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32. See the Control of Borrowing Order, 1958.
33. The Borrowing (Control and Guarantees) Act 1946, S.1(1)(a).
34. Id., S.1(1)(b).
35. Id., S.1(1)(c)(i).

4) The circulation in Great Britan of any offer for subscription, sale or exchange of any shares in, or debentures or other securities of, any body corporate, not incorporated under the law of England or Scotland.[36]

However, the right of the person concerned in any such transaction is not affected by the fact that the transaction is in contravention of any Orders made under the provisions.[37]

Restrictions under the Companies Act

The administrative controls provided in the Companies Act 1956 in relation to issue of shares and acceptance of deposits are to ensure that, companies do not employ unfair means for raising capital. The subscribers to the memorandum of association of a company becomes the shareholders of the company on registration. They should be enrolled as members of the company.[38] These members can take any number of shares of the company subject to the limits laid down in the memorandum.[39] But for issue of shares to others, the general public, it is obligatory that a prospectus or a statement in lieu of prospectus is issued.[40] Before issuing such prospectus, a copy of it should be delivered to the Registrar, signed by the director, proposed director or a duly authorised

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36. Id., S.1(1)(d)(i).

37. Id., S.1(3).

38. The Companies Act 1956, S.41. See also Official Liquidator v. Sulaman Bhai, A.I.R.1955 M.B.166 where it was held that "the subscribers of the memorandum is to be treated as having become a member by the very fact of subscription."

39. The rules framed by the Central Government under Section 58A(1) will apply to this.

40. Id., Ss.58A, 70.

agent of the company.[41] Prospectus should be issued within ninety days after the date on which a copy thereof is delivered for registration. Otherwise it would be deemed that prospectus is issued without complying with the requirements.[42] Punishment is provided for such non-compliance.[43]

Administrative control over the requirements as to the contents and nature of the prospectus is exercised through this registration requirements. This is in addition to the civil and criminal liabilities prescribed under the Act.

The relevant provision of the Act reads,

> "the Registrar shall not register a prospectus unless the requirements of Sections 55, 56, 57 & 58 and sub-sections (1) and (2) of this Section (S.60) have been complied with and the prospectus is accompanied by the consent in writing of the person, if any, named therein as the auditor, legal advisor, attorney, solicitor, banker or broker of the company or intended company to act in that capacity."[44]

The Central Government has power under the Act to frame Rules in consultation with the Reserve Bank of India prescribing the limits upto which, the manner in which and the conditions subject to which, deposits may be invited or

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41. Id., S.60
42. Ibid.
43. Id., Ss.55-68.
44. Id., S.60(3).

accepted by a company either from the public or from its members.[45] In the exercise of these powers the Central Government has framed the Companies (Acceptance of Deposits) Rules 1975. The Rule covers all kinds of deposits except those which are specifically excluded therein.[46] The directors or the promoters should announce the issue of capital in the proforma framed by the Central Government. The Rule also prescribes the procedure for acceptance of deposits and the returns to be made to the Registrar. Frequent amendments are being made in these Rules to implement the governmental policy in this regard.[47]

The restrictions and requirements in the issue of prospectus and the acceptance of capital is a major protection to prospective investors. The disclosures to be made in the prospectus make it possible for the investing public to assess the future of the company and the security of their investment.

Judicial interpretations have widened the scope and ambit of these provisions. It was held that even an advertisement in a news paper offering to the public some shares of the company for sale is a 'Prospectus' as defined in the Act.[48] It was also held that even a private person who is knowingly a party to the issue of prospectus which is punishable under the Act.[49] The Calcutta High Court considered

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45. Id., S.58A(1).
46. The Companies (Acceptance of Deposits) Rules 1975, Clause 2(b).
47. See the Amendments made in 1981 & 1982.
48. Prasatha Nath v. Kalikumar, A.I.R. 1925 Cal.714.
49. S.K.Ghose,J. in Praggnanday v. D.H.Railway Co., A.I.R. 1936 Cal.33(DB).

this matter as one of great importance in the interests of the community and held that the Court should interfere where there is a contravention of law.[50]

In the case of a company in the formative stage, the promoter is personally liable to third parties upon all contracts made on behalf of the intended company, until, with their consent, the company takes over this liability.[51] The meaning of the term promoter is also wide. 'Promotion' is regarded as a term, not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence. Any person who undertakes to take part in forming a company or who with regard to a proposed newly formed company, undertakes a part in raising the capital for it, is prima facie a promoter of the company because he has taken part in setting a going company formed with reference to a given object. It was held that a person may be a promoter eventhough he has taken a comparatively minor part in the promotion proceedings.[52]

However, in a decision of the Pubjab High Court,[53] a limitation is imposed in the application of these provisions. The Court held,

> "where a company offers shares to selective persons, it cannot be said to be extending an invitation to buy shares to the 'public'."[54]

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50. Id. at p.33.

51. Palku v. State of Madhya Pradesh, A.I.R.1961 MP.5.

52. W.W.Chitaley & V.B.Bakhale, The AIR Manual, (1979) Vol.6, p.582.

53. Tek Chand,J. in Rattan Singh v. Moga Transport Co., A.I.R. 1959 Punj. 196.

54. Id. at p.198.

An offer of shares to an individual as such is not within the prohibition of the word 'public' as used in the Act. The reasoning seems to be based on the strict literal interpretation of the word 'public' appearing in Section 67 of the Act. But the Company Law Committee made the following remark in this regard,

> "This Section is expected to serve as a sufficient deterrent to unscrupulous company promoters making untrue and deceptive statement in prospectuses with a view to obtaining capital from the public."[55]

So it is respectfully submitted that such a narrow construction would defeat the very object of these provisions.

Allotment of Shares

Allotment of shares is an appropriation out of the previously unappropriated capital of a company.[56] It is the acceptance by a company of the offer to take shares.[57] Strict controls are envisaged at the stage of allotment also. Thus, no valid allotment can be made till the amount of minimum subscription, which is to be stated in the prospectus, is received in cash.[58] Similarly, a company which has not issued

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55. Report of the Company Law Committee, (1952), p.62.

56. Sarkar, J. in Shri Gopal Jalan & Co. v. Stock Exchange Association Ltd., A.I.R. 1964 S.C.250; Gopal Paper Mills v. I.T.Commr., Calcutta, (1972) 2 S.C.C.80.

57. In Re Florence Land & Public Works Ltd., (1885) 29 Ch.D.421.

58. The Companies Act 1956, S.69.

a prospectus shall not make allotments unless at least three days before such allotment a statement in lieu of prospectus has been filed with the Registrar.[59] In the case of companies which have issued prospectus, they cannot allot shares at once after the issue of prospectus, but have to wait until the beginning of fifth day from the date of issue of the prospectus.[60] If the prospectus contain a statement that an application has been or will be made for permission for the shares to be dealt in, on a recognised stock exchange, the allotment will be void if the permission has not been applied for before the tenth day after the issue of prospectus or if the permission has not been granted before the expiry of ten weeks from the date of closing of the subscription list.[61]

Companies (Amendment) Act 1974, brought one more restriction in the allotment of shares.[62] No allotment exceeding 25% of the equity share capital of a company, including any equity share already held, can be made to any individual, group, constituent of a group, firm, body corporate or bodies corporate under the same management. After the allotment, the company should within thirty days, file with the Registrar a return of allotment detailing the

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59. Id., S.70(1).
60. Id., S.72.
61. Id., S.73.
62. Id., S.108A.

cash allotment, allotment other than for cash, bonus allotment and allotment at a discount.[63] Such filing of returns is not necessary when shares are allotted after they have been forfeited on account of non-payment of calls.[64] Similarly, these restrictions do not apply to a private company which is not a subsidiary of a public company.[65]

The restrictions contained in these provisions relating to allotment of shares could achieve the following objectives (1) prevent any bid to achieve the controlling interest in a company by an individual, group or corporation in the same group of management (2) ensure that disclosure provisions are properly adhered to by the companies (3) ensure that no fraud is practiced in the matter of allotment of shares, (4) prohibit the mis-appropriation of application money received by companies in case the actual allotment is not made, and (5) prohibit the use of subscription money, when the minimum required capital, for the purpose for which capital is issued, is not subscribed.

The Act requires companies to file a return of allotment with the Registrar showing the actual position of the allotment made. The failure to file such statements does not result in the allotment of the fully paid shares becoming

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63. Id., S.75.

64. P.B.Mukharji, J. In re Calcutta Stock Exchange Association Ltd., A.I.R. 1957 Cal.438.

65. The Companies Act 1956, S.108A.

invalid, but make the directors liable for punishment.[66] Where the shares are allotted otherwise than for cash, the Registrar of Companies has to satisfy himself in respect of the title of allottee to the allotment of shares. For this purpose the Registrar must have before him the evidence of the title of the allottee to the allotment.[67]

The English Position

Under the English law also, the allotment is an appropriation, to some person or corporation, of a certain number of shares.[68] There is prohibition to the issue of securities to or for the benefit of persons resident outside the scheduled territories, except with the permission of the Treasury. A company having a share capital and not being a private company should either file a prospectus or file a statement in lieu of prospectus with the Registrar.[69] No allotment of any share capital of a company, offered to the public for subscription, can be made unless the minimum subscription has been subscribed to and the sum payable on application for minimum subscription has been paid to and received by the company.[70] Where a prospectus states that

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66. Emperor v. Nathuram, A.I.R. 1919 Lah.361; See also Govinda Pritamdas v. Amarendra Nath, 1978 Tax. L.R. 2382 (Cal.).

67. The Companies Act 1956, S.75(1)(b). See also Sudharshan Talkies v. Chief Controlling Revenue Authority, A.I.R. 1978 Delhi 162 (DB).

68. Halsburys Laws England, op.cit., p.202.

69. The Companies Act 1948, S.48.

70. Id., S.47. See also Mears v. Western Canada Pulp and Paper Co. Ltd., (1905) 2 Ch.353 (CA).

application has been or will be made for permission for the shares or debentures issued thereby to be dealt in on any stock exchange, any allotment made on an application in pursuance of that prospectus will be void under the following conditions: (1) such permission has not been applied for, before the third day after the first issue of prospectus, or (2) if such permission has been refused before three weeks from the date of closing the subscription list.[71] The company should, within one month of making allotment of any of its shares, deliver to the Registrar, a return of the allotments for registration.[72] The Courts have power to extend the time for registration on an application of the Company.

Listing in Stock Exchanges

There is no statutory requirement, either in India or in England, that shares should be dealt in stock exchanges. But when the prospectus or advertisement for deposits states that the shares or stocks would be dealt in stock exchanges, the company should comply with the relevant legal requirements. Stock exchange listing enables the shareholders to find a ready market for their shares so that they can convert their investment into cash whenever they like.[73]

Companies, with a view to induce intending investors to subscribe for their shares, by giving the assurance that

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71. Id., S.51.

72. Id., S.52(1).

73. Union of India v. Allied International Products Ltd., (1970) 3 S.C.C.594.

the shares will become easily marketable, usually announce that an application hasbeen made to the stock exchange for quotation of the shares or debentures offered for subscription. Law steps in to protect investors in these circumstances. Provisions are contained in the Act to control this situation.

Application for listing should be made to the named recognised stock exchange within ten days of publication of the prospectus. If stock exchange listing is denied, all the application money received should be refunded. The relevant section says, that where permission has not been applied for, before the tenth day after the first issue of prospectus any allotment made on the basis of each prospectus is void.[73a] Even where permission has been applied for before that day, the allotment made on application in pursuance of such prospectus shall be void, if the permission has not been granted by the stock exchange, before the expiry of ten weeks from the date of closing of subscription lists. If the permission was given subject to certain conditions being fulfilled, and since those conditions were not complied with and the permission revoked, the conditional permission does not amount to a grant of permission as contemplated by Section 73(1) of the Act. The permission intended under that sub-section is an unqualified permission.[74] So also if within

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73a. The Companies Act 1956, S.73(2).

74. Hamilton v. Umedbhai S. Patel, (1979) 49 Com.Cas.1.

four weeks from the date of closing of the subscription list, the stock exchange sends no intimation either extending the time or notifying that the application though not at present granted would be given further consideration, the application would be deemed to have been refused.[75]

What would be the result if the company has applied for listing in more than one stock exchanges and only one of such stock exchange grants listing facility to the company and others refuse for it? The Supreme Court considered this question in Union of India v. Allied International Products Limited.[76] In this case the company A submitted applications to three stock exchanges for enlisting its shares. One of the stock exchanges approved the listing while the other two rejected. Regarding the validity of the allotment made by the company, the Court observed,

> "The allotment of shares will be invalid only when permission for quotation is not obtained. When permission from one or more of the exchanges is obtained, it carries out the object of the Act. It will be a mechanical interpretation wholly divorced from the true object and intendment of the Act to hold that even if permission is secured for quotation of shares in an exchange, the allotment will be invalid because another exchange has not granted the permission."[77]

It is felt necessary that in such cases the validity of the allotmant should be subject to the approval of the

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75. Union of India v. A.I. Products (1970) 1 S.C.C.594.
76. (1970) 3 S.C.C.594.
77. Id. at p.601 per J.C. Shah, J.

Registrar. The Registrar should ascertain the circumstances leading to the refusal by some stock exchanges and should grant approval if it is satisfied that there is no violation of the relevant Act and Rules.

Listing in a recognised stock exchange assures an easy dealing of the shares or debentures listed therein. The stock exchanges thoroughly checks the accounts and balance sheets of the companies listed by them and ensures that the affairs are managed properly. Any default will receive prompt attention and the value of the shares would become deteriorated. Stock exchanges are under a duty to ensure these matters to retain its recognition as they are under the strict control of the Central Government.[78] They cannot take any arbitrary decision in relation to any company in matters of listing or revoking the permission already given. So it would be a great relief to the investing public, if all companies receiving substantial part of their shares from public are required to list their securities in a stock exchanges.

Increase of Share Capital: Intimation to the Registrar

Increase in the capital of a company may be effected by the following methods:

1) Further issue of subscribed capital;
2) Conversion of loans or debentures into shares;
3) By issuing bonus shares; or
4) Capitalisation of reserves.

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78. The Securities Contracts (Regulation) Act 1956, Ss.3-12.

Any increase in share capital beyond the authorised capital, need be intimated to the Registrar of Companies, together with the resolution authorising such increase, within 30 days after passing the resolution.[79]

The authorised share capital of a company can be increased by the issue of new shares, if so permitted by its articles.[80] Such alteration can be made only upon a decision taken by the company at its general meeting. The directors have no power in this behalf.[81] The increase in the share capital is effected with the creation of new shares simpliciter and it is not necessary that the new shares have been offered, allotted or the names of the shareholders be registered in the books of the company.[82] The authorisation of the increase of the capital by giving power to issue new shares is only an increase in the authorised capital of the company and is different from the actual increase of such capital by the creation of new shares.[83] Application of Section 97(1)[83a] of the Companies Act 1956 takes place at the creation of new shares simpliciter and it

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79. The Companies Act 1956, S.97(1).

80. The Companies Act 1956, S.94(1)(a).

81. Id., S.94(2). See also W.W. Chitley & W.B. Bathala, Op.cit., p.620.

82. Mahalaxmi Mills Co.Ltd. v. State, A.I.R.1968 Raj.331.

83. Re Bank of Hindustan, China, and Japan, Campbells case, (1873) 9 Ch.App.1.

83a. The Sub-section provides for giving of notice to the Registrar about the increase in share capital.

is not necessary that the new shares should have been offered.[84] If there is no authority under the articles to increase the share capital, the articles should be altered first by passing special resolution.[85]

Further issue of Capital: Pre-emptive Rights

The board of directors of a company has the power to increase the subscribed capital of a company by allotment of further shares, within the limits of its authorised capital.[86] The further issue should ordinarily be offered to the existing holders of equity shares pro rata. The Act prohibits discrimination against shareholders and prevent the directors from offering shares to outsiders before offer is made to the shareholders[87] except in the circumstances specified in the Act. The directors are under a mandate to offer the new shares in the first instance to its members in proportion to the existing shares held by them.[88]

But these further shares may be offered to any person in any manner irrespective of the existing shareholders if a special resolution is passed by the company in general meeting or if the proposal has been carried out by a majority of

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84. See Supra n.89.

85. Taylor v. Pilsen, Joel and General Electric Light Co., (1884) 27 Ch.D.268.

86. The Companies Act 1956 S.81(1). See also In Re Hindustan General Electric Corporation Ltd., A.I.R.1959 Cal.679.

87. Nanalal v. Bombay Life Insurance Co., AIR 1950 S.C.172; Shanti Prasad v. Kalinga Tubes Ltd., A.I.R.1962 Orissa 202.

88. Mathalone v. Bombay Life Assurance Co., A.I.R.1953 S.C.385(390); Nanalal Zaver v. Bombay Life Assurance Co., A.I.R.1949 Bom.56(DB); Needle Industries Ltd. v. Needle Industries Newey (India) Holdings Ltd., (1981) 51 Com. Cas.743.

votes and the Central Government is satisfied, on the application of the board of directors that the proposal is most beneficial to the company.[89] The director's power in this regard extends only to the limit of authorised capital.[90]

The pre-emptive right of shareholders[91] is not available in the case of private companies.[92] Here the discretion of the directors is greatly un-checked. Approval of the Central Government is a condition precedent for denying the pre-emptive rights of existing members. But there is nothing in the Act to show that the Central Government should give notice to the existing shareholders and obtain their views before granting an approval under the provision. This appears to be necessary considering the effect of such an action on existing shareholders.

Conversion, Consolidation and Division of Share Capital

When the increase in the subscribed capital of a public company is caused by the exercise of any option attached to debentures issued or loans raised by the company, pre-emptive rights are not available.[93] If the articles of association of the company authorises, there is no prohibition on companies to convert all or any of its fully paid up shares into stock

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89. Id., S.81(1A).

90. Fatch Chand v. Hindsons (Patiala) Ltd., A.I.R.1956 Pepsu 89(94).

91. See supra, n.88.

92. The Companies Act 1956, S.81(3)(a).

93. Id., S.81(3)(b).

and reconvert that stock into fully paid up shares of any denomination.[94] Only condition is that notice should be given to the Registrar specifying the matter within thirty days of such conversion.[95] The Registrar will there upon record the notice and make necessary alterations in the company's memorandum and articles.[96]

To exclude the right of pre-emption, the option to convert should be contained in the term of issue of loans or debentures. Moreover, approval of the Central Government for such terms must have been obtained before the issue was made or it should have been made in conformity with the Rules, if any, made by the Central Government.[97]

The Central Government's Power to Convert Debentures and Loans into Shares

The Central Government has the power to convert into shares any debentures issued to or loan taken from the Government by a company.[98] Expediency of public interest is the major consideration to be taken by the Government in ordering such conversions.[99] Regard should also be had to matters like financial position of the company, its reserves liabilities, profits during the preceeding five years and the current market value of the company's shares.[100] If the terms and conditions proposed by the Government are not

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94. Id., S.94(1)(c).
95. Id., S.95(1).
96. Id., S.95(2).
97. Ibid.
98. Id., S.84(4).
99. Ibid. For a discussion on public interest, See Supra Chapter IV.
100. Id., S.81(5).

acceptable to the company, it may within thirty days, prefer an appeal to the Court. The decision of the Court would be final. Section 94A of the Act[101] provides that, where the Government or any public financial institution has converted its debentures or loans into shares, the capital of that company shall thereby stand increased by an equal amount and its memorandum altered accordingly. The Central Government is required to send a copy of the order to the Registrar so that he may effect necessary alterations in the company's memorandum showing the increase of the capital.

Procedure for consolidation or Division of Shares

For the consolidation and division of share capital, the procedure is simple, if such powers is conferred by the articles of the company. There could be no objection for sub-division of fully paid equity shares and confirmation by the Court is not necessary.[102] However, notice should be given to the Registrar about the consolidation or division within thirty days.

The duty of the Registrar in matters relating to registration of conversion, division or consolidation of shares seems not to be purely ministerial. He has to see whether the legal requirements under the Act have been complied with. By the requirement of registration and the power of the Central Governments to order conversion of debentures held by it, the Government exercises much control in this area. It is even to be doubted whether the power of Central Government is an alternative to nationalisation.

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101. Inserted by the Companies (Amendment) Act 1974.

102. In re Chowgule & Co.Pvt.Ltd., 1972 Tax.L.R.2163 (Goa, Daman Diu J.C.'s Court).

CHAPTER - 8

Maintenance of Share Capital and Transfer of Shares

Preservation of share capital of a company is one of the principal aims of governmental control. It is essential for the stability of the company also. Deterioration or diversion of share capital affects adversely the interests of the shareholders and creditors. Deterioration of share capital may take place when shares are issued at a discount, brokerage or commission is allowed in the issue of shares, or due to reduction of share capital. Similarly, when dividend is paid out of share capital, or when company purchases its own shares out of its funds, the share capital is reduced. Forfeiture of shares, surrender of shares and payment of interest out of share capital are other modes of reduction of share capital. Strict legal controls are envisaged in the Companies Act 1956, to prevent deterioration or diversion of share capital.

In the matter of transfer of shares, the directors of a company enjoys much discretion. When the articles of a company authorises the directors to refuse registration of share transfer, in the interest of the company, they may use this power arbitrarily. Most of the principles evolved by the administrative law are not available to check the

abuse of discretion by the directors. The Central Government and the Courts exercises control in relation to transfer of shares. This ensures some protection to the shareholders, eventhough the power is very much limited. These two aspects, preservation of share Capital and transfer of Shares, are considered in this chapter.

Issue of Shares at A Discount

Governmental controls are exercised in matters relating to the issue of shares at a discount, payment of brokerage and underwriting commission, through the requirements of approvals and sanction. Generally, allotment of shares at a discount is ultra vires and the law does not tolerate such acts even when it is done in an indirect way. In Moseley v. Koffyfontain Mines Ltd.,[1] a company issued debentures at a discount, and gave each debenture holder the right to convert each of his debentures into shares. The Court held that it was a colourable scheme to issue shares at a discount and therefore not legal.

However, law permits the issue of shares at a discount on the following conditions: (1) Discount can be allowed on that class of shares which the company had already once issued at full value; (2) the company intending such issue must have become entitled to commence business at least one year before the date of such issue; (3) a resolution specifying the rate of discount, being not greater than 10%, and authorising the

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1. [1904] 2 Ch.108.

issue is passed in the general meeting of the company. A higher rate of discount can be allowed, if the Central Governme is of the opinion that such higher rate can be allowed, considering the special circumstances; and (4) sanction of the Company Law Board is obtained and the shares are issued within two months of the Company Law Board's sanction.[2] While giving sanction, the Company Law Board can impose appropriate terms and conditions as it may deem necessary.

There is an embargo on the company reissuing shares at a discount without obtaining the permission of the Company Law Board. If the directors allot forfeited shares as fully paid up shares on payment of a lesser amount resulting loss to the company, the issue of shares is at a discount and sanction is required.[3] Thus in Biochemical and Synthetic Products Ltd. v. Registrar of Companies,[4] the company forfeited some of its shares for non-payment of calls. Thereafter, the directors purported to reallot the shares as fully paid up shares on payment of a lesser amount than the face value. This resulted in loss to the company. In these circumstances the Court held that the sale was an issue of shares at a discount and the Court's sanction was necessary. The Court said,

> "It is, therefore, plain enough that the shares were issued at a discount and this was done without the sanction of the Court as required by Section 79 of the Companies Act."[5]

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2. The Companies Act 1956, S.79.
3. Biochemical and Synthetic Products Ltd. v. Registrar of Companies, A.I.R.1962 A.P.459 (461).
4. Ibid.
5. Id. at p.461 per S. Raju, J.

Same is the case when an arrangement for the issue of fully paid shares is such that in the course of its working out there is a possibility that it would have the same effect as if the shares were issued at a discount.[6]

Payment of Commission

Regarding payment of commission, a company can pay a commission to any person in consideration of his subscribing or agreeing to subscribe for, any shares or debentures of the company or his procuring or agreeing to procure subscriptions.[7] The following conditions have to be satisfied for this purpose (1) the articles of the company authorise such payment (2) the rate of commission is less than five per cent or two and half per cent or any less amount prescribed by the articles in the case of shares and debentures respectively (3)the rate is disclosed in the prospectus or the statement in lieu of prospectus (4) the number of shares or debentures so underwritten is stated in the prospectus (5) a copy of the underwriting contract is delivered to the Registrar along with the prospectus. There is clear prohibition against payment of commission on any shares which are not offered to public, except where a person has agreed to subscribe for the shares before the prospectus is issued.[8]

Payment of Brokerage

A company can lawfully pay brokerage.[9] But brokerage can be paid only to a person who carries on the profession

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6. Trustees Corporation v. Commissioner of Income Tax, A.I.R.1930 P.C.151 (154).
7. The Companies Act 1956, S.76(1).
8. Id., Sub-Sections (4A) and (5).
9. Id., S.76(3).

of broker. It does not seem to be lawful to pay brokerage to a person who has casually induced another to subscribe. In The Commissioner of Income Tax v. Balasundaram & Co.,[10] the Madras High Court had to consider such a question. Here a firm acting as the managing agent of a company claimed income tax deduction in respect of the commission paid by it to share brokers for arranging sale of the shares of the managed company. There was no evidence to show that the firm was carrying on the business of share brokers. So the Court declined to grant deduction in this respect and said,

> "[Unless] the assessee is a dealer in shares, it would not have been eligible for the allowance of any loss sustained by it in the said sale. The assessee is not shown to be a dealer in shares."[11]

Share Premium Account

The company is at liberty to issue shares at a higher rate than the nominal value. Such premium may be received in cash or in kind.[12] But the extra value so collected should be carried to a separate account called, the 'share premium account' and should be maintained with the same sanctity as that of share capital.

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10. C.I.T. Madras v. Balasundaram & Co., (1980) Tax.L.R. 1136 (Mad.). See also Andreae v. Zinc Mines of Great Britain Ltd., [1928] 2 K.B.454.
11. Id. at p.1139, per Sethuraman, J.
12. The Companies Act 1956, S.79(3).

The English Position

Under the English law also the conditions for issue of shares at a discount are the same as in India, except that instead of the Company Law Board in India, the proposal should be sanctioned by the Court.[13] It is the Court having jurisdiction to wind up the company, thatis competent to sanction such issue.[14] The amount of discount allowed on any issue of shares at a discount, so far as it is not written off, must be specified in the prospectus, annual returns and balance sheets.[15] Provisions similar to the Indian law exists in relation to payment of underwriting commission and brokerage also. Section 56 of the Companies Act 1948, (English Act), make provision for constituting a share premium account in all cases in which, on issue of shares, the consideration received by the company exceeds the nominal amount of the newly issued shares and that assets representing the share premium account cannot be distributed by way of dividend. The Companies Act 1981, provides certain exemptions to this requirement.[16] They are (1) merger by the formation of a holding company, (2) takeover by a new holding company, (3) group reconstruction and (4) shares for share aquisition before 4th February 1981.

Trusts and Beneficial Holdings

The Companies Act 1956 does not recognise any trust

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13. The Companies Act 1948, S.57(1).
14. Ibid.
15. Halsbury's Laws of England, Op.Cit., para 149.
16. See Editorial, Journal of Business Law, (1981) March.

or beneficial interest of any person in any share.[17] Except a person whose name is registered as the owner or holder of the share in the register of members of the company, nobody can claim to be a shareholder of the company.[18] The object of the provision is that a person dealing with the company may not be affected by the entry of any kind of trust in the register of members.

But a company can take notice of any trust brought to its notice otherwise than by entry in the register. The company may take note of any relations between the trustees and the cestui que trust in respect of its shares. If a trustee is on the company's register as a holder of shares, the relation which he may have with some other person in respect of shares is a matter with which the company has to do nothing. But if the company is aware that the person in whose name the share is entered is only a benamidar, there is nothing in the provision to preclude the company from putting forward that contention.[19] However, when shares are transferred to a bank for securing loans, no trust is created and the bank is not a trustee for the purpose of the Companies Act.[20]

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17. The Companies Act 1956, S.153 reads, "No notice of any trust, express, implied or constructive shall be entered on the register of members or debenture holders."

18. Murshidabad Loan Office v. Satish Chandra Chakrabarthi, A.I.R. 1943 Cal.440.

19. S. Parameswari v. Kamadhenu Metal Rolling Mills Ltd., 1971 Tax.L.R.449 (Mad.).

20. New Bank of India v. Union of India, (1981) 51 Com.Cas. 375 (Delhi).

The Central Government is empowered to appoint a person as public trustee[21] and any person holding shares of a company in trust (trustee) should make a declaration to that effect, to the public trustee.[22] The prohibition under Section 153 in entering the notice of trust on the register of company,[23] when considered in the light of the above mentioned provisions, gives rise to the conclusion that there can be a trust of shares.[24] The only limitation is that the exercise of powers by the trustees is curtailed by the intervention of the public trustee. The benami-holding cannot be used as a technique to evade the provisions of law relating to control of economic concentration or acquiring control of the company by dubious means.

The appointment, remuneration and service conditions of the public trustee is governed by the Companies (Public Trustee) Rules 1973. When a person makes a declaration to the public trustee under Section 153B that he is holding shares or debentures of a company in trust, he should give a copy of the declaration to the company. But these provisions do not apply to a trust not created in writing. Likewise, trusts not exceeding one lakh rupees, even if in writing, is exempted.

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21. The Companies Act 1956, S.153A.

22. Id., S.153B (1).

23. The Section reads, "No notice of any trust, express, implied or constructive, shall be entered on the register of members or of debenture holders."

24. See E.D. Sassoon v. K.A. Patch, (1943) 45 Bom.L.R.46 (50).

The voting rights of the shares held in trust are to be exercised by the public trustee.[25] He can attend the meeting himself or appoint a government officer or the trust holder himself to attend the company meeting. He may even abstain from exercising the voting power if the interests of the beneficiaries of the trust are not adversely affected.[26] A shareholder may contend that a trust under which the voting rights have become vested in the public trustee is itself illegal or void.[27]

The public trustee is not an independent authority and in the exercise of powers and functions vested in him, he is under the administrative control of the Central Government.[28] He is more a servant of the Central Government implementing its directions which are not inconsistent with the provisions of the Act. The powers of the public trustee and the procedure that he should follow are prescribed.[29]

Another requirement in relation to the holding of beneficial interests in shares is that the person holding such beneficial interests should make a declaration to the company to this effect. The company in turn should make a declaration to the Registrar.[30] The form and contents of such declarations are prescribed.[31]

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25. The Companies Act 1956, S.187B.
26. Ibid.
27. Public Trustee v. Rajeshwar Tyagi, (1973) 43 Com.Cas.371 (Delhi).
28. The Companies (Public Trustee) Rules 1973, Clause 10.
29. Id., Clauses 11 & 12.
30. The Companies Act 1956, S.187C.
31. The Companies (Declaration of Beneficial Interests in Shares) Rules 1975.

The Central Government has power to investigate whether the provisions of this Section have been complied with or not. For this purpose the Government may appoint one or more inspectors to investigate and report whether there is any contravention of the provisions.[32]

Reduction of Share Capital

The share capital of a company is the only security on which a creditor can rely and the conservation of share capital is one of the main principles of company law. Since any reduction diminishes the fund of the company and adversely affects the interests of the creditors, the Government exercises strict controls over reduction of share capital.

Reduction of share capital may be effected either with the confirmation of the Court or without such confirmation, according to the procedure adopted for the purpose. Companies having a share capital and limited, either by shares or by guarantees, can reduce the share capital by passing a special resolution and subject to confirmation by the Court, if the articles of the company so permit. If the articles do not permit reduction, the articles will have to be amended first. Forms of reduction which do not require confirmation by Courts are (1) forfeiture of shares for non-payment of calls (2) surrender of shares made in circumstances which would justify a forfeiture (3) cancellation of nominal share capital which has not been taken, or agreed to be taken, by any person (4) payment

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32. The Companies Act 1956, S.187C.

of dividend out of paid up share capital and (5) purchase by company of its own shares.[33]

In the case of reduction of share capital with the confirmation of the Court, the procedure to be followed for effecting such a reduction is given in the Act itself. In exercise of powers conferred by the articles, a special resolution should be passed in the general meeting of the company and got confirmed by the Court by presenting a petition to the appropriate Court.

Though the question of reduction of capital is a domestic matter to be decided by the majority,[34] the Court, before it proceeds to confirm the reduction, must see that the interests of the minority are adequately protected and there is no unfairness in such confirmation.[35] The power of the company to reduce the capital cannot extend to the return of some part of its capital to its members.[36] The matters to be considered by the Court in sanctioning any reduction are mainly business principles and business practices.

Any reduction of share capital must be registered with the Registrar of Companies. For this purpose a certified copy of the Court's order and the minutes approved by the Court showing the share capital of the company as altered by the order,

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33. Indian Iron and Steel Co. v. Dalhousie Holdings Ltd., A.I.R. 1957 Cal.293 (308). As to the English position in the matter of reduction of share capital, se Halsbury's Laws of England, op.cit., para 173.

34. In re Khattar Electrical Engineering Co., A.I.R.1938 Pesh. 41, In Re Bengal, Burma Steam Navigation Co., A.I.R.1939 Rang.417.

35. In re Khattar Electrical Engineering Co., supra n.34.

36. In re Panruthi Industrial Co., A.I.R. 1960 Mad.537.

the amount of share capital, the number of shares into which it is to be divided, the amount of each share, the amount, if any, at the date of the registration deemed to be paid up on each share etc. should be delivered to the Registrar. When the Registrar certifies the registration of the reduction, the corresponding part of the original memorandum and articles would be substituted by the new alteration.[37] When a company has passed a special resolution for the reduction of share capital, has got it confirmed by the Court and the certificate of the Registrar registering the reduction has also been obtained, the certificate of the Registrar conclusively establishes that the resolution for reduction had been duly passed as required by law.[38]

Forfeiture of Shares

The articles of association of a company may provide for the forfeiture of shares in the event of default to pay the calls on shares. However, shares cannot be forfeited unless there is a clear power to that effect in the articles. So when the power under the articles was only to expel a member, it was held that the company cannot deprive the expelled member of his shares.[39] Regulations 29 to 35 of Table A, specifies the power of forfeiture. The Indian law permits forfeiture of share for reasons other than non-payments of calls even. So the provisions in the articles permitting

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37. The Companies Act 1956, S.103(5).

38. Ladies Dress Association Ltd. v. Pulbrook, [1909] 2 Q.B.376 (381).

39. Madhwa Ram Chandra Kamath v. Canara Banking Corporation, A.I.R. 1941 Mad.354.

forfeiture for non fulfilment of engagements with the company itself or with other members of the company was also held valid.[40] Forfeiture can be enforced even in cases of fully paid up shares, for matters other than payment of calls.[41]

A forfeiture under which, according to the articles, the forfeited share could be cancelled, results in reduction of share capital. But when the intention is to re-issue forfeited shares there is no reduction.[42] So if a company forfeit its shares under the articles and the articles provide for re-issue of such shares, confirmation by the Court is not necessary. Consequently, the reduction need not be registered with the Registrar of Companies also. If the company chooses not to re-issue the forfeited shares, thereby reducing the capital, all the formalities relating to reduction of capital could be avoided. This is an unhealthy position.

Surrender of Shares

Like forfeiture, the surrender of shares may also amount to the reduction of share capital.[43] Eventhough our company law does not contain any express provision permitting surrender of shares, the Courts have allowed surrender of shares in circumstances justifying forfeiture.[44] In Mirza Ahamad Namazi, In re,[45] a shareholder surrendered his shares

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40. Naresh Chandra Sanyal v. Ramani Kanto Roy, A.I.R.1949 Cal.360.
41. N.C. Sanyal v. Calcutta Stock Exchange Association, A.I.R. 1971 S.C.422.
42. Naresh Chandra v. Ramani Kanto, See Supra n.40.
43. Bellerby v. Rowland & Marwoods Steam Ship Co., [1902] 2 Ch.14.
44. In re Mirza Ahamad Namazi, A.I.R.1924 Mad.703(704).
45. Ibid.

to the company and was accepted by the directors. Thereafter the company went into liquidation. The liquidator challenged the validity of the surrender of shares. The Madras High Court held that the surrender would be valid only if it was made under conditions warranting forfeiture. Devadoss, J. observed,

> "I think it is well settled now that a company cannot exercise wide-powers of accepting a surrender. It can only accept a surrender under conditions and limitations under which shares can be forfeited."[46]

Acceptance of any other surrender by the directors would amount to reduction of share capital requiring confirmation by the Court.[47] In Mangal Sain v. Indian Merchants' Bank,[48] a shareholder of a company under liquidation claimed that he ceased to be a member of the company and was not liable to contribute as he had surrendered his shares and the board of directors had accepted the surrender. The Court rejected this plea and observed,

> "The principle ... applicable to cases of surrender is that a surrender is good if it amounts to a forfeiture. It is not open to shareholder to surrender at will his shares, especially when he has to meet future calls and it is not open to the company to accept surrender of shares unless the act of the company can be brought within the rules relating to forfeiture of shares. To hold that a company can by a resolution of its directors accept surrender of shares would be to allow a company to reduce its capital at its pleasure."[49]

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46. Id. at p.704.
47. Collector of Moradabad v. Equity Insurance Co., A.I.R. 1948 Oudh.197; Bellerby Case Supra n.43; Mangal Sain v. Indian Merchants Bank, Amritsar, A.I.R.1928 Lah.240.
48. Ibid.
49. Id. at p.241 per Zafar Ali, J.

Reduction of Share Capital by Conversion

Another mode of reducing the share capital is conversion of equity shares, or preference shares into redeemable preferenc shares. Rightly, the Patna High Court in M.C. Bharucha v. Arjun Prasad[50] had held that it was a mode of reduction of share capital if the company returned part of the capital money to the preference shareholders in cash. Similarly, the conversion of issued preference shares into redeemable preference shares was also held to be equivalent to reduction of share-capital.[51] So both these mode of reduction require confirmation by the Court and registration.

Cancellation of Share Capital

A company may cancel any part of its share capital, which at the date of exercising the power on that behalf, have not been subscribed for by any person, and diminish the amount of the shares so cancelled. This sort of diminition of the capital is not deemed to be a reduction of share capital under the Act.[52] However, notice of such cancellation should be given to the Registrar.

Payment of interest out of Paid Up Capital

The Companies Act 1956, permits the payment of interest out of share capital in certain cases.[53] This can be done if the money is raised to defray the expenses of the construction

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50. M.C. Bharucha v. Arjun Prasad, A.I.R. 1956 Pat.364(D.B).
51. Ibid. per Ramaswami, J.
52. The Companies Act 1956, S.94(1)(e) & (3).
53. The Companies Act 1956, S.208.

of any work or building or the provisions of any plant in contingencies mentioned in Section 208 of the Act, eventhough such money constitutes share capital.[54] But a number of formalities are prescribed for such payment. A special resolution should be passed in the general meeting of the company. Previous sanction of the Central Government should be obtained. The payment of interest shall be made only for such periods as may be determined by the Central Government and the rate of interest shall not exceed four percent unless the Central Government approves a higher rate. Since such interest is paid out of capital, it is certainly a reduction in the share capital of the company. But the Act expressly provides that the payment in the above circumstances will not operate as a reduction of capital and hence no confirmation by the Court is necessary.

Purchase of own shares by Company

Companies having a share capital and limited, either by shares or by guarantee, are prohibited from purchasing its own shares unless the consequent reduction in capital is effected and sanctioned in pursuance of the Act.[55] The object of this provision is to prevent a person from acquiring control of a company and paying for its shares out of the accumulated assets of the company itself. In other words it is intended to prevent a person from plundering the funds of

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54. Challapalli Sugar Ltd. v. I.T. Commr., Andra Pradesh, A.I.R. 1975 S.C.97.

55. The Companies Act 1956, S.77.

the company for his own benefit.[56] For this purpose giving of any financial assistance by way of loan, guarantee, provision of security etc. are also prohibited. A subsidiary company would not be allowed to buy the shares of its holding company for the same reasons.[57] A number of exemptions are provided in this matter.[58] The exemption include payment of loan to its employees, not exceeding six months wages, for purchase of company's shares.

Buying its own shares by a company involves a permanent reduction of share capital. So it is considered as illegitimat and in violation of law.

The English Law on Purchase of a Company's Own Shares

With the enactment of Companies Act 1981, a company is allowed to purchase its own shares[59] including any redeemable shares if authorised to do so by the articles. But such a purchase should not result in, there being no member holding other than redeemable shares in the company.[60] The purchase of company's own shares may take place on the same conditions and with the same consequences as the redemption of redeemable shares.[61] There a distinction is made between 'off market purchase' and 'market purchase' of a company's own shares.[62]

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56. Powlie v. Slaker, (1979) M.L.J.465, as cited in (1980) J.B.L.48.

57. Trevor v. Whitworth (1887) 12 App.Cas.409, Indian Iron and Steel Co. v. Dalhousie Holdings Ltd., A.I.R.1957 Cal.293.

58. The Companies Act 1956, S.77(2).

59. The Companies Act 1981, S.46.

60. Id., S.46(3).

61. See infra n.66.

62. Off market purchase is governed by Section 47 and market purchase by Section 49.

A number of formalities and publicity should be made before such purchase is made.[63]

Maintenance of Share Capital: An Appraisal

Under the English law, reduction of capital includes reduction of nominal share capital, whether issued, unissued and if issued, whether fully paid or not.[64] But under the Indian law, cancellation of unpaid and unissued shares are not treated as reduction of share capital. Similarly forfeiture of shares, if allowed by the articles and if the articles provide for reissue of the forfeited shares, is not considered as reduction in share capital here. In similar conditions even surrender of shares are allowed. These methods may give a fair scheme for unscrupulous businessmen to effect reduction of share capital, thereby adversely affecting the interests of shareholders and creditors.

Another aspect is the function of the Court in this matter. The question for decision is mostly concerned with business principles and practices. The English practice of leaving the matter to the veredict of the Courts need not be copied here. The better way appears to be to entrust this function to some competent administrative tribunal. There can be some arrangement within the company itself to settle dispute regarding these matters between the management and the shareholders.

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63. For a discussion on these matters, see Gore-Brown, On Companies, (43rd Edn.1982), para 13-6-C to 13-6-D.

64. See Halsburys Laws of England, op.cit., para 173 et.seq.

The purchase of own shares by companies is a matter of active debate in recent times, especially after the passing of (English) Companies Act 1981. The present English Act permits such purchase under certain conditions.[65] When there is a surplus of funds with the company and company is able to pay good dividends, the law permits the capitalisation of such surplus money and issue of bonus shares. Then there could be no objection if under similar circumstances and with the approval of a greater majority of members, say 90 per cent of the members, the companies are allowed to purchase its own share. Disclosure provisions need to be widened to indicate such particulars also in the annual financial statements.

Redemption of Shares

The Companies Act 1956 allows a company for the redemption of redeemable preference shares issued by it, either out of its profits or out of capital specially raised for the purpose.[66] The redemption cannot be made out of the sale proceeds or other property of the company.

The Act provides that a company limited by shares may issue redeemable preference shares if so authorised by its articles. Such redemption cannot be made unless the share so redeemed is fully paid up. Any premium payable on redemption should be paid out of the profits of the company or out of the company's share premium account. If the company proposes

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65. See Gower, L.C.B., "Companies Owning Their Own Shares," 21 mod.L.R.313; Editorial, (1981) 131 N.L.J.p.167.

66. The Companies Act 1956, S.80.

to redeem preference shares otherwise than out of the proceeds of a fresh issue, a reserve fund called 'the capital redemption reserve fund' is to be raised out of the profits otherwise available for dividend. A sum equal to the nominal shares redeemed should be transferred to it.

A redemption of share capital according to this provision would not be treated as a reduction of share capital.[67] The capital redemption reserve account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid up bonus shares.

The English Position

The (English) Companies Act 1981, authorises a company to issue redeemable shares of any class.[68] The redeemable shares may not be preference shares. They should be redeemed wholly or partly out of share premium account.[69] The conditions of redemption are almost the same as in India.[70] However, private companies may redeem shares out of capital.[71] The redemption of share is not considered as reduction of share capital here also.

Transfer of shares

Transferability of shares is one of the primary objects

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67. Id., Sub-Section(3).

68. The Companies Act 1981, S.45.

69. Id., S.62(3).

70. Id., S.62 provides the three conditions (1) shares may be redeemed only if it is fully paid up; (2) the terms of redemption should provide for payment on redemption; (3) the redeemable shares of public companies may be redeemed only out of distributable profits or out of the proceeds a fresh issue of shares made for the purpose of redemption.

71. Id., S.45(5).

in the establishment of a joint stock company.[72] These shares are prima facie transferable under the company law, not only in India[73] but in other countries as well.[74] But the articles of a company may restrict the right of transfer. In the case of private companies, the restriction would be rigorous.[74a] When the articles of a company restricts the power to transfer shares, the directors can refuse registration of transfer at their discretion.[75] But the ground on which the registration of transfer is refused is a matter subject to judicial as well as administrative scrutiny.[76]

Administrative controls in relation to transfer of shares extends to different aspects. The Central Government may restrict or even prohibit the transfer of shares for different purposes.[77] The Controller of Capital Issues and

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72. Blackburon, J., in Re Bhakia & San Francisco Railway Co., /1868/ 3 Q.B.584.

73. The Companies Act 1956, S.82; See also: Ontario Jockey Club v. Samuel McBride, A.I.R.1928 P.C.291; Arjun Prasad v. Central Bank of India, A.I.R.1956 Pat.32.

74. See the Companies Act 1948, S.73.

74a. The Gauhati High Court has held that in the case of private companies which are not subsidiaries of public companies, there is not even a right to appeal in case of refusal to register a transfer or transmission of shares, even if the articles provide for such transfer or transmission in certain cases. See Beena Barua v. Dalgvien Tea Co.(Pvt)Ltd., 1981 Tax.L.R.2592 (Gauhati).

75. B. Chowkhani v. Western India Theatres Ltd., A.I.R.1957 Cal.709 (712).

76. See the Companies Act 1956, Ss.111 & 155.

77. See id., Ss.108A, 108B, 108C & 250(2).

the Reserve Bank of India may exercises control over transfer of securities. In addition, there can be some agreements with financial institutions restricting the transferability of shares for the purpose of securing loans.

The Procedure for Transfer of Shares

The procedure for transfer of shares is to present to the company a duly stamped instrument of transfer executed by the transferor and the transferee. The instrument of transfer should be in the prescribed form. In the case of unquoted companies, the parties should deliver the deed of transfer to the company within a period of two months from the date on which the Registrar makes endorsement in the prescribed form. In the case of quoted shares, the deed of transfer may be presented on any day before the register of members is closed for annual general meeting. In the former case an extension of time may be granted by the Central Government on application.

A company refusing to register a transfer on any grounds whatsoever is required to send notice of the refusal to both the transferor and the transferee within two months.[78] On receiving such notice of refusal or if the company fails to register the transfer within two months, the parties have two options; (1) to appeal to the Central Government[79] or (2) to approach the Court.[80]

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78. Id., S.111(2); By the Proviso to the Section, a default in this respect renders the company and every defaulting officer liable to penalty.

79. Id., S.111(4).

80. Id., S.155.

The Discretion of Directors in Refusing to Register Transfer of Shares

The articles of a company may empower its directors to refuse to register a transfer.[81] So even if all the requirements in relation to transfer is fully complied with, the directors may, in their discretion, refuse to register a transfer.

However, the directors should exercise their power to refuse to register a transfer of shares bona fide and in the interest of the company. Usually such powers will be exercised, if the calls on shares are unpaid, or the company has a lien on the shares. The Court will not interfere with the discretion of the directors unless it is shown that they did not act bonafide.[82] Similarly, they are not bound to disclose to the transferee any reason for rejecting the transfer. But, if they choose to give reasons for their decision, the Court may enquire whether they are legitimate or not.[83] Similarly, a bare denial to register the transfer of shares would not oust the jurisdiction of the Court.[84]

Eventhough, the Court will not enquire into the reasons for refusal to register transfer unless malafide intention is proved, the Central Government can ask for such reasons

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81. The Companies Act 1956, S.111(1).
82. Re Coalport China Co., [1895] 2 Ch.404.
83. In re Rede Steam Shipping Co., [1917] 1 Ch.123.
84. Sadashiv v. Gandhi Seva Samaj, A.I.R. 1958 Bom.247.

and the company is bound to disclose the reasons to the Central Government.[85] By giving right of appeal to the Court and to the Central Government, the abuse of discretion by the directors in refusing to register transfer of shares is very much checked.

Appeal to the Central Government

A provision for administrative appeal to the Central Government in case of refusal to register a transfer or transmission by a company is provided in the Act.[85a] It is a control over the exercise of discretion by company directors to refuse registration of a transfer of shares. The Supreme Court has held that, the Central Government in appeal under Section 111(3), exercises judicial function as the Court under Section 155 and is therefore a tribunal.[86]

In Harinagar Sugar Mills v. Shyam Sunder,[87] the company refused to register a transfer of a block of shares made by one of the shareholders to one Shyam Sunder. The transferee of shares filed an appeal to the Central Government under Section 111(3) of the Companies Act 1956. The Government ordered registration of transfers. The order of the Government was challenged in the Supreme Court. One of the questions considered by the Supreme Court was whether the Central Government

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85. See infra n.109.
85a. The Companies Act 1956, S.111(3).
86. Harinagar Sugar Mills v. Shyam Sunder, A.I.R.1961 S.C.1669.
87. Ibid.

exercising appellate powers under Section 111 was a tribunal exercising judicial functions. The Court answered in the affirmative and said,

> "... the Central Government exercises judicial power of the State to adjudicate upon rights of the parties in civil matters when there is a lis between the contesting parties, the conclusion is inevitable that it acts as a tribunal and not as an executive body."[88]

The powers of director to refuse to register a transfer is subjected to a number of limitations. It seems to be proper to entrust some administrative authorities to check whether the directors have acted within their powers. But here concurrent powers are given to the Central Government and the Courts. The remedy of an appeal under Section 111 is not a bar for the Court to exercise its power under Section 155.[89]

The Courts have an overriding power under Section 155. In one case, the Central Government in an appeal under Section 111 held that the applicant was entitled to be registered as a member of the company. Thereafter, the company disputed the right to transfer in a proceeding under Section 155. The Calcutta High Court held that Section 155 was the controlling section and gave the Court an overriding power notwithstanding any previous order of the Central Government under Section 111.

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88. Id. at p.1676 per Shah, J.

89. Joseph v. South Indian Bank, 1978 Tax.L.R.1717 (Ker.). See also Surendra Prakash v. Goel Industries, 1980 Tax.L.R.2007 (All.).

Section 111 may have given a speedy remedy in cases which should not normally come to the Court, but the power of the Court to order rectification of register under Section 155 remains unaffected.[90]

However, the Punjab High Court has taken the view that the Courts do not have any overriding powers.[91] In Arjan Singh v. Panipat Woollen and General Mills,[92] a shareholder transferred a number of shares which the company refuse to register. On an appeal to the Central Government an order for registering it was made which was implemented by the managing agent. This was challenged by the board of directors of the company under Section 155 of the Companies Act 1956. The respondent argued that the powers of the Court under Section 155 and that of the Central Government under Section 1 were alternate remedies and the Court cannot set aside a decision given by the Central Government. In this regard, the Court observed,

> "[Since] the Central Government hearing an appeal under Section 111(3) is also exercising judicial function, it is not feasible to hold that under the Act a position could arise in which there could be conflict between the orders made by two authorities acting judicially, ...Since Section 155 does not purport to confer overriding powers on the Court, it should be held that the two sections provide alternative remedies."[93]

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90. Hasmunnessa Begum v. Vidyasagar Cotton Mills Ltd., A.I.R.1962 Cal.330.

91. Arjan Singh v. Panipat Woollen and General Mills Co. Ltd., A.I.R.1963 Punj.341.

92. Ibid.

93. Id. at p.344 per S.B. Kapoor, J.(emphasis added).

The more common and acceptable view is that the power of the Court to order rectification under Section 155 and the power of the Central Government under Section 111 are alternative remedies.[94]

Jurisdiction of Courts when the Question Involves Complicated Facts

The Courts are normally reluctant to order registration of the transfer of shares when the facts involved in it are complicated. The Bombay High Court has remarked that in such cases a separate action and not an application for rectification of the register would be the proper remedy.[95] In Devakumar v. Rupak Ltd.,[96] there was serious dispute regarding the title to the shares and a suit was pending between the parties in the Civil Court. At this time one of the parties applied for relief under Section 155. The Patna High Court held that the case cannot be decided in a summary way and the parties should get the question determined in the Civil Court.

However, there is nothing in the language of Section 155 of the Act which suggests that the jurisdiction conferred upon the Court is of a summary enquiry. It does not preclude or forbid a full and thorough enquiry in respect of title to shares claimed. It can be seen that at least some of the High

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94. Harinagar Sugar Mills v. Shyam Sunder, A.I.R.1961 S.C. 1669; South Indian Bank v. Joseph Michael, 1977 Tax.L.R. 2457 (Ker); Manohar Govindram Tal reja v. Mill Stores and Cotton Co.Pvt.Ltd., 1979 Tax.L.R.2106 (Cal); Joseph v. South Indian Bank, 1978 Tax.L.R.1717 (Ker).

95. Manilal v. Western India Theatres Ltd., A.I.R.1963 Bom.40; Laxmi Narayan v. The Praga Tools Corporation, A.I.R.1953 Hyd.267.

96. Devakumar v. Rupak Ltd., A.I.R. 1955 Pat.486.

Courts have taken this view. For example, the Gujarat High Court in Gulabari Kalidas Naik v. Laxmidas Lallubhai Patel,[97] held,

> "A bare persual of Section 155 on its own language does not indicate that the jurisdiction conferred by the Section is one hedged in with a condition that it can be exercised when relief can be granted in a summary manner...Sub-Clause(b) of Sub-Section(3) further widens the jurisdiction of the Court under Section 155 when it permits or enables the Court generally to decide any question which it is necessary or expedient to decide in connection with the application for rectification."[98]

The Central Government's Power to Direct Not to Give Effect to A Transfer

An intimation regarding the proposed transfer of shares is to be given to the Central Government in certain cases.[99] If on such intimation, the Central Government is satisfied that, there is the possibility of a change in the composition of the board of directors of the company as a result of such

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97. 1978 Tax.L.R.(N.O.C.)33 (Guj).

98. Ibid., per D.A. Desai, J.

99. Id., S.108B(1) reads, "Every body corporate, or bodies corporate under the same management, holding whether singly or in the aggregate, ten per cent or more of the nominal value of the subscribed equity share capital of any other company, shall, before transferring one or more of such shares, give to the Central Government an intimation of its or their proposal to transfer such shares and every such intimation shall include a statement as to the particulars of the share proposed to be transferred, the name and address of the person to whom the share is proposed to be transferred, the share holding, if any, of the proposed transferee in the concerned company, and such other particulars as may be prescribed."

transfer, the Government may direct that the transfer shall not be given effect to. A direction of this nature would be issued only when the Government feels that the change in the composition of the board of directors would be prejudicial to the interests of the company or to the public interest. Direction may also be given to transfer those shares to the Central Government or to a corporation owned or controlled by the Government.[100] Any contravention in this regard is punishable.[101]

Restrictions are made in relation to transfer of equity share capital of a foreign company also if it is having a place of business in India. Every such body corporate is forbidden from transfering securities to any Indian citizen or a body corporate incorporated in India except with the approval of the Central Government, if the total nominal equity share value of the transferor is ten percent or more of the equity share capital of the foreign company.[102] The Central Government may direct companies not to give effect to the transfer if it is satisfied that the transfer would lead to a change in controlling interest of the company, which is prejudicial to the interests of the company or to the public interest.[103] Section 250 of the Companies Act empowers the Central Government to restrict the transfer of any shares of a company for a period not exceeding three

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100. Id., Sub-Section 2(b).
101. The penalty provided under Sub-Section(6) is fine upto five thousand rupees.
102. The Companies Act, 1956, S.108C.
103. Id., S.108D.

years. The Government can exercise such power when as a result of an investigation under Sections 247, 248 or 249 or otherwise, it feels that there is good reason to find out relevant facts about any shares, whether issued or to be issued, and such facts cannot be found out unless the restriction is imposed. The Government may at any time vary or rescind any order made by it.[104] Under the Foreign Exchange Regulation Act 1973, permission of the Reserve Bank is necessary for effecting any transfer to or in favour of any person resident outside India.[105] Transfer of securities require the consent of the Controller of Capital Issues unless exempted under the Capital Issues (Control) Act 1947,[106] or the exemption order made under it.[107]

Need for Reform in Transfer of Company Securities

Transferability of shares is of universal acceptance. So is the restrictions on transfers. Company's articles very often contain some restrictions on the right to transfer shares. But the power conferred on the directors should be exercised reasonably and in good faith for the company's benefit and not arbitrarily.[108] The discretion of directors

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104. Id., S.250(5).
105. The Foreign Exchange Regulation Act 1973, S.19(1)(6).
106. The Capital Issues Control Act 1947, S.5.
107. The Capital Issues (Exemption) Order 1969.
108. Re Coalport China Co., [1895] 2 Ch.404.

in refusing to register a transfer is subject to administrativ as well as judicial scrutiny.[109]

However, when the directors of a company refuse to register transfer of shares, the aggrieved party is put in dilema. If the order refusing registration of transfer is not a speaking order, he is in a difficult position to prove before the Court malafides of the directors in the matter. Without proving this, he may not get relief under Section 155. Of course, he is in a better position when he chooses to make an appeal to the Central Government. The Government may call for, from the company, the reasons for refusing transfer and decide the case on merits. It appears to be better to transfe both the powers of the Central Government and the Court to some independent tribunal with a provision for appeal to the High Courts.

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109. See Halsbury's Laws of England, op.cit., para 398.

CHAPTER - 9

Amalgamations, Take-overs and Mergers

Extensive governmental controls are exercised in matters relating to amalgamations, take-overs and mergers of companies. Different purposes are sought to be achieved by this process. One of the principal aims of such controls is prevention of economic concentration. When companies in the same line of production or services are merged, thereby eliminating competition, it may prove detrimental to the interest of the community. The Companies Act 1956 and the Monopolies and Restrictive Trade Practices Act 1969 try to prevent monopolistic practices by companies.

Sometimes, the amalgamation, take over or merger may be detrimental to the interest of the company itself or to some of its shareholders. The purpose of such an action may be to benefit the management or majority shareholders. In such cases, governmental intervention would help the aggrieved parties to get relief.

A brief discussion on the control over production, distribution and supply of goods and services is also made in this Chapter, since it is much related to the expansion of companies. The Industries (Development and Regulation) Act 1951, and the Essential Commodities Act 1955 contain elaborate provisions in this regard.

Prevention of Economic Concentration

Company is no more considered as a property of its shareholders.[1] It is not a mere device for making profits, but it is a social unit having rights and responsibilities of its own.[2] If the corporation has to function effectively, it has to be accountable to the public at large.[3] The Sachar Committee remarked, "we have reached a stage where the questio of social responsibility of business to the community can no longer be scoffed at or taken lightly."[4] So the company must behave and function as a responsible member of the society just like any other individual. Social responsiveness shown to the needs of the community is the real test to ascertain the extent of the social purpose performed by the company in the development of the country. There should be proper utilisation of the resources by the companies, for the benefit of all. The products should be distributed for the optimum use of maximum members of the society. So the production, distribution and supply of good should be properly arranged.

When a company goes into liquidation, the workers, consumers and the community as a whole suffers. But some times allowing a company to survive may be more dangerous. Eventhough economic concentration is detrimental to the

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1. See National Textile Workers' Union v. P.R. Ramakrishna, 1983 Tax.L.R.2047 (S.C.).
2. Ibid.; See also George Goyder, The Responsible Company, Basil Blackwell, Oxford, (1961), pp.40-47.
3. See id., p.97.
4. The Report of the High Powered Committee on Companies Act and MRTP Act (1978), para 12.1.

interest of the consumers, it may be necessary to amalgamate two or more companies to limit unhealthy competition. Considering all these needs, the company law has equipped the administrative authorities with wide powers to regulate joint stock companies for the protection of public interest. The power to enforce disclosure requirements in accounts, the power to take steps for prevention of oppression and mismanagement, the power to inspect books and other documents of companies, the power to cause investigations into the affairs of the company etc.[5] are only some of such powers. The Central Government enjoys wide powers for preventing economic concentration, for ensuring fair distribution of goods and services and several other matters.

Economic Concentration

Growth of large enterprises is necessary, if not indispensable, for the attainment of higher level of productivity These enterprises have the capacity and financial viability to experiment changes in technology and methods of doing business. But, in a country where free market competition is considered as the insurer of goods and services of better quality at reasonable prices, the establishment of large enterprises may cause dangers. When there are no competitors, these firms will be in a position to dictate the quality and prices of goods. So monopolisation is controlled to protect public interest.

Causes for Economic Concentration

The Monopolies Enquiry Commission revealed some of the

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5. For a discussion in these powers, see infra Chapter 15 & 16.

causes of economic concentration in private hands.[6] In the opinion of the Commission, concentration of economic power is the central problem; monopolistic and restrictive trade practices are only functions of such concentration.[7] The commission attributed the following causes for the concentration of economic power in the hands of a few individuals:

(1) the prevalence of managing agency system.[7a] Under this system a number of enterprises, whether in the same line of production or not, were managed by the same managing agent. This reduced competition.

(2) investment of funds by one company in acquiring assets, stocks or shares of another independent company. The devices of forming a holding company or amalgamation is the commonly applied method here.

(3) interlocking of directorships - when there is a common director for a number of companies in the same line of production, he will be in a position to influence the policy of these companies so as to cause concentration.

(4) establishment of dominant undertakings with foreign collaborations.

The concentration of economic power may be either countrywise or product wise. The company law provides checks to control all these types of concentration. The licensing

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6. See the Report of the Monopolies Enquiry Commission (1965), Chapter-II.

7. Ibid.

7a. This system was abolished in India by the Companies (Amendment) Act 1969 (19 of 1969).

system for establishment of new undertaking, registration of monopolistic undertakings, control over amalgamation, take-over etc. are some of these devices.

Registration of Monopolistic Undertakings

The Monopolies and Restrictive Trade Practices Act 1969, requires that certain undertakings, having considerable economic power should be registered with the Central Government.[8] It is obligatory for these undertakings to submit annual returns to the Monopolies and Restrictive Trade Practices Commission containing details about their organisation, business, conduct, practice, management, costs of production and connections with other undertakings.[9] These obligations apply to the following type of undertakings:[10]

(1) An undertaking which has assets worth not less than twenty five crores of rupees. This may be the value of its own assets or may be the value of its own assets together with assets of its interconnected undertakings.

(2) A dominant undertaking,[10a] if the value of its assets or the sum total of the value of assets of all inter-connected undertakings constituting the dominant undertaking is not less than one crore rupees.

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8. The Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969), S.26.

9. Ibid.

10. Id., S.20.

10a. Id., S.2(d) defines 'dominant undertaking'. All undertaking which either by itself or along with interconnected undertakings, produces, supplies or distributes a substantial part of the total goods of any description, are treated as dominant undertakings. For a discussion, see A.Ramaiya, Guide to Monopolies & Restrictive Trade Practices Act, 2nd edn., Wadhwa and Co., Agra, (1982), pp.5,18,19 & 20.

Two distinct criteria are taken to determine economic power: (1) size of the undertaking and (2) market power of the undertaking. The idea is that the very presence of 'big business' in industry would have a deterrant effect on the entry of small units. Dominant undertakings with assets less than one crores of rupees in value, even though they may be monopolistic undertakings do not come within the purview. The value of assets for this purpose is the value on the last day of the financial year of the undertaking concerned, immediately preceeding the calendar year in which the question of its coming within the definition occurs.[11]

Approval of the Central Government

The law does not prevent the creation of monopolistic undertakings. The only requirement is that they should get the approval of the Central Government for establishing or expanding the business. Such approvals would be granted when the Government is satisfied that the establishment or expansion is not likely to lead concentration of economic power to the common detriment or prejudicial to the public interest in any manner. When the Government feels doubts about this aspect, the application would be sent to the Monopolies and Restrictive Trade Practices Commission for inquiry and report. After receiving and considering the report, the Government would pass necessary orders. A right of appeal to the Supreme Court is given to the parties.[12] The scheme of expansion :

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11. Ibid.
12. Id., S.55.

or the scheme of finance for such expansion cannot be varied except with previous approval of the Central Government. The number of undertakings having paid up share capital of one crore rupees or more registered every year shows that the approvals are given in most cases.[12a]

But the Central Government will be in a position to watch the activities of these undertakings due to this registration requirement.

General provisions regarding the registration and licensing of industrial undertakings applies to the monopolistic undertakings also.[13]

Amalgamation

Amalgamation is the blending of two or more companies. The shareholders of each blending company become substantially

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12a. The number of Companies having a Share Capital of One Crore rupees registered during different years were as follows:

Year	Private Companies	Public Companies	Total
1956-57	13	15	28
57-58	28	11	39
59-60	13	18	31
60-61	22	67	89
61-62	17	57	74
66-67	3	22	25
67-68	3	20	23
71-72	15	44	59
72-73	7	59	66
76-77	3	38	41
77-78	7	42	49
78-79	11	37	48
80-81	12	67	79
81-82	21	81	102

Source: Annual Reports of the Working and Administration of the Companies Act 1956 (1956-57 to 81-82).

13. See the Industrial (Development and Regulation) Act 1951

(f.n. contd.)

the shareholders in the company which is to carry on the blended undertaking. There may be amalgamation either by transfer of two or more undertakings to a new company or by transfer of one or more undertakings to a existing company.[14] It may either be a de jure merger of two or more companies by a consolidation of their undertakings or a de facto merger by the acquisition of a controlling interest in the capital of one by the other or of the capital of both the companies.[15] Though the Companies Act 1956 (1 of 1956) does not provide a definition for the term, the Courts in India have taken a realistic view. For example, the Andhra Pradesh High Court held that the amalgamation is a state of things under which either two companies are so joined as to form a third company or one is absorbed into or blended with another.[16] Similarly, the Madras High Court has held that an amalgamation can be a case of merger of one company with another or the take-over of two or more companies by a new company.[17] But, the latter view does not sound good. In the case of a take-over, amalgamation may or may not happen. Only thing here is that the controlling power is transferred.

(f.n. 13 contd.)

Chapter III; For a discussion on these matters, see Supra Chapter 5.

14. See Halsbury's Laws of England, (4th edn.) Buttorworths, London, (1974), para 1539; See also Re South African and Cold Storage Co., Wild v. South African Supply and Cold Storage Co., [1904] 2 Ch.268; Brooklands Selangor Holdings Ltd. v. Inland Revenue Commissioners, [1970] 2 All E.R.76.

15. See L.C.B. Gower, Modern Company Law, (2nd edn.1967),p.550.

16. S.S. Somayyajulu v. Hope Prudhomane & Co.Ltd., (1963) 2 Comp.L.J.61 (A.P.).

17. Beardsall & Co.Ltd., In re, (1968) 1 Comp.L.J.102 (Mad.).

Under the Income-Tax Act 1961, (43 of 1961), amalgamation means the merger of two or more companies to form one company in such a manner that:

1) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

2) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation; and

3) the shareholders holding not less than 90 percent in value of the shares in the amalgamating company or companies (other than shares held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.[18] So, there should be a transfer of both rights and liabilities to the transferee for amalgamation of a company under the Companies Act 1956 (1 of 1956).

Re-construction, Arrangement and Take over

Control under the Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969), exists not only in respect

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18. The Income-Tax Act 1961, S.1(1A).

of amalgamations but also in respect of take overs, reconstruction and arrangements.[19] Take-over bid may be in the form of an offer to purchase the shares of a company either for cash or for shares in another company. Reconstruction involves the winding up of an existing company and the transfer of its assets and liabilities to a newly formed company, formed to take the place of the existing company. It may involve the conversion of the shareholders of the existing company into shareholders of the new company. When a dispute exists between the company on the one side and any of its members or creditors or a class of members or creditors on the other side, the company may make a compromise of such dispute. Similarly, all modes of re-organising share capital, including interference with preferential and other rights attached to some shares form an arrangement between the company and its members. All these categories of transaction are to be confirmed by the Court.[20] Administrative controls also exists in relation to these matters.

Administrative Controls over Amalgamation, Take over & Mergers

Administrative controls envisaged and exercised under the company laws in relation to these matters may be classified

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19. See the Companies Act 1956, Ss.391-396; The Monopolies and Restrictive Trade Practices Act 1969, Ss.20-26.

20. See Re General Motor Cab.Co., [1913] 1 Ch.377; Re Guardian Assurance Co., [1917] 1 Ch.431; Re St.James Court Estate, [1944] 1 Ch.6; Hindustan Commercial Bank Ltd. v. Hindustan General Electric Corpn., A.I.R.1960 Cal.637; See also, Re NFU Development Trust Ltd., [1973] 1 All E.R.135. Here the Court held that where the membership rights are proposed to be surrendered or otherwise terminated or confiscated without compensation, it is not proper to consider it as an arrangement.

as under:

a) Registration of circulars and the Court's orders, sanctioning amalgamation, with the Registrar of Companies;[21]

b) The power of the Central Government to receive notices of, and make representations to, all schemes of amalgamation etc. brought before the Courts;[22]

c) Power of the Central Government to direct amalgamation of two or more companies in the public interest;[23]

d) Power to accord approval to a scheme of amalgamation, merger or take-over of two or more companies coming under the provisions of the Monopolies and Restrictive Trade Practices Act 1969 (44 of 1969);[24]

e) Power of the Monopolies and Restrictive Trade Practice Commission to enquire and make recommendations about the scheme.

The purpose of these provisions is to see that the scheme does not work prejudicial to public interest.

f) The power of the Central Government to frame Rules prescribing disclosures to be made.[26]

Power of the Central Government to Receive Notice

It is obligatory on the Courts to give notice to the Central Government of every application made to it under Section 391 or 394 of the Companies Act 1956 (1 of 1956). Before passin

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21. The Companies Act 1956, Ss.391(3) & 394(3).
22. Id., S.394A.
23. Id., S.396.
24. The Monopolies & Restrictive Trade Practices Act 1969,S.23.
25. Id., Ss.31 & 32.
26. The Companies Act 1956, S.395.

any order on the proposed compromise or arrangement or a scheme of amalgamation, the Court should take into consideratio the representation, if any, made by the Government.[27] This would enable the Government to study the proposal in the light of the facts and information available with it. The Government can raise objections wherever it is necessary, and place before the Court certain facts which might not have been disclosed by the applicants. By this process, the Court would be in a position to take into account the interests of the investing public at large.

Wherever it is established that the affairs of the compan were conducted in a manner prejudicial to the public interest, the Courts would not accord its sanction to the scheme of amalgamation. The Companies Act 1956, provided:

> "...no compromise or arrangement proposed for the purpose of, or in connection with, a scheme for the amalgamation of a company, which is being wound up, with any other company or companies, shall be sanctioned by the Court unless the Court has received a report from the Company Law Board or the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest;
>
> Provided further that no order for the dissolution of any transferor company...shall be made by the Court unless the Official Liquidator has, on scrutiny of the books and papers of the company, made a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest."[28]

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27. Id., S.394A.
28. Id., Proviso to S.394(1).

The purpose of notice to the Central Government is to safeguard public interest when companies propound scheme of amalgamation.[29] In In Re, Piramal Spinning and Weaving Mills Ltd.,[30] the Bombay High Court examined the purpose of giving notice to the Central Government about a scheme of amalgamation. In this case, a scheme of amalgamation was made between two companies and a notice of the application for amalgamation to the Court was given to the Central Government. The Central Government filed an affidavit showing that the reasons set out in the petition for amalgamation were not convincing. The Court held that there was no reason why the Court at the instance of the Government should examine the question of fairness or adequacy of reasons for amalgamation.[31] The Court observed,

> "The main reason why a notice is given to the Regional Director under Section 394-A is to ensure that public interest is safeguarded when companies propound a scheme of amalgamation."[32]

So when it is shown that there is nothing contrary to the public interest in the scheme of amalgamation, the Court need not give much importance to the other arguments made by the Government.

The Karnataka High Court expressed the view that on any application made under Section 391 or Section 394 of the Companies Act 1956, notice should be given to the Central

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29. In Re, Piramal Spinning and Weaving Mills, 1979 Tax.L.R. 2141 (Bom.).
30. Ibid.
31. Id. at p.2143.
32. Ibid. per Sujatha v. Manohar, J.

Government by both the transferor and the transferee company.[33]

In one case the company, Sumani Private Ltd., was seeking amalgamation with another company. The company contended that the official Liquidator was required to make a report to the Court only in respect of a company which was being wound up and not in respect of a company which was a going concern. The Court negatived this contention and held that the dissolution of a transferor company could not be ordered without first obtaining a report in respect of both the transferor and the transferee company.[34]

The Act requires that the Court should hear the representation of the Central Government before passing final orders on applications for compromise or arrangement.[35] Dissolution of a transferor company cannot be ordered without considering such representation.[36]

The Calcutta High Court held that notice contemplated under the Act should be given at a stage when the application is made to the Court for sanctioning the scheme. Notice need not be given at the initial stage, before the Court makes an order on an application under Section 391(1) calling for a meeting of the creditors or of the members.[37]

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33. In re Electro Carbonium Private Ltd., In re Electric Materials Private Ltd., (1979) 49 Com.Cas.825 (Kant).
34. In re Sumani Pvt.Ltd., (1979) 49 Com.Cas.547(Bom.) at p.553 per R.L. Aggarwal, J.
35. In re, Tarachand Podder, A.I.R. 1968 Cal.310.
36. In re Sumani Pvt.Ltd., (1979) 49 Com.Cas. 547(Bom.).
37. In re Tarachand Podder, A.I.R. 1968 Cal.310.

Here, before a petition under Section 391 was admitted, a question was raised whether notice of the application under Section 394A should be given to the Central Government before any order was made. The Court answered in the negative and said,

"...the words "any order" in Section 394A must be construed to mean "any final order." Consequently the words "every application" mean an application under Section 391(2) or Section 394. I hold, therefore, that at this initial stage of the present proceedings no notice to the Central Government is necessary."[38]

This dilatory process makes the process of amalgamation very difficult, time consuming and expensive. It appears to be beneficial to send a notice of the application for the proposed amalgamation to the Central Government right at the time of presenting the application. A copy of the proposed scheme should also be enclosed with the notice. By this process, the Central Government would be in a position to study the scheme and raise objection or make suggestions, which can be considered by the general meeting also. By this, the Courts will be in a position to get a balanced view of all the suggestions before making a final Order.

The two provisos to Section 394(1) of the Act makes another difficulty. By the first proviso, the Court should not sanction a scheme of amalgamation of a company, which is being

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38. Id. at p.314 per S.Datta, J.

wound up, before receiving a report from the Company Law Board or the Registrar to the effect that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest. By the second proviso, the Court cannot order dissolution without winding up, of any transferor company without receiving a report from the Official Liquidator, to the effect that the affairs of the company have not been conducted in a manner prejudicial to the public interest.

The Kerala High Court is of the view that the first proviso is not attracted to a case involving proceedings for the sanction of a scheme for amalgamation and for dissolution without winding up of the transferor company.[39] The Court examined this question in Official Liquidator v. Madurai Co. Pvt.Ltd.[40] Here a scheme of amalgamation was sanctioned by the Company Court without giving notice of the application to the Official Liquidator. The Official Liquidator contended that by virtue of the provisions contained in the second proviso to Sub-Section (1) of Section 394 of the Act, the sanction given by the Company Court was liable to be set aside. But the Division Bench observed that the order passed by the Company Judge was not liable to be set aside for the sole reason that no notice of the proceedings was issued to the Official Liquidator.[41]

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39. Official Liquidator v. Madura Co.(P) Ltd., 1975 K.L.T. 562; 1976 Tax.L.R.1616 (Ker.).

40. Ibid.

41. Id. at p.1618 per Bhaskaran, J.

As far as the transferor company is concerned, its business comes to a stand still, on amalgamation. It is dissolved and the Official Liquidator has the best opportunity to examine its records, books and accounts. It would be of great help to the Court to ascertain the correct position of the company from the report of the Official Liquidator. So, it is necessary to give notice to the Official Liquidator and examine his report before any final order is made in this regard.

There is no obligation on the Court to accept the contentions of the Central Government while sanctioning an amalgamation.[42] Only thing that the Court should do is to consider the representations, before issuing final orders. Thus, when the Central Government objected to a scheme of amalgamation on the ground that the valuation of shares made by two independent chartered accountants was not fair, the Court rejected the objection.[43] Even if the valuation of shares proposed in a scheme of amalgamation is open to criticism, that by itself will not necessarily justify the withholding of sanction by the Court on the ground that the valuation is unfair.[44]

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42. See In re Piramal Spinning and Weaving Mills Ltd., (1980) 50 Com.Cas.515; 1979 Tax.L.R.2141 (Bom.).

43. See Re Associated Hotels of India Ltd., (1968) 2 Comp. L.J.292(Cal.); In re, Cotton Agents (Rajastan) Ltd., (1968) 2 Comp.L.J.7 (Raj.); A.I.R.1968 Raj.311; M.Q. Investments & Industrial Co.Ltd. v. New Shorrock Spinning & Mfg.Co.Ltd. (1972) 42 Com.Cas.145. See also Bhagwandas Garg v. Canara Bank Ltd., (1981) 51 Com.Cas. 38 (A.P.).

44. In re Piramal Spinning and Weaving Mills Ltd., Supra n.42.

Registration Requirements

When a scheme of compromise, arrangement, reconstruction or amalgamation is approved by the Court, it should be registered with the Registrar of Companies.[45] Every offer containi provisions for transfer of shares on amalgamation or circular containing such offer and every recommendation to the members of the transferor company by its directors to accept such offers should be accompanied by the prescribed information.[46] Such circulars should be presented to the Registrar for registration before it is issued.[47] The Registrar may refuse to register any such circular which does not contain the required information or which sets out such information in a manner likely to give false impression.[48]

Provision for appeal to the Court against an order of the Registrar refusing to register any such circular is contained in the Act.[49] When the Court has approved a scheme of amalgamation, the Court has judicially decided the matter on merits and the purpose of registration of the order is to make it a public document. But in the case of registration of offers or circulars, the Registrar is exercising some

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45. The Companies Act 1956, S.391(3), provides that an order made by the Court sanctioning a scheme of compromise or arrangement will have no effect until a certified copy of the order is registered with the Registrar. Id., S.394(3) also makes it obligatory to file a certified copy of the Courts order sanctioning a scheme of reconstruction or amalgamation within thirty days of making such order. Default is punished with fine upto fifty rupees.

46. Id., S.395(4A).

47. Ibid.

48. Ibid.

49. Ibid.

discretion. The power to register a circular or refuse to register it is to be exercised judicially, as the matter is appealable to the Court. Where, a company makes an offer to the shareholders of another company to acquire the shares of the latter company, the offer may be for all the issued shares or for all the shares of one or more specified classes. It may be separate offers for different classes of shares. The registration provision is introduced to safeguard the interests of all shareholders and prevent malpractices in acquisition of shares. The directors of the transferor company and persons closely connected with its management will be in a better position to assess the impact of such offers. So when they do not give the prescribed particular or if the information given by them is false or misleading, it is the duty of the Registrar to refuse registration. It would be more appropriate to require the Registrar to submit such cases for the decision of some independent administrative tribunal.

The non-acceptors of the offer have other statutory rights also. They are entitled to get notice of the take-over within one month of the date of the transfer. They may require the transferee company within three months to acquire their shares and the transferee company is bound to oblige.[50] But, when the holders of 90 per cent of the shares approve the scheme, the transferee company gets the rights to acquire the

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50. Id., S.395(1).

shares of the dissenting shareholders.[51] Normally, the Courts will dis-allow such bids only when there is malafides.[52] Moreover, the burden to prove malafides is on the dissenting shareholder.[53] The burden of proof will be shifted to the other party in certain circumstances.[54] Considering the delay and expenses involved in the proceedings before the Courts, the registration provision should be used as an effective remedy in these matters.

The Central Government's power to Direct Amalgamation

The Central Government can direct the amalgamation of two or more companies into a single company. The Government can exercise this power when it is satisfied that such an action is essential in the public interest.[55] The Central Government should notify in the Official Gazette the order providing for the amalgamation and defining the constitution, powers, rights assets, interests, authorities, privileges, liabilities, duties and obligations of the amalgamated company.[56] The order may contain such consequential, incidental or supplemental provisions necessary to give effect to the amalgamation. Any order

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51. Ibid.
52. Re Carlton Holdings Ltd., [1971] 1 W.L.R.918, [1971] 2 All E.R.1082.
53. Re Bugle Press Ltd., [1960] 3 All E.R.791.
54. Like where the take-over bidder and the accepting majority are the same parties; Re Bugle Press Ltd., [1960] 3 All E.R.791; attempt to impose more liability on minority shareholders without their consent, Bisgood v. Henderson's Transvaal Estates Ltd., [1908] 1 Ch.743; etc.
55. The Companies Act 1956, S.396.
56. Ibid.

made by the Government in this regard should provide for the old shareholders, old debenture holders and other creditors to have the same interests in the company resulting from the amalgamation, as they had in the original companies. If the interests or rights of such persons in the newly formed company is less than his interests or rights in the original company, he is entitled to compensation. The extent of compensation should be assessed by some authority prescribed by the Governmen for that purpose.[57]

Before making any order for amalgamation, the Government should send a copy of the proposed order to the concerned companies. The Government should also consider the suggestions and the objections made by those companies andmake such modifications as may be necessary. The Government may fix the period within which the suggestions and modifications should be made; the period being not less than three months. Any order of amalgamation made by the Government should be laid before both Houses of Parliament.

When an amalgamation is brought about in the above manner, the amalgamating companies would be extinct and the new amalgamated company comes into existence.[58] Since there is a statutory power of amalgamating a company with another company without any specific power in the memorandum, it is not necessary that the company's memorandum should contain such powers.[59]

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57. Ibid.

58. See Metliss v. National Bank of Greece and Athens, [1957] 2 All E.R.1(5).

59. In Re, Marybong and Kyel Tea Estate Ltd., [1977] 47 Com. Cas.802 (Cal.).

The Central Government can exercise the power to direct amalgamation of two or more companies only when such amalgamation is in the public interest. Cases may arise when an amalgamation of two or more companies is necessary to prevent unhealthy competition and to facilitate optimum utilisation of available resources, or to reduce management cost. The observance of the usual procedure prescribed by the provisions of the Act in such cases may lead to unnecessary delays and thereby become detrimental to public interest. The question as to what is public interest in individual cases has to be determined taking into consideration a number of circumstances.[60] Since the power of the Government is subject to the Parliamentary scrutiny, abuse of power in this regard is minimised. However, the Central Government cannot make an unreasonable order. The Court could examine the order and set aside it if it is found unreasonable.[61]

There is no need for the Court's sanction for this type of amalgamation, whereas in other cases confirmation by the Court is expressly made essential to the validity of a scheme of amalgamation. Here the requirement is impliedly eliminated. The dissenting members or creditors here is in an unhappy position. Since the action is in the public interest and subject to scrutiny of the Parliament, they cannot object to

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60. See supra Chapter 4.

61. For example, See Mahindra & Mahindra v. Union of India, 1983 Tax.L.R.457 (Delhi).

the scheme of amalgamation as in other cases. The only remedy would be to dispose of his interests and cease to have any dealing with the amalgamated company. If this opportunity is also denied, he can approach the Courts challenging the administrative action. Considering the intensity of the consequences that follow an order under this provision, it is felt necessary that a statutory right of appeal to an independent tribunal should be provided.

Preservation of Books and Papers of Amalgamated Company

A company which has been amalgamated with or whose shares have been taken or acquired by another company, cannot dispose of its books and papers without the approval of the Central Government.[62] Before granting such permission, the Government may appoint a person to examine the books and papers for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion, formation or management of the company.[63] This provision ensures that any paper concerning the affairs of a company, which may be disadvantageous to it for any reason, is not disposed of so as to destroy the evidence.

Approval of the Central Government under the Monopolies and Restrictive Trade Practices Act 1969

Approval of the Central Government under this Act is necessary before the Court can sanction any scheme of merger,

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62. The Companies Act 1956, S.396A.
63. Ibid.

amalgamation or take-over of a company if any of the following conditions exist:

1) if the scheme involves amalgamation of a dominant undertaking with any other undertaking;

2) if the effect of the scheme is to create a dominant undertaking.[64]

When a scheme of merger or amalgamation having the above effects is proposed, an application should be made to the Central Government in the prescribed form, for approval. No action can be taken to give effect to the scheme without obtaining the approval. On receipt of such an application, the Government may or may not refer it to the Monopolies and Restrictive Trade Practices Commission for an enquiry. If so referred, the Commission should report to the Central Government its opinion after making necessary enquiries. On the receipt of the Commission's report, the Government may pass such orders as it may deem fit. The approval of the Central Government is, however, not necessary where the merger or amalgamation relates to inter-connected undertakings.[65] When a scheme is approved by the Central Government under this provision, it cannot modify the proposal or any scheme of finance with regard to such proposal except with the previous approval of the Central Government.[66] Any merger or amalgamation or take-over in contravention of these provisions is subjected to

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64. The Monopolies and Restrictive Trade Practices Act 1969, S.23.

65. Id., Sub-Section(3).

66. Id., Sub-Section (5).

severe penalty.[67] Besides, the Government may direct the dismemberment, dissolution or splitting of the undertaking. Here also it is not necessary that the Government should consult the Monopolies and Restrictive Trade Practices Commission before taking such actions. The order of the Government is appealable to the Supreme Court.[68]

Merger and amalgamation are very important features of modern business world. The efforts of the Government in this regard are partly preventive and partly corrective. Under the preventive measure, the Government restricts the formation of monopolistic undertaking by a scheme of licensing, registration and approvals. The Government can refer any matter relating to this to the Monopolies and Restrictive Trade Practices Commission for enquiry and report. If on the Commission's findings, the Government is of the view that the existence of the monopolistic undertaking is prejudicial to the public interest, the Government can direct the division of the undertaking.[69]

There is no compulsion on the part of the Government to refer any matter to the Commission or to implement its suggestions. The Sachar Committee made a study of this matter and found that the number of cases referred to the Commission are very limited.[69A]

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67. Id., Sub-Section (5).

68. Id., S.55.

69. The Monopolies and Restrictive Trade Practices Act 1969, S.27.

69A. Thus the applications received by the Government from

(f.n. contd.)

It can be seen that in majority of cases, the Government accords its approval without referring the matter to the Commission. It is desirable that the law should prescribe the cases where enquiry by the Monopolies and Restrictive Trade Practices Commission is compulsory.

Interlocking of Directorships, Intercorporate Investment and Loans etc.

Interlocking of directorship and intercorporate loans and investments are some other methods creating economic concentration. The Companies Act 1956 (1 of 1956) contains certain provisions regulating these matters.[70] The Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969) also contains some provisions to regulate the matter. No person who is a director of a dominant undertaking shall be appointed

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(f.n. 69A contd.)

1.6.1970 to 31.12.1977 and the action taken thereof were as follows:-

Provisions of the Act.	Applications received by the Government.	Reference made to the Commission	Approval given by the Government.	Undisposed application.
S.21	354	33	241	36
S.22	183	19	102	23
S.23	81	7	64	7
Total	618	59	407	66

Source: Report of the High Powered Expert Committee on Companies Act and MRTP Act 1978, Para 20.10 and 20.11.

70. See infra Chapter 10.

as director of another undertaking engaged in the same line of business, without obtaining the prior approval of the Central Government.[71] Any appointment in contravention of this provision would be void. But, any act done by such person would be valid unless it is done after it has been shown to the undertaking and the concerned director that the appointment was void.[72] As suggested by A. Ramaiya, to be free from confusion, the provision should be such that no approval is necessary for appointing a person as the director of an inter-connected undertaking, if he does not hold such position in more than ten inter-connected undertakings.[73]

Control over Economic Concentration:
A Comparative Analysis

For controlling dominant firms different measures are adopted in different countries. Corwin D. Edwards gives the following types of controls practiced by different countries.[74]

1) Provision about restriction contrary to the public interest which, in some countries, are equally applicable to agreements and practices of particular firms, whether powerful or not;

2) Provision about particular types of business practices, applicable to all firms, whether powerful or not;

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71. The Monopolies and Restrictive Trade Practices Act 1969, S.25.

72. Id., Proviso to Sub-Section(1).

73. See A. Ramaiya, Guide to Monopolies and Restrictive Trade Practices Act (2nd edn.1982, Wadhwa and Company, Agra), p.81.

74. See Corwin D. Edwards, Control of Cartels and Monopolies, Oceana Publications, New York, (1967), p.178.

3) Provision applicable equally to dominant firms and restrictive agreements, but not applicable to firms and business practices;

4) Special provisions concerned with dominant firms, dominant positions or monopolies, designed to curb the conduct of powerful enterprises or to prohibit monopolisation; and

5) Provisions about mergers and other means of concentrating economic power, designed to provide information about such arrangements or to discourage or limit them.

The British Department of Trade can refer to the Monopolies Commission, the question whether a proposed merger involving over 30 per cent of the supply of a kind of goods or acquisitions of over £5 million were in the public interest or not. It can delay such mergers pending the report of the Commission and prevent them unless they are found unobjectionable. It may order diverstiture, divorcement or dissolution of the company.[75] Under the (English) Companies Act 1948 also, an order sanctioning a scheme of compromise, arrangement, reconstruction or amalgamation has no effect until a copy of the order has been delivered to the Registrar for registration.[76] If a company makes default in complying with these provisions, the company and every officer of the company who is in default is liable to fine not exceeding £1 for each copy in respect of which default is made.[77]

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75. The Monopolies and Mergers Act 1965, S.27.

76. The Companies Act 1948, S.206; See also Halsbury's Laws of England, Vol.7, op.cit., para 1537.

77. Ibid.

In the U.S.A., the possession of monopoly power in the market and the wilful acquisition or maintenance of that power is an offence.[78] Similarly, mergers are regulated by Clayton Act.[79] The Federal Trade Commission, an independent quasi-judicial body with independent Administrative Law Judges and Prosecuting Attorneys, is entrusted with the administration of the antitrust provisions. On receipt of a complaint, the lawyer in the Anti-Monopoly Bureau prepares and presents a case for the prosecution. The order of the Administrative Law Judges can be appealed to the Federal Trade Commission.[80] The Commission can issue cease and desist orders. Questions of law as well as question of fact not supported by substantial evidence may be appealed against.[81] The Federal Trade Commission has investigatory powers and has the authority to proceed against even false advertising.[82]

In Japan, the Fair Trade Commission attached to the Prime Minister's Office, investigates and recommends corrective action in cases of monopolisation by companies.[83]

It appears that in India, the law intended to check concentration of economic power does not work well. Inspite

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78. The Sherman Act 1890, S.2., See also U.S. v. Grinnel Corp., 384 U.S.563 (1966).

79. The Clayton Act 1914, S.7.

80. See the Federal Trade Commission Act 1914.

81. Ibid.

82. Anonymous, "Developments in the Law. Deceptive Advertising" (1967) 80 Harv.L.Rev.1005. See also Harry G.Henn, Law of Corporations, West Publishing Company, New York (1970), p.617 et.seq.

83. See Corwin D. Edwards, op.cit., p.353-355.

of all legal prohibitions, concentration of economic power is increasing.[84] There is an urgent need to equip the Monopolies and Restrictive Trade Practices Commission with sufficient powers to receive complaint from the public, investigate and issue binding orders. Just like the Monopolies Commission in England, the Indian MRTP Commission need be empowered to stay mergers or amalgamations pending investigations.

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84. The study made by the Reserve Bank of India in 1982 revealed that there was an increase of 30.2% assets for every year for the twenty top business houses in India during the period 1971-1982.

PART - III

CONTROL OVER MANAGEMENT OF COMPANIES

CHAPTER - 10

Appointment and Removal of Directors

Federalism in Company Management

The management and control of a company is shared between the share holders duly assembled in general meeting[1] and the directors normally appointed at such meetings.[2] Both these organs of the company, the members in general meeting and the directors, derive their power and authority from the Act and the memorandum and articles of association. Thus the management of a company is apparently based on the principle of federalism viz. division of powers and responsibilities. But the principle of company federalism lies only in theory and in practice oligarchy of directors prevails. To mitigate the effects of this dominance and to reflect the social aspects of company's functioning and to protect the interests of different sections of the community.

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1. The election of directors, approval of accounts, adoption of resolutions for some important matters etc. are to be done in the general meetings.
2. The Companies Act 1956, S.291, authorises the directors to exercise all powers the company is entitled to exercis other than those reserved for the general meetings.

governmental control over management is necessary. Instead of providing representation to the various interest groups[3] on the management board of companies, the Companies Act 1956 envisages intervention by the Government in different matters. This power extends to the calling of general meeting, appointment, remuneration and removal of directors and even the nationalisation of the company.

Management Structure

The predominant form of company management in this country was till lately represented by the managing agency system.[4] When the importance of the system declined rapidly and the system itself was abolished,[5] the form of management through boards and managing directors emerged as the predominant form. Considering the economic and social obligation of modern business this form of management also fails to protect the overall interests of all parties participating in an enterprise.[6] The Sachar Committee[7] while examining the management structure of Indian companies recommended professionalisation of company management.[8] This apart, there is

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3. The workers, the consumers, the suppliers of raw materials and the neighbouring community are very much interested in the working of a company.

4. The Administrative Reforms Commission, Report of the Working Group on Company Law Administration, (1968), p.36.

5. The managing agency system was abolished in India by the Companies (Amendment) Act, 1969, (19 of 1969).

6. The Administrative Reforms Commission, op.cit., p.36.

7. The Report of the High powered Committee on Companies Act & MRTP Act, 1978.

8. Id. at para 5.6.

growing demand from various sections of the people to give a place to the representatives of workers, consumers, environmentalists etc. in the decision making body of companies. But even the Sachar Committee, which gave consideration to this problem, did not recommend such participation in Indian companies. The present position is that there is no compulsory provision to give representation to even minority shareholders.[9]

The Companies Act requires every company to have a board of directors. Every public company[10] should have a minimum of three directors and other companies should have at least two directors on its board.[11] This board functions as the executive authority. The directors are responsible for the direction, conduct, management and superintendence of the company's affairs. They lay down the general policy of the company, direct its affairs, appoint the company's officers, ensure that they carry out their duties and advise the shareholders regarding the distribution of profits. Any person in the position of director and managing the business of the company would be deemed to be a director of the company, regardless of the designation given to him.[12]

As per the Companies Act, the individual authority of the managerial personnel is always subject to the general

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9. The Companies Act 1956, Section 265 leaves it to the discretion of each companies whether or not to provide for proportional representation in the board of directors.

10. In respect of public companies which have become so by virtue of S.43A of the Companies Act 1956, minimum number of directors is two.

11. The Companies Act 1956, S.252.

12. Id., S.2(13).

superintendence, control and direction of the board.[13] There is no such power exercisable by the shareholders and, therefore, no question of any control or direction over them.[14]

Maximum Number of Directors

The upper limit for the strength of director board is not laid down anywhere in the Companies Act. A company in general meeting can vary the number of directors at any time within the limits set in its articles.[15] It is not even necessary for the company to pass a separate resolution to fill the additional vacant post. It was held to be sufficient compliance with the law when the company had chosen to appoint additional directors within the permissible limits so as to increase the number of its directors.[16] An increase beyond the limit prescribed in the articles could be made only by an alteration of the articles of the company by a special resolution.

Eventhough there is no statutory restriction on the maximum number of directors and the company is at liberty to fix the maximum number, after the first registration of the articles, the company cannot increase the number of directors beyond the permissible maximum under the article except with the approval of the Central Government. No such permission is

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13. Id., S.2(24).
14. Before the Factories (Amendment) Act 1976, the Factories Act 1948 provided that in the case of a private company, any shareholder of it can be prosecuted or punished for violation of the Act (S.100(2)). Now the provision is deleted.
15. Id., S.259.
16. Lalji Bhai C. Kanadia v. Lalji B. Desai, A.I.R.1972 Bom.276.

necessary if the total number of directors, as increased, would not be more than twelve.[17]

Proportional Representation

The company may provide in its articles the system of proportional representation for the appointment of its directors This is only an enabling provision and companies are not bound to adopt such a system at present.[19] However, the Central Government acting under Section 408 of the Companies Act, may direct a company to introduce the system of proportional representation on the board of companies.

Eventhough the principle of proportional representation is not accepted as a compulsory provision under the Companies Act, the articles of the company may provide for proportional representation. The election in such cases may be done either by the single transferable vote or by a system of cumulative voting.[20] Under the present system of voting, a majority of 51 percent or more of the shareholders are in a position to monopolise all the directorships. The result is that even a respectable minority of the shareholders can not get one of their representatives placed into the directorate. They would have no means of knowing how the affairs of the company are being managed. This may lead to mutual suspicion and

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17. The Companies Act 1956, S.253.

18. Id., S.265. See also Ved Prakash Jamija, "Proportional Representation on Boards of Companies," (1969) 2 Comp. L.J.29.

19. See supra n.9.

20. The Companies Act 1956, S.265.

attendant dangers to the business of the company. Administrative intervention is necessary in such circumstance. This state of affairs could be avoided if proportional representation is made compulsory.[21]

Appointment of Directors

(a) Appointment at General Meetings

The usual procedure for appointment of directors is by election. It is the common method of shareholder participation in the management of a company. In the case of a new company, the first directors are named in its articles of association. If this is not done, the signatories to the memorandum of association would be deemed to be the directors of the company.[21a] They are not directors proper, but law regards them as such until the appointment of directors takes place.[22] The idea behind such a deeming provision was explained by the Supreme Court of India in O.M.P.Works (P) Ltd. v. B.K. Thakoor.[23] The Court observed that as the office of a director is to some extent an office of trust, there should be somebody readily available who can be held responsible for the failure to carryout the trust.[24]

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21. P.N. Bhagavati, J. gives a thought provoking account of the importance of the system of proportional representation in his article, "Rights of Minority Shareholders," published in Current Problems of Corporate Law Management and Practice, (1964), Indian Law Institute, New Delhi, p.247.

21a. The Companies Act 1956, S.254.

22. John Morley Building Co. v. Barrag, [1891] 2 Ch.386.

23. Oriental Metal Pressing Works (P) Ltd. v. Basker Kashinath Thakoor, A.I.R. 1961 S.C.573.

24. Ibid.

(b) Restrictions in the Appointment of Directors

In the election of directors certain restrictions are laid down in the Act. But all these restrictions are not of universal application. Private companies which are not subsidiar of a public company and deemed public companies[25] are excluded from the application of many of these conditions. All companies regardless of its class are prohibited from appointing any body corporate, association or firm as its director. Only individuals can be appointed as directors.[26] Regarding the number of directors, the minimum number is prescribed.[27]

No person shall be a director of more than twenty companies at a time.[28] If any person is elected as director in contravention of this provision he should elect the companies in which he proposes to act as director.[29] For computing the number, the following classes of companies would be excluded: (1) a private company which is neither a subsidiary nor a holding company of a public company, (2) an unlimited company, (3) an association not carrying on business for profit or which prohibits the payment of a dividend, and a company in which such person is only an alternate director.[30]

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25. Private companies which have become public companies by virtue of Section 43-A of the Companies Act 1956.

26. The Companies Act 1956, S.253.

27. The Companies Act 1956, S.252 provides that all public companies other than those which has become such by virtue of S.43-A, should have at least 3 directors. Every other company should have at least two directors.

28. Id., S.275.

29. Id., S.277.

30. Id., S.278.

Share Qualification

Under the Companies Act 1956, there is no obligation that a person should acquire some share qualification for being elected as director. But if the articles of association require share qualification, he should acquire such qualification shares within two months of his appointment. However, the nominal value of the qualification share shall not exceed five thousand rupees or the nominal value of one share where it exceeds five thousand rupees. Holding of share warrant shall not be considered equivalent to holding of shares.[31]

The Indian law does not prescribe any age restrictions for appointment as director.[32]

Removal of Disqualifications by the Central Government

A person having any of the disqualifications prescribed in Section 274 of the Companies Act 1956 is ineligible for appointment as director.[33] Section 261 of the Companies Act 1956,

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31. Id., S.270.

32. Sections 280, 281 & 282 which originally regulated these matters were omitted by the Companies (Amendment) Act 1965.

33. The Companies Act 1956, S.274 reads, "(1) A person shall not be capable of being appointed as director of a company, if - (a) he has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force; (b) he is an undischarged insolvent; (c) he has applied to be adjudicated as an insolvent and his application is pending; (d) he has been convicted by a court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of that sentence; (e) he has not paid call in respect of shares of the company held by him whether alone or jointly with others and six months have elapsed from the last day fixed for the payment of the call; or (f) an order disqualifying him for appointment as director has been passed by a court in pursuance of Section 203 and is in force, unless the leave of the

(f.n. contd.)

requires passing of special resolution for appointing certain persons as directors.[34] The High Court may restrain a person from acting as director of a company, except with the leave of the Court, if he is convicted of any offence in connection with the formation, promotion or management of a company.[35] Similar restrictions can be applied to a person found guilty of misfeasance in relation to a company or of any breech of duty to the company or of any offence connected with the winding up of a company.[36] Where the articles of a company indemnify its directors except where there is wilful negligence or default, they cannot be disqualified for breach of duty, unless it is shown that they have acted with the knowledge that they were committing a breach of duty or were recklessly careless.[37] The Central Government may remove the disqualification incurred by any person by a notification in the Official Gazette.[38]

Every person proposed as a candidate for the office of a director should sign and file with the company his consent to act as director of the company.[39] This provision does not apply to a director retiring by rotation or otherwise and to a person who has left at the office of the company a notice

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(f.n.33 contd.)

court has been obtained for his appointment in pursuance of that section." No age qualification is mentioned in the Section.

34. The Companies Act 1956, S.261 envisages the condition where a managing agent could appoint a director in terms of the articles of association of the company.

35. Id., S.203.

36. Ibid.

37. Doss v. Connel, A.I.R. 1938 Mad.124.

38. The Companies Act 1956, S.274(2).

39. Id., S.264.

signifying his candidature.[40] The nature of this obligation was considered by the Bombay High Court in Lalitbhai C. Kapadia v. Lalitbhai B. Desai.[41] In this case, two persons were appointed as additional directors of a company. In the next annual meeting of the company they were appointed as directors eventhough they had not filed their consent to act as directors in accordance with the provisions of Section 264(1) of the Companies Act. When this appointment was challenged, they argued that they were not required to file any letters of consent under the Act. The Court said

> "...the section, in my opinion appears to be directory in so far as the persons who would desire to be a candidate for the office of a director would be required to file his consent ...Those who have once acted as directors were only seeking reappointment. It was considered throughout that formal consent on their part was not necessary..."[42]

Regarding the case of additional directors, the Court said,

> "...One of the persons, who is exempted from the condition of filing such a consent is one who has left at the office of the company a notice under Section 257 signifying his candidature for the office of a director. This clearly shows that the provision about consent is in connection with the appointment of directors at the meeting of the

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40. Ibid.

41. A.I.R. 1972 Bom.276.

42. Id. at p.292 per Bhasme, J; See also In Re Thakur Paper Mills, 1975 Tax.L.R.1656 (Pat.).

> company...various expressions used by the Legislature certainly indicate that Section 264(1) does not in any manner regulate the appointment of additional directors under Section 260 of the Act."[43]

Filling up of the Vacancies of Retiring Directors

Not less than two-thirds of the total number of directors in a public company should be persons liable to retirement by rotation and should be appointed by the company in general meeting.[44] The articles of a company may provide for the retirement of all directors at every annual general meetings.[45] If the articles are silent in this matter, all the directors of a company, including private company, are to be appointed in general meeting.[46] The directors to retire by rotation at every annual general meeting are those who have been longest in office since their last appointment. Between persons who became directors on the same day the person to retire are to be determined by lot in the absence of any agreement.[47] The place of the retiring director should be filled in the same general meeting in which he has retired. If no person is elected as director and the meeting has not expressly resolved not to fill the vacancy, the meeting would stand adjourned for one week. The retiring director would be deemed to have been re-appointed if the place of the retiring director is not filled in the

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43. Id. at p.295 per Bhasme, J.
44. The Companies Act 1956, S.255.
45. Ibid.
46. Ibid.
47. Id., S.256.

adjourned general meeting also.[48] This rule will have no application when (1) a resolution for re-appointment of the person was put to the meeting and lost; (2) the retiring director has expressed his unwillingness to be so appointed; (3) he is not qualified or is disqualified for appointment; (4) a resolution, special or ordinary, is required for appointment or reappointment by virtue of any provisions of the Act; or (5) a resolution for appointment of two or more persons as directors by a single resolution was passed unanimously by the company, and the name of the retiring director is excluded in that single resolution.

Filing of Consent with the Registrar of Companies

A person appointed as director should within thirty days of his appointment file with the Registrar of Companies his consent in writing to act as director.[49] This provision is not applicable (1) to a director reappointed after retirement by rotation or immediately on the expiry of his term of office; (2) an additional or alternate director or a person filling a casual vacancy in the office of a director; (3) a person named as director of the company under its articles as first registered; and (4) to directors appointed in a private company which is not a subsidiary of a public company.[50]

Appointment by Board of Directors

While the general power to appoint directors is vested

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48. Ibid.
49. The Companies Act 1956, s.264.
50. Ibid.

in the general meetings of shareholders, there are cases when the board of directors, the Central Government or the Court can appoint new directors.

When the office of any director appointed by the company in general meeting is vacated before his term of office would expire in the normal course, the resulting vacancy may be filled up by the board of directors.[51] When an express power is conferred on the board of directors of a company to appoint additional directors, they can lawfully exercise such rights.[52] The person so appointed shall hold office only for the un-expired term for which appointment was made. By an express provision in the articles of association of the company, the power of the board of directors even in such contingencies may be taken away. The term of office of such additional directors extend only upto the date of the next annual general meeting of the company. The principle that the directors cannot continue in their office for any length of time by committing a breach of their duty under Section 166 to call an annual general meeting, applies to the additional directors also. So they are also bound to vacate their offices at the latest, on the first day on which an annual general meeting could have been called as required by Section 166.[53]

The power of the board to appoint additional directors extends to the co-option of members who failed to be elected

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51. Id., S.262.

52. Id. S.260; See also Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holdings Ltd., A.I.R.1981 S.C.1298.

53. Krishna Prasad v. Colaba Land and Mill Ltd., A.I.R.1960 Bom.312.

as director at a general meeting.[54] In Gurprasad v. Rameshwar,[1] a person who failed to get elected as director of the company was appointed as additional director of the company by the board of directors. Upholding the validity of the appointment, the Allahabad High Court said,

> "The circumstances that he failed to secure his election at the general meeting merely implied that he was not elected for a longer term. It did not, in any way, detract from the authority of the directors to co-opt him for the limited time which would expire on the date of the next general meeting."[56]

This reasoning, it is submitted, appears to be unjust. The failure of the person to secure election implies that he has lost confidence of the shareholders. When the shareholders expressly show their unwillingness to elect a person as the director, it is not proper to use some dubious means to place them in the board of directors.

This power could be exercised even at a time when the strength of the directorate has fallen below the statutory minimum or below the quorum prescribed by the articles of association.[57] In Ananthalakshmi v. The Indian Trades and Investments Ltd.,[58] the board of directors of a company

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54. Gurprasad v. Rameshwar, A.I.R. 1933 All.344 D.B.
55. A.I.R. 1933 All.344.
56. Id. at p.346 per Niamatullah, J.
57. See also Anantha Lakshmi v. Indian Trades & Investments Ltd., A.I.R. 1953 Mad.467 (470).
58. A.I.R. 1953 Mad.467.

appointed certain persons as the directors of the company at a time when the strength of the board was below the statutory minimum. The Madras High Court held that thie appointment was valid.[59] However, the directors cannot appoint additional directors exceeding the maximum number fixed in the articles.

The articles of a company may delegate the power of appointing additional directors to the board to the exclusion of general meetings or may reserve the power to the general meeting to the complete exclusion of the board of directors.[60] The board of directors can appoint new directors when the articles of association empower the directors to do so. In such cases, the general meeting cannot exercise such powers in the absence of specific reasons.[61]

In Viswanathan v. Tiffin Baryte Asbestoes and Paints Ltd.,[62] the articles of the company provided that the power of the general meeting was limited to electing a director in the place of one who retired at the annual meeting. The power to appoint other directors was vested in the board of directors. In spite of this, the general meeting appointed directors in the place of directors who resigned after election. The Court held

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59. Id. at p.470 per Venkatarama Aiyar, J.

60. Ram Kissendas v. Satya Charan, A.I.R.1950 P.C.81; Ananthalaxmi v. I.T.I. Ltd., A.I.R.1953 Mad.467; M.K. Sreenivasan v. Subramonia, A.I.R.1932 Mad.100.

61. Viswanathan v. Tiffins B.A. & P.Ltd., A.I.R.1953 Mad.520.

62. A.I.R.1953 Mad.520.

that the appointment was valid since there was inherent power on the general meeting when, due to some reasons, the functioning of the company became difficult.[63] The absence of a legally constituted board which could function and the inability or unwillingness of the board to function were held to be valid reasons for exercise of the power by the general meeting.[64] The appointment of additional directors by the board of directors cannot be challenged as unlawful when such power is expressly conferred by the articles and there is no allegation that the number of directors has exceeded the prescribed limit.[65]

Appointment by the Central Government

For preventing oppression and mismanagement, the Central Government has power to appoint directors.[66] This power may be exercised under Section 408 on a petition made to the Central Government for prevention of oppression and mismanagement. This power is a very important one. Its importance is clear from the observation of the Orissa High Court in Shantiprasad v. Kalinga Tubes Ltd.[67] The Government can select any person, not necessarily a member of the company, and appoint him as director. The directors or additional directors appointed by the Government do not require share qualification, even if the articles of association of the company require such qualification.

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63. Id. at p.524 per Venkatarama Ayyar, J.

64. Viswanathan v. Tiffins B.A. & P. Ltd., supra n.61; See also Worcester Corsetry Ltd. v. Witting (1936) Ch.640 (CA); Barron v. Potter, (1911) 1 Ch.895; Ram Kissendas v. Satya Charan, A.I.R. 1950 P.C.81.

65. In re Patrakola Tea Co., A.I.R. 1967 Cal.406.

66. The Companies Act 1956, S.408.

67. A.I.R. 1962 Orissa 202.

They do not retire by rotation. However they are liable to be removed at any time by the Government. No change in the board of directors made after the appointment of the government directors can be effective unless it is approved by the Central Government. The Central Government may issue necessary and appropriate directions in regard to the affairs of the company. The directors appointed by the Government should make reports to the Central Government from time to time. The Government can exercise these powers either in its own motion or on application of not less than one hundred members of the company or of member holding one-tenth of the voting power in the company. The term of appointment of such directors shall not exceed three years at a time. When an application is made to the Central Government under Section 408 of the Companies Act, the Central Government can, in suitable cases, appoint any number of persons to the board of directors of the company.[68]

Appointment by the Court

Power to appoint directors is conferred on the Courts also for preventing oppression and mismanagement.[69] In Rajamundry Electric Supply Corporation Ltd. V. Nageswar Rao,[70] the Supreme Court considered the nature of the powers exercised by the Courts in this regard. In this case two administrators were

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68. See infra Ch.18 for a discussion on this aspect.
69. The Companies Act 1956, S.402.
70. A.I.R. 1956 S.C.213.

appointed by the Company Court, Andhra Pradesh while disposing of a petition under Sections 397 and 398. Against this order, an appeal was filed in the Supreme Court. The company contended that the appointment of administrators in suppression of the directorate was an interference with the internal management of the company. But upholding the High Court's decision, the Supreme Court said,

> "... the appointment of administrators under S.153-C (present Section 402) cannot be attacked on the ground that it is an interference with the internal management of the affairs of the company. If a Liquidator can be appointed to manage the affairs of a company when an order for winding up is made under Section 162, administrators could also be appointed to manage its affairs, when action taken under Section 153-C."[71]

Similarly it was held that the Court was competent to constitute an advisory board under Section 402 of the Act for the management of a company, though this was an innovation in the company administration by the Court.[72] This power includes the power to give interim directions to the managing committees.[73] The only condition is that these directions should be with reference to the administration and management of the affairs of the company.[74]

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71. Id. at p.217 per Bose, J.
72. Richardson and Cruddas Ltd. v. Haridas Mundhra, A.I.R. 1959 Cal.695.
73. Lord Krishna Sugar Mills v. Abnash Kaur, 1972 Tax.L.R. 1667 (Delhi).
74. T.P. Sokkalal Ram Saint Property P.Ltd., In Re; (1978) 48 Com.Cas.503 (Mad.).

Controls under the MRTP Act 1969

The Monopolies and Restrictive Trade Practices Act 1969 also imposes certain restrictions in the appointment of directors for preventing interlocking of directorship thereby increasing concentration of economic power. Under this Act, a person who is a director of a dominant undertaking cannot be appointed as a director of any other undertaking except with the prior approval of the Central Government.[75] But the approval is not necessary to the appointment of a person as director unless he holds office in more than ten interconnected undertaking.[76]

Administrative Controls in the Appointment of Directors: An Assessment

Administrative interference with the appointment of directors is envisaged in the following circumstances:

(1) Persons appointed as first director of a company should file his written consent to act as such with the Registrar of Companies along with other documents at the time of registration of the company.[77] A person appointed as director subsequently should, within thirty days of his appointment, file his consent to act as director.[78]

(2) When a person is elected as director in more than

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75. The Monopolies and Restrictive Trade Practices Act 1969, S.25.
76. Ibid.
77. The Companies Act 1956, S.33.
78. Id., S.264.

twenty companies before the commencement of the Companies Act he should intimate the choice made by him to the Registrar of Companies having jurisdiction and also to the Central Government in respect of each of such company.[79]

(3) When a company proposes to increase the number of directors beyond the permissible maximum under its articles as first registered, it should obtain the permission of the Central Government.[80]

(4) The Central Government may remove some of the disqualifications of any person for appointment as director of a company.[81]

(5) The Government may give directions to a company to follow the principle of proportional representation in the election of directors for the prevention of oppression and mismanagement.[82]

(6) The Government may prohibit any change in the constitution and structure of the board of directors of a company.[83]

(7) The Government may appoint such number of directors as the Government may deem necessary to effectively protect the interests of the company or its shareholders or the public interest.[84]

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79. Id., S.276(1)(c).

80. Id., S.259.

81. Id., S.274(2). This Section empowers the Central Government to remove disqualification on the basis of some criminal convictions or on the basis of failure to pay any call in respect of shares.

82. Id., S.408.

83. Id., S.409.

84. Id., S.408.

The idea behind these controls is mainly to ensure that the management of a company is placed in the hands of able persons. The office of director being an office of trust, there should be some person responsible to carry out the trust. When the consent is filed, the person undertakes to discharge the obligations under the Act. Concentration of economic power and consequent dangers could be minimised by limiting the directorships that a person is permitted to hold. The present permissible extent itself is too high as no one would be able to pay attention to all aspects of twenty companies. Even this limit could be safely exceeded by being directors of other private or charitable companies. The obligation to make the choice and file consent with the Registrar would naturally dissuade a person to take up directorship of more than the permissible limit. Permissible number of directorships needs a rethinking. It should be limited to a reasonable number including private and charitable companies.

The permission of the Central Government is necessary for increasing the number of directors only if the number exceeds the permissible maximum under its articles as first registered. Even here, if the permissible maximum is twelve or less than twelve, no such permission is necessary. Similarly, the provision is not applicable to government companies. If the object is to prescribe a maximum limit to the number of directors in a company it should be done in clear terms. For this purpose, companies should be classified into small, medium and large companies and the maximum number of directors

in each class should be prescribed. When this is done, the administrative authorities may be empowered to approve an increase in the maximum number limit in suitable cases.

In England also the Registrar of companies exercise wide discretionary powers in relation to the appointment of directors The consent of the directors to act as such, the register of directors of a company etc. should be filed with the Registrar. But the power to remove disqualification for appointment as director and the power to appoint directors for prevention of oppression and mismanagement are peculiar to the Indian law. The restriction on interlocking of directorships is used as an antimonopoly measure in England also.

The Companies Act 1956, or any Rules made under it fails to provide guidelines regarding the functions of a director appointed by the Government. Very often the directors appointed by the Government are passive observers of the functioning of the company. The powers, functions and duties are not properly defined. The criteria for selection is also not defined. The Central Government should be authorised to make, and should make, rules regulating these matters. The power of the Government to make nomination to the board of directors of a company could be developed as an alternative to compulsory winding up. But then, the exercise of this power should be made objective. First appointment of Government directors should be for only a short period. For any extension of the term proceedings should be taken in some quasi-judicial body

and should be made only upon an order from such body. There could be provision for an appeal to the Company Court against the decision.

Appointment of Managerial Personnel

Formerly the company law recognised four types of managerial personnel, viz. (1) managing director, (2) managing agent, (3) secretaries and treasurers and (4) manager.[85] But after the abolishion of the institutions of managing agent and secretaries and treasurers,[86] there are only two classes of managerial personnel now. But companies can employ only one type of managerial personnel,[87] as the employment of more than one type simultaneously is needless, expensive and prohibited under the Act.[88] The Allahabad High Court took the view that, the Act prohibits only the company from appointing or allowing continue the employment of more than one type of managerial personnel. The person who was appointed or employed or whose appointment or employment was allowed to continue contrary to the terms of the Act could not be treated as contravention of the Act.[89]

A wholetime director, who is a person in the wholetime employment of the company, is treated in the same footing as the managing director.[90] There are two other forms of managerial

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85. The Companies Act 1956, S.197A.
86. These institutions were abolished w.e.f. 3.4.1970. See Id., S.324A.
87. Id., S.197A.
88. Ibid.
89. Raghunath Swarup Mathur v. Har Swarup Mathur, (1967) 37 Com.Cas.802(All); A.I.R.1968 All.241.
90. The Companies Act 1956, Explanation to S.269(1).

men having statutory recognition. They are secretary and soleselling agents. Now it is obligatory for a company having a paid up share capital of Rs.25 lakhs or more to have a whole-time company secretary. A modern company secretary is an important executive officer of the company having statutory rights and duties.[91] Sole selling agents are not managerial personnel in its strict sense, as they do not weild apparently any substantial powers in the affairs of the company. But there is every possibility of erstwhile managing agents or secretaries and treasurers trying a come back in guise of sole selling agency system. The terms of appointment, remuneration and termination of the services of all these categories of persons are under strict control of administrative authorities.

Removal of Disqualification by the Government

Managing director, wholetime director or manager of a company shall not be an undischarged insolvent or a person convicted by a court of an offence involving moral turpitude. He should not be a person who suspends or has at any time suspended, payment to his creditors, or makes or has at any time made a composition with them.[92] The provisions relating to managing directors and wholetime directors are stiffer than that of managers. In the case of managers there is a limitation

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91. Panorama Development (Guildford) Ltd. v. Fidelis Furnishing Fabrics Ltd., [1971] 3 All E.R.16(CA); the Companies Act 1956, S.2(45).

92. The Companies Act 1956, Ss.268 & 385.

of disqualification for a period of five years.[93] In their case disqualification incurred by any person can be removed by the Central Government by a notification in the Official Gazette.[94]

Number of Managing Directorships that Can be Held by A Person

A person is not eligible to be appointed as manager or managing director for more than two companies.[95] In the case of appointment for the second company, it should be made only with the unanimous resolution of the board of directors passed at the board meeting. But there is no bar to a person holding more than two managing directorships in private companies. The Central Government may permit a person to be appointed as managing director of more than two companies. Such powers will be exercised only if the Government is satisfied that the companies should have a common managing director for their proper working and should function as a single unit. The term of appointment of manager or a managing director is limited to five years at a time.[96] The Act does not, however, prohibit perpetual management and a managing director can be reappointed after a term is over. For example in O.M.P. Works (P) Ltd. v. B.K. Thakur,[97] the Supreme Court held that, eventhough by allowing a person to be reappointed as director for several terms in succession leads to perpetual management, the Act

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93. See the Companies Act 1956, S.385(1).
94. Id., S.385(2).
95. Id., S.316.
96. Id., S.317.
97. See O.M.P. Works (P) Ltd. v. B.K. Thakoor, supra n.23.

does not intended to prohibit such contingencies.[98] Amendment of any provision relating to appointment or reappointment of a managing or wholetime director or of a director not liable to retire by rotation, require approval of the Central Government.[9]

The Government Approvals

The appointment or reappointment of managing or wholetime director of a company requires the Government approval.[100] In the case of a company incorporated after 1960, a person can be appointed as a managing or wholetime director without the approval of the Central Government, but such appointments shall be having no effect after the expiry of three months unless the Central Government gives its approval within that time. In the case of existing companies, the reappointment of a person as managing or wholetime director for the first time would be ineffective unless approved by the Central Government. All the above provisions apply only to public companies and private companies which are subsidiaries of public companies. Provate companies are exempted from the operation of these provisions.[101]

The Act provides guidelines for the grant or refusal of approval by the Government. This ensures the exercise of this power by the Central Government or its delegate, the Company Law Board, fairly and reasonably. The Company Law Board

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98. Ibid.

99. The Companies Act 1956, S.317.

100. Id., S.269.

101. Id., S.269(1) states that the provision is applicable to public companies and private companies which are subsidiaries of public companies only.

should give approval under the following conditions:[102] (1) It is in the interest of the company to have a managing or wholetime director. (2) The proposed managing or wholetime director is a fit and proper person and his appointment is not against public interest. (3) The terms and conditions of appointment are fair and reasonable. The Government may accord approval to the appointment for a period lesser than the period for which the person is proposed to be appointed by the company. If the appointment of any person is not approved by the company. If the appointment of any person is not approved by the Central Government the person so appointed should vacate his office on the day on which the Central Government's decision is communicated to the company.[103]

Regarding the obligation to obtain the approval of the Central Government to the appointment of a managing director, the Madras High Court said in Hussain Khan v. Registrar of Companies,[104]

> "The approval of the Government of India would be necessary only in a case when the office of the managing director was created for the first time after the commencement of the Act."[105]

Here the petitioner was convicted and sentenced to imprisonment for acting as managing director of a company without obtaining the approval of the Central Government. He had acted as the managing director of the company before the

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102. Raymon Engineering Works v. Union of India, A.I.R.1970 Delhi 5.

103. The Companies Act 1956, S.269(5), makes him punishable with a fine of five hundred rupees for everyday during which he fails or omits to vacate such office.

104. A.I.R.1965 Mad.307 at p.308 per Kailasam, J.

105. Ibid.

Companies (Amendment Act) 1960 came into force and he obtained approval for his reappointment after the Act came into force. His contention was that, for his subsequent reappointment, further approval was not necessary. This argument was accepted by the Court. The Delhi High Court has taken the opposite view.[106] Here, a person was appointed as the managing director of a company with the approval of the Central Government, after the commencement of the Companies (Amendment) Act 1960 (65 of 1960). The same person was reappointed as the managing director on the expiry of the period of first appointment. The question arose whether the Government approval was necessary for the reappointment. The Court held that the case came within Section 269(1) of the Act.[107] A plain reading of the Section gives the conclusion that the view taken by the Madras High Court is more reasonable.

The Government approval of the appointment of directors is intended to serve the following purposes: (1) to ensure that it is in the interest of the company to have a managing or wholetime director (2) the person appointed as the managing or wholetime director is a fit and proper person.

The Act gives clear guidelines as to the factors that should be taken into consideration for granting approvals.[108]

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106. Rayeon Engineering Works v. Union of India, supra n.103.

107. Id. at p.10, per Rangarajan, J.

108. The Companies Act 1956, S.269(3) reads, "The Central Government shall not accord its approval under sub-section (1) in any case unless it is satisfied that (a) it is in the interest of the company to have a managing or wholetime director; (b) the proposed managing or wholetime director of the company is, in its opinion, a fit and proper person to be appointed as such and that the appointment of such person as managing or wholetime director is not against the public interest, and (c)..."

This envisages two conditions, namely the fitness of the person and desirability of creating the post of managing director. Sub-Section (2) of Section 269, on the other hand, makes it obligatory to obtain the Central Governments approval only in the case of "reappointment for the first time after the commencement of the Act." The section, as it stands, provide no control for the Government over the subsequent appointments, eventhough serious irregularities or illegalities may have been committed by such director. This is an unsatisfactory position and needs urgent reform.

The Act does not prohibit a person from acting as managing director before the receipt of the approval of the Central Government. But if the appointment is in violation of any statutory provisions, the company would be an offender and would be liable to punishment.

The Company Law Board to whom powers under this section is delegated, has power to impose conditions while granting approvals.[109] The question of malafides is not a relevant consideration for the Courts in examining such conditional approvals. The Delhi High Court considered this aspect in Raymon Engineering Works v. Union of India.[110] Here, the Company Law Board accorded approval to a person to act as the managing director of a company, but imposed certain conditions

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109. Company Law Board v. Upper Doab Sugar Mills, A.I.R.1977 S.C.831. C/o Upper Doab Sugar Mills v. Company Law Board, 1971 Tax.L.R.1675.

110. A.I.R.1970 N.D.5.

while granting such approval. The company challenged the order of the Company Law Board imposing conditions on the grounds of malafides. The Court held,

> "Once the Central Government had the power then the question of malafides itself is not very relevant, especially in the context of the conditions being seen to be quite just and proper and also having been agreed to by the petitioner company itself."[111]

When the company applies to the Central Government for permission to appoint a particular person as a managing director of a company, for a specific period, it is an occasion when the Central Government could exercise the powers under Section 637A, its approval being required under Section 269(1) of the Act, in relation thereto. In such a situation, the absence of anything to the contrary contained in such or any other provision of the Act, the Central Government may accord, give or grant such approval, subject to such conditions, limitations or restrictions, as it may think fit to impose and may, in the case of contravention of any such condition, limitation or restriction, rescind or withdraw such approval.[112]

Substantial powers of management of a company rests with the managing or wholetime director of a company or its manager. Hence it is desirable to have proper control on their appointments,

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111. Id. at p.13 per Rangarajan, J.

112. Raymon Engineering Works v. Union of India, A.I.R.1970 Delhi 5(7).

remuneration and other service conditions. Under the present law such control is exercised only when a managing or wholetime director or a manager is appointed to conduct the affairs of the company. There is no obligation on any company to have any such posts. After the abolishion of the managing agency system, there may be any of the following management structure for companies (1) a company managed by a managing or wholetime director or a manager (2) company managed by the board of directors as a whole without assigning any substantial powers on any one of the directors. (3) Executive officers of the company acting as management under the direction and control of the board. In the latter two cases it is difficult to find a single person responsible for the company's acts. So it is desirable to insist on the appointment of managerial personnel for all companies, as suggested by the Sachar Committee.[113] All companies whether public or private having a substantial amount as paid up capital should have a managing director or manager. Qualifications, including age qualifications.[114] should be prescribed in the Act itself. Approvals should be made compulsory only when the person sought to be appointed is not having all the prescribed qualifications or is disqualified. There seems to be no justification in keeping out private companies of considerable size and having public importance from the purview of administrative controls in relation to

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113. See the Report of the High Powered Expert Committee on Companies Act and MRTP Act 1978, para 5.9 et seq.

114. Under the present law in India, there is no age restrictions for the appointment of directors.

appointment of directors. For the proper discharge of the functions of the managing director it is necessary that no person shall be allowed to act as managing director of more than one company having a paid-up capital of rupees 25 lakhs or more. There need be no exemption to private companies and government companies in this regard.

Removal of Directors

(a) Removal of Managerial Personnel

The relationship between the managing director or manager and the company is like that between a principal and agent. So their appointment can be revoked by the board at any time under Section 203 of the Indian Contract Act 1872 (19 of 1872) even if the articles of the company do not provide for such removal.[115] But the managing director so removed from office can, in his own name, maintain a case to have a declaration that despite such removal he continued to be in office and that the person elected in his place was not the managing director.[116] But when a person is removed from the directorship by the Government, he cannot continue as managing director or manager.

Removal of Directors by the Shareholders

Under Section 284, the director of a company can be removed by the shareholders in general meeting by an ordinary resolution. However a special notice is required to be given to the company

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115. Shantha Shamsher v. Kamani Bros., A.I.R.1959 Bom.201.
116. Ratna Velu Sami v. Manickavelu, A.I.R. 1951 Mad.542.

for moving such a resolution.[117] This power of the share-holders is an overriding power and can be exercised irrespective of any contrary provision or any agreement.[118]

The following classes of directors are not liable to be removed by the share holders as stated above (1) directors appointed by the Central Government in pursuance of Section 408; (2) the directors of private companies holding office for life as on April 1, 1952; (3) A director who was appointed as such where the company had adopted a system of electing two-third of its directors by the principle of proportional representation

Though the provision apply to private companies as well, the directors of a private company can easily evade his removal by incorporating certain provisions as shown by the decision of the House of Lords in Bushell v. Faith.[119] In this case, the articles of the company provided that on a resolution for removal of a director, he would have the right to three votes per share. When a director of the company was sought to be removed by a resolution, he used this right and defeated the motion. Lord Donovan of the House of Lords, held that since the Act had no provision against the phenomenon of articles of association carrying "weighted votes," the exercise of such power was perfectly valid. Even in public companies, an individual share holder has no right, by himself alone, to compel the inclusion in the agenda of a meeting a resolution

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117. The Companies Act 1956, S.284(2).
118. The Report of the Company Law Committee 1952, para 111.
119. (1970) 1 All E.R.53; (1970) 2 W.L.R. 272.

for removal of a director.[120]

To remove a director under Section 284 of the Companies Act 1956 (1 of 1956), certain essential requirements are to be fulfilled. The director concerned must be given a reasonable opportunity to make representation against the proposal for his removal. The shareholders of the company also should get adequate opportunities of being acquainted with such representation before they subscribe to a resolution for removal.[121] However, the competency of a general meeting summoned by the directors to pass a special resolution to remove a director is not affected by any irregularity, such as the insufficiency of notice to the director concerned, in the convening of the board meeting at which the resolution to summon the general meeting was passed.[122] The difficulty of the shareholders in this regard is well explained by Trebilcock.[123] He observed that it is very difficult for shareholders, practically even impossible, to discover the breaches of directors in time and do anything effective about them. In large public companies, it is well neigh impossible to do so while the directors remain in office. The

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120. Pedley v. Inland Waterways, [1977] 1 All E.R.209; 1978 Tax.L.R.2268. The reasoning was that a resolution should be supported by such number of members who are entitled to requisition a meeting. Though this may prevent poorly supported and rash individual attempts at removal of directors, from the point of view of the shareholder's right and the wording of the Section (S.184 of the English Act) the decision is open to doubt. On the interpretation of S.284 of the Indian Act, the corresponding section in the Indian law, it is doubtful if this decision can form a precedent.

121. The Companies Act 1956, S.284(4); See also In Re Buttonies & Co., A.I.R. 1969 Cal.550.

122. Browne v. La Trinidad, [1887] 37 Ch.D.1(10).

123. M.J. Trebilcock, "The Liability of Company Directors for Negligence," (1969) 32 Mod.L.R.499.

failure of the company itself often be the first clear sign that the directors have been incompetent. At this stage the company is usually so hopelessly insolvent that there is little or nothing that can be salvaged for the shareholders.

Realising this matter the Companies Act 1956 (1 of 1956) has given such powers on the Courts and the Central Government to remove managerial personnel.

Removal of Directors by the Court

Section 402 read with Sections 397 and 398 confers wide power to the High Courts to remove company directors. These provisions deal with the prevention of oppression and mismanagement. Here, the Court takes action on a petition by the shareholders, by the Registrar or by the Central Government. It is an alternative remedy to winding up and hence the Court would act only in circumstances warranting such action.[124]

Removal of Directors by the Central Government

The Central Government Government has wide powers to remove company directors from office. In order to ensure fair and honest commercial practice in the administration of companies, the power of the Central Government is stated in very elaborate terms.[125] The Government can remove managerial personnel from office on the recommendation of the High Court when there are any of the following circumstances.

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124. For further discussion on this topic, see Chapter 18, infra.

125. See the Companies Act 1956, Ss.388B, 388C, 388D & 388E.

(1) Any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust;

(2) The business of the company is or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices;

(3) A company is or has been conducted and managed by such persons in a manner which is likely to cause or has caused serious injury or damage to the interest of trade, industry or business to which such company pertains; or

(4) The business of a company is or has been conducted and managed by such person with intend to defraud its creditors, members or any other person or otherwise for a fradulent or unlawful purpose or in a manner prejudicial to public interest.

If any one of these conditions is present, the intervention of the Court could be sought by the Central Government by presenting a petition stating a case against the person and joining him as respondent. Then the Court would decide whether the person is a fit and proper person to hold the office of director or other managerial office.[126] The Court may also make an interim order restraining such person holding such office till the disposal of the case.[127] If the decision of the Court on

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126. S.P. Jain v. Union of India, (1966) 2 Com.L.J.51 (Bom.).
127. The Companies Act 1956, Ss.388-B(4) & 388 C(1).

the conclusion of enquiry is against him, the Government may, by order, remove him from office, after giving him a reasonable opportunity to show cause against the same.[128] Such person is debarred from holding office for five years and no compensation is payable to him.[129]

The power of the Central Government under these provisions are not arbitrary or discriminatory, but justiciable. The Government is required to state the circumstances which led to the conclusion that a reference should be made to the Court. The Government should record the reasons for the decision also.[130] The power is not only to remove the directors from existing office but also to restrain future conduct.[131] Under Sections 397 and 398, the Court interferes only if circumstances justifying winding up order does exist; but under these provisions the Government can interfere even if no such circumstances exist, if the affairs of the company are conducted in a manner prejudicial to public interest.[132]

The power of the Central Government under this Section is delegated to the Company Law Board.[133] But the exercise of this power and discharge of these duties by the Company Law Board is subject to the control of the Central Government. This control does not end with merely vesting a general supervisory power to be exercised by the Central Government over the activities of the Company Law Board. Section 637 of the Act

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128. Id., S.388-E.
129. Ibid.
130. S.P. Jain v. Union of India, supra n.127.
131. Ibid.
132. Richardson & Cruddas Ltd. v. Haridas Mundra, A.I.R. 1959 Cal.695.
133. See the Companies Act 1956, S.637.

which authorised the Central Government to make the delegation does not indicate that the section has the effect of a complete abdication or surrender of power by the Central Government to the Company Law Board. So the Central Government can take back any power delegated to the Company Law Board by this provision. However, when the delegation remains in force, the Central Government could not exercise the powers delegated to the Company Law Board. For example, in Vinod Kumar v. Union of India,[134] the Central Government had delegated its powers under Section 408 of the Act to the Company Law Board. By a subsequent notification, the Government took back the power to select the personnel for appointment as directors. By exercising the power, the Central Government selected the persons to be appointed as directors of the company and determined the period for which they should act as directors. The Delhi High Court held that it was contrary to law. The Court said,

> "In this case, the number of the directors as well as the period has been decided by the Central Government. This seems to be contrary to the delegation now remaining with the Company Law Board..."[135]

The Constitutional validity of Section 388-B of the Act empowering the Central Government to remove directors was considered by the Calcutta High Court in A.P. Jain v. Union of India.[136] The Court held that the provision was not violative of Article 14 of the Constitution.[137]

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134. (1982) 52 Com.Cas.211 (Delhi).
135. Id. at p.232 per D.K. Kapur, J.
136. 1972 Tax.L.R.2124(Cal.).
137. Id. at p.2136 per B.C. Mitra, J.

The formation of opinion by the Central Government is a subjective process. When a Court of competent jurisdiction has, while examining a question under Section 398 read with Section 402 of the Act has decided as to what period the person should be debarred from becoming a director and from interfering or intermeddling with the conduct and affairs of a company then it is not competent for the Company Law Board to refer the matter again to the Court under this provision.[138] Here there had been a judicial exercise of discretionary power after weighing proper materials. In other cases, since the formation of opinion of the Government is a subjective process, it cannot be questioned or challenged by a party aggrieved by the action taken by the Company Law Board.

The Court could look into the question whether there had existed any materials to justify the formation of such opinion.[1]

When the circumstances specified in the Section does exist, it is the statutory duty of the Company Law Board to make a reference.[140] In such cases the Company Law Board can state a case asking the Court to record a finding that the person concerned in the conduct, management and affairs of the company is not fit to hold the post of director in the company.[141]

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138. See Bennett Coleman & Co. v. Union of India, (1977) 47 Com.Cas.92.

139. A.P. Jain v. Union of India, supra n.136.

140. Ibid.

141. In re Aurna Purushottam, (1966) 68 Bom.L.R.431.

CHAPTER - II

Remuneration and Other Benefits to the Directors

The company directors are groups of men occupying vital position in the economic system of the country and handling money belonging to the public, including themselves. In relation to the company they manage, they hold a prestigious position by which they can get all possible information relating to the company. Any misdeeds done by them may come to light only after a long time, either at the time of auditing or at the time of general meeting. In order to prevent the directors from misusing their position and authority to the detriment of the company strict legal controls are provided in the Companies Act 1956. Similarly, the diversion of company funds to the personal benefit of directors are also sought to be checked.

The remuneration of directors is one of the areas where stringent administrative controls are provided in the Act. In addition to the elaborate legal provisions in these matters, provisions are there enabling the Central Government fo fix administrative ceiling on the remuneration of directors and to give approvals for payment of minimum remuneration to directors. This administrative ceiling which can be consider as a 'ceiling within the ceiling' is considered here. Simila

other areas like the payment of loans etc. to directors, holding office of profit in the company by the directors, appointment of sole-agents etc. are also considered in this chapter.

Remuneration of Directors

As a general rule, the directors of a company are not entitled to any remuneration in the absence of any provision to that effect in the company's articles or a resolution in the company's general meeting.[1] The Companies Act provides that the remuneration should be determined either by the articles of the company or by a resolution in the annual general meeting. So his right to remuneration is limited to what has been sanctioned by the articles.[2] The articles of the company may provide for the passing of special resolution to fix the remuneration. Whatever may be the method adopted for the determination of remuneration, it shall be subject to the provisions of Sections 198 and 308 of the Companies Act and shall be inclusive of the remuneration payable to such director for services rendered by him in any other capacity. If the services so rendered are of professional nature and the person possesses the requisite qualification for the practice of that profession, the Central Government may permit the exclusion of

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1. In re London and General Bank (No.2), [1895] 1 Ch.D.673.
2. Dikshit and Co. v. Mathura Rao Prasad, A.I.R. 1925 All.71.

fees paid for rendering such services, for computation of total remuneration. In R.Gac Electrodes Ltd. v. Union of India,[3] the question whether the previous approval of the Central Government was necessary or not for payment of remuneration to a director of a company for services of a professional nature rendered by him, was considered by the Kerala High Court. Here an advocate was appointed as the director of a company and remuneration was paid to him for the professional services rendered by him. The Company Law Board contended that the term remuneration given in Section 310 includes all remunerations received in any capacity and includes remuneration received for services of a professional nature rendered to the company. But the Court said,

> "As remuneration for services of a professional nature will not be remuneration determined under Section 309(1) the payment of the same to a director will not increase the remuneration he is entitled to under Section 309(1). So, it goes without saying that for payment of remuneration ... of a professional nature, no previous sanction of the Central Government ... is necessary."[4]

The sitting fees paid to the directors for attending board meetings are also excluded.

The Legislative Ceiling

A single managing or wholetime director can be paid

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3. 1981 Tax.L.R.2574 (Ker.).
4. Id. at pp.2576, 2577 per K.K. Narendran, J.

managerial remuneration upto five percent and if there are more than one managing or wholetime directors upto 10% of the net profits. The maximum percentage represent a kind of subceiling within the overall ceiling of 11% of the net profit. The present law also permits the directors other than managing or wholetime directors, to receive by way of remuneration, for all of them together, a remuneration upto 1% of the net profits. Where a company has not appointed any managing or wholetime director, the directors of the company may be paid collectively remuneration not exceeding 3% of the net profits. Any increase in this 1% or 3% limit respectively requires the Government's approval.

Refund of Excess Remuneration

Any director who draws remuneration in excess of the ceiling without the prior sanction of the Central Government should refund the excess money so drawn, to the company. The company cannot waive such refund, unless permitted by the Government. An increase in remuneration of any director, including managing or wholetime director, whether at the time of appointment or otherwise, would not have any effect unless approved by the Central Government. But the process of granting such approval is not purely discretionary. The Government has to take into account all relevant matters and act judicially. Otherwise the order of the Central Government would be void.[5] For example in Cibatul v. Union of India,[6] the petitioner, a

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5. The Companies Act 1956, S.637AA.
6. (1980) 50 Com.Cas.437 (Guj).

highly qualified professional man, was reappointed as the managing director of the company for a period of five years. He applied for approval of the Central Government for his reappointment. Eventhough the Government gave approval for two years, the terms and conditions set out by the company were greatly varied. The Gujarat High Court considered the nature of the powers of the Central Government and the factors that should be considered by the Government in according approvals. In this regard, the Court said,

> "The order passed on the face of it should show that the order was passed after taking into consideration all the relevant objective facts."[7]

A subsidiary company can pay no remuneration to any managing or wholetime director who is in receipt of remuneration from the holding company on a percentage basis. In the case of managers, the ceiling is five per cent of the net profits or he may be paid by way of monthly remuneration. An increase in the remuneration beyond the ceiling requires governmental approval.

Minimum Remuneration

The Central Government is empowered to approve payment of minimum remuneration not exceeding fifty thousand rupees per annum to the managerial personnel, if in any year a company

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7. Id. at p.454 per S.L. Talati, J.

earns no profits or the profits are inadequate. The Central Government may even sanction an increase in the minimum remuneration if it is satisfied that such increase is necessary for the efficient conduct of the business of the company. The increase in the minimum remuneration shall be of a specified sum and for a specified period. The Central Government may impose conditions while sanctioning increase in minimum remuneration. To make the provision relating to remuneration more clear, the Act explains that the following types of perquisites also should be included in the remuneration:- (1) any expenditure incurred by the company in providing any rent free accommodation, or any other benefit or amenity in respect of accommodation free of charge (2) any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate (3) any expenditure incurred by the company in respect of any obligation or service which, but for such expenditure by the company, would have been incurred by the concerned persons (4) any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for, any managerial personnel.[8]

Administrative Ceiling on Remuneration

Within the statutory limits laid down by the Act on managerial remuneration, the Central Government can lay down certain administrative guidelines prescribing the monetary

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8. The Companies Act 1956, S.193.

limits in respect of salary, commissions and other perquisites.[9] But in doing so, the Central Government should take into account the size of the company's capital and the qualifications, experience as well as the integrity of the individual to be appointed as managing or wholetime director.[10] In the exercise of powers conferred under the Act, the Government has issued guidelines and administrative ceilings on the salary and perquisites of managerial personnel.[11]

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9. Ibid.

10. Id., S.637A.

11. See the Revised guidelines on Administrative Ceilings on salary and perquisites of managing directors, dated 9th Nov.1978(1980) 18 CWN.16.

    It reads, "substantive remuneration: (1) The maximum remuneration payable to managing or wholetime directors, part-time directors or managers from one or more companies put together, subject to statutory limits has been fixed as under:

    a) The salary inclusive of DA and all other fixed allowances should not exceed Rs.60,000/- per annum.

    b) A commission on net profits upto 1% of the net profits may be allowed in addition to salary as an incentive for efficient and sound management, but this should be at least 20% of the salary subject to an overall ceiling that salary plus commission would not exceed 72,000/- per annum (Bonus will be treated as part of commission).

    c) Where a company proposes to pay remuneration in the form of commission on net profits alone, this shall be subject to a maximum limit of Rs.72,000/- per annum.

    d) Hence forth, perquisites will be restricted to an amount equivalent to the annual salary subject to a maximum of Rs.60,000/- per annum reckoned on the basis of actual expenditure or liability incurred by the company as provided by explanation to Section-198 of the Companies Act 1956. There would, however, by separate non-interchangeable ceiling on expenditure on pensionary benefits, medical treatment and housing. Within this overall limit, the perquisites that may be allowed by the company will be as under:

(f.n.contd.)

The Central Government's power to adopt an administrative ceiling within the statutory ceiling fixed by Sections 309 and 198 of the Companies Act 1956, in relation to managerial remuneration, is exercised to achieve different purposes. It may be

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(f.n.11 contd.)

(i) Company's contribution towards provident fund: non-interchangeable ceiling of 10% of the salary.

(ii) Company's contribution towards pension/super-annuation fund: non-interchangeable ceiling of 15% of salary.

(iii) Gratuity: payable in accordance with the approved fund and which does not exceed one-half months salary for each completed year of service subject to a non-interchangeable ceiling of Rs.30,000/- or 20 months salary whichever is less.

(iv) Medical benefit for self and family: non-interchangeable ceiling of one month salary subject to a maximum of Rs.5,000/- per annum.

(v) Leave and leave travel concession.

(vi) Housing including furniture, fixtures, appliances, gas and electricity: non-interchangeable ceiling of 40% of salary on condition that 10% of salary would be born by the managerial personnel.

(vii) Free use of company's car with driver.

(viii) Personal accident insurance.

(ix) Free telephone facility at residence.

(x) Fees of clubs subject to a maximum of two clubs; admission and life membership fees to clubs will not be allowed.

Minimum remuneration: In the event of inadequacy of profits in any financial year, a cut of 10% will be imposed on substantive pay while the ceiling of perquisites will not be altered (No commission or bonus will be payable in the case of absence or inadequacy of profits).

Exceptions: Expatriates and persons possessing high or rare skill would not be covered by the ceilings on managerial remuneration. These cases will be decided on merits.

used to control the flow of company funds to the management in excess of what is required. It may also be used for implementing governmental policy relating to income and wages.

The administrative ceiling fixed by the Central Government here is a ceiling within the ceiling. An overall maximum limit for the managerial remuneration payable to managing directors and managers is prescribed by the Act.[12] The limit has been fixed at 11% of the net profits inclusive of any monthly payments made by way of remuneration, but exclusive of fees payable to directors for attending the board meetings. Methods are prescribed in the Act itself for computation of net profits[13] and ascertainment of depreciation.[14] These statutory provisions give a precise and equitable mode of ascertaining depreciation and net profits for computing managerial remuneration. This avoids disparities resulting from application of different methods to different individual cases.

As a result of the guidelines, the ceiling of managerial remuneration is reduced considerably. Under the present guidelines the ceiling has been reduced to the following extent compared to the earlier one:

(1) Ceiling on salaries inclusive of DA and all other fixed allowances have been reduced from Rs.90,000/- to Rs.60,000/- per annum.[15]

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12. The Companies Act 1956, S.198.

13. Id., S.349.

14. Id., S.350.

15. The guideline reported to have been issued by the Central Government during August 1983 has again revised this ceiling. The present ceiling on salary is Rs.90,000/- per annum. See the Express News Service, "Salary Ceiling Raised for Company Executives," Indian Express, Vol.LI. No.278, dated 12.8.1983, p.9.

(2) Ceiling on commission has been reduced from Rs.45,000/- to Rs.12,000/- per annum.[16]

(3) Ceiling on perquisites have been reduced from Rs.88,000/- to Rs.60,000/- per annum.[17]

Thus the ceiling on the overall managerial remuneration inclusive of commission and perquisites under the new guidelines is 1.32 lakhs per annum as against Rs.2.23 lakhs under the old guidelines. It may however be mentioned that while the net effect of the revised guideline is lowering of the ceiling on managerial remuneration generally, there has been an increase in the case of perquisites admissible in the event of payment of minimum remuneration payable in the absence of inadequacy of profits.[18]

The purpose of the ceiling on managerial remuneration is to control management cost. The earlier view was that in determining whether the remuneration paid to the directors is within the permitted limit, only those amounts paid to them as directors and not for other purposes have to be taken into account. The Bombay High Court explained the position in Ramaben A. Thanawala v. M/s Jyothi Ltd.[19] Here a qualified Mechanical and Electrical Engineer was appointed as managing agent of the company. Before his appointment he used to draw

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16. The present ceiling is Rs.45,000/- see ibid.
17. The present ceiling is Rs.67,500/- see ibid.
18. The overall ceiling now is Rs.2.02 lakhs, see ibid.
19. A.I.R.1958 Bom.214.

a salary of ₹.3,000/- per month. This was continued after his appointment as director also. On a petition by a shareholder on the ground that the total remuneration paid to the managing agent was in excess of the limits laid down in the Act, the Court made the following observation:

> "If it was intended by the legislature that the remuneration referred to in Sub-section (3) should include not only the remuneration paid to the director as a director, but also remuneration paid to him in any other capacity whatsoever, appropriate language could have been used for that purpose,...."[20]

But now the position is different. The overriding provisions should be given effect to, in regard to the remuneration of persons mentioned in the Act. The Supreme Court explained the position in Company Law Board v. Upper Doab Sugar Mills.[21] Here two persons were appointed as managing directors of a company for the first time after coming into force of the Act. While granting approvals for such appointment, the Company Law Board inserted the condition that the total remuneration of each managing director by way of commission and salary should not exceed rupees one lakh twenty thousand per annum. The company challenged the power of the Company Law Board to impose such a condition. The validity of the administrative guidelines prescribing a ceiling on managerial remuneration was also questioned. Regarding the power of the

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20. Id. at pp.215, 216 per Chagla, C.J.
21. A.I.R. 1977 S.C.831.

Company Law Board to impose conditions while granting approval, the Court observed,

> "The Board, in our opinion, acted well within its power in imposing this condition. Section 637A of the Act makes it clear inter alia that where the Central Government is required or authorised by any provision of the Act to accord approval in relations to any matter, then, in the absence of anything to the contrary contained in such or any other provisions of the Act, the Central Government may accord such approval subject to such conditions limitations or restrictions as it may think fit to impose."[22]

But the Supreme Court failed to consider the question of the validity of a general administrative ceiling on the remuneration of directors. It diverted from this question and decided the case by holding that since the directors were appointed for the first time after the coming into force of the Act, the Company Law Board was well within its powers to impose conditions while granting the approval.[23] But the Court refused to accept the view taken by the Delhi High Court in this matter.[24] Referring to the general administrative policy of the Government in fixing ceiling on managerial remuneration, the Delhi High Court had observed that any such policy which resulted in placing a ceiling below the legislative

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22. Id. at p.836 per Khanna, J.

23. Ibid.

24. See Upper Doab Sugar Mills v. Company Law Board, 1971 Tax.L.R.1675 (Delhi).

ceilings fixed by Sections 198 and 309 was illegal as being contrary to Sections 198 and 309.[25] About this point the Supreme Court remarked that the Company Law Board is imposing a maximum administrative ceiling on the total amount payable to a managing director, which is not covered by the Act. The Company Law Board is following a basic principle that no individual should be paid remuneration exceeding Rs.1,20,000/- per annum. Within this range, the Board is exercising discretion considering the nature of the company.[26] On this basis the Supreme Court set aside the order of the Delhi High Court.[27]

It is interesting to note some of the observations made by the Delhi High Court in this regard. The Court said,

> "A study of the scheme of the Act shows that the legislature has itself occupied the entire ground relating to fixation of the remuneration of managing directors. It has not left anything to be done regarding such remuneration by the Government or the Board except when the remuneration is to be enhanced above the statutory limits under the proviso to Sections 198(4) and 309(3). The Legislature has specifically legalised the Articles of Association and the resolution by the company fixing the remuneration in Section 309(1) and thereby excluded any interference whether of any general law or by way of administrative action in the fixation of such remuneration."[28]

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25. Id. at p.1681 per Desh Pande, J.
26. The Company Law Board v. Upper Doab Sugar Mills, supra n.21 at p.836.
27. Ibid.
28. Upper Doab Sugar Mills v. Company Law Board, supra n.24 at p.1678, 1679 per Deshpande, J.

But, as observed by the Supreme Court, the legislative ceiling applies to remuneration only. The administrative ceiling covers other benefits and perquisites as well. When the administrative ceiling on remuneration including perquisites does not offend the legislative ceiling, there appears to be no harm.

Recently the Delhi High Court examined the validity of the administrative guidelines in Mahindra & Mahindra Ltd. v. Union of India.[29] Here the company appointed five persons as its directors and fixed their remuneration by a resolution of the company in general meeting. Thereafter an application was made to the Government for approval. The Government approved the appointments but reduced the remuneration to a maximum of Rs.1,20,000/- relying upon the administrative guidelines issued by the Government. The company challenged the order and also questioned the validity of the administrative guidelines. The Court held that the guidelines dated November 9, 1979 was violative of the provisions of the Act and ultravires the powers of the Central Government.[30] The Court observed that the Central Government had to fix the remuneration within the limits specified in the Act. The Government should have regard to the following conditions while fixing

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29. 1980 Tax.L.R.2132 (Delhi).
30. Id. at p.2144 per Prakash Narain, Ag.C.J.

remuneration:[31] (1) the financial position of the company; (2) the remuneration or commission drawn by the individual concerned in any other capacity including his capacity as sole-selling agent; (3) the remuneration or commission drawn by him from any other company; (4) professional qualifications and experience of the individual concerned; and (5) public policy relating to the remuneration. So the Court came to the conclusion that the Government cannot fix remuneration of a director nor can it formulate a policy nor can it give any administrative instruction except in accordance with the mandate of the Act.[32]

Similar view was taken by the Bombay High Court in All India Reporter Ltd. v. Union of India.[33] Here the Court held that while granting an approval under these provisions, the Government should take into account the relevant materials relating to financial structure of the company and its managerial structure.[34]

A comparative Analysis:

The managerial remuneration is subject to strict legal control in all countries. In England, the remuneration should

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31. Id. at p.2143 per Prakash Narain, Ag.C.J.
32. Ibid.
33. 1982 Tax.L.R.2422 (Bom.). See also All India Reporters Ltd., Nagpur v. Union of India, 1982 Tax.L.R.2429.
34. Id. at p.2429 per Sujatha Manohar, J.

be fixed by the articles or by the company in general meeting. The governmental interference is less compared to India.[35] But the Counter Inflation legislation in England required that, while the legislation is operative, the remuneration should be in accordance with the statutory requirement.[36] The remuneration should fall within the statutory limits, no increase may be paid less than twelve months after the last increase, and the restrictions on pay apply to other terms and conditions of employment including benefits in kind and other fringe benefits.[37] Australia follows the English practice in many respects in relation to remuneration of directors.[38]

Control over remuneration should be viewed not only as a means to prohibit flow of corporate funds to the managerial personnel. It could be used to guard public interest and to avoid exploitation of consumers. While in India the salaries of even low paid employees are sought to be regulated to contain inflation, it is astonishing to find that even the Sachar Committee dis-regarded this principle on the ground that 'cost of production' and 'total managerial remuneration' has no close relationship in India.[39] This is significant in

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35. See the Companies Act 1948, Sch.I, Table A, Art.76; For a general discussion on the remuneration of directors in England see Halsbury's Laws of England, Op.Cit. para 488 et seq.

36. The Counter-Inflation (Price and Pay Code) Order 1973.

37. Ibid.

38. See Yorston & Brown, Australian Secretarial Practice, (4th Edn.), p.318-319.

39. See the Sachar Committee Report, 1978, para 6.6.

the light of the observation of the Bootalingam Committee that managerial remuneration goes upto or over three lakh rupees even where workers get starvation wages.[39A]

The Sachar Committee has shown the hollowness of the system of approvals and sanctions in relation to managerial remuneration.[40] In 1976, out of the 858 applications considered, only 21 were rejected and in 1977, only 27 applications out of 712 applications were rejected. This shows that the approval system does not serve any worth-while purpose. As far as the public sector companies are concerned, the Bureau of Public Enterprises prescribes the guidelines for managerial appointment and remuneration. It has prescribed four pay scales for the chief executive including managing and wholetime directors in public sector undertakings according to the size and importance of the undertakings. It is better to prescribe such tentative pay scales for the public companies also. At least, it should be ensured that the total remuneration of managerial men including all perquisites and sitting fee for board meetings do not exceed ten times the total income of the least paid workar of the company with a maximum ceiling of Rs.1,20,000/-[41] In view of the recent decisions of the Courts, it is necessary to make amendments in the Act for this purpose.

39A. The Report of the Study Group on Wages, Income and Prices, 1978, Government of India, New-Delhi, paras 5.25 to 5.33.

40. The Sachar Committee Report, 1978, para 6.10.

41. This correspond to the salary allowed to the President of India. However, considering the cost of living and other factors some increase is justified.

Loan to Directors

There are strict regulations in the Companies Act to restrict the lending of money by a company to its directors. The following cases of loans shall not be given by the company without the previous approval of the Central Government:

(1) Loans to directors of the company or to the directors of its holding company or to any other partner or relative of any director.

(2) Loans to any firm in which such director of his relative is a partner.

(3) Loans to any private company of which any such director is a member or a director.

(4) Loans to any body corporate at whose general meeting any such director or directors control twentyfive percent of voting.

(5) Loans to any company whose board or other managers are accustomed to act in accordance with the instructions of the board of directors, any director or directors of the lending company.[42]

The company cannot even guarantee a loan taken by the directors from any other person and provide security for such loan. The prohibition extends to providing any security or guarantee for a loan given by the director to any person. But

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42. The Companies Act 1956, S.295(1).

a private company which is not a subsidiary of a public company and a banking company may give loans to its directors. The provision allows loans to be given by a holding company to its subsidiaries or by a managing agent to the managed company. Similarly a holding company may guarantee loan to its subsidiaries.

There is no guideline given in the Act as to the conditions under which the Company Law Board would allow payment of loans etc. to directors. However, the decision of the Mysore High Court gives some guidance in this respect. The court said:

> "It cannot be said that ordinary right to contract which an individual may have under the Contract Act is taken away from him, the moment he becomes a director of the company in the matter of entering into a contract with that company. The position of the director in certain respects is fiduciary. The point for examination in such cases is whether in a given situation, there arises any conflict between his duty as a director and interest as an individual. Apart from that essential circumstance which operate as an informative factor, the only other position that has to be examined is whether having regard to the terms and nature of the contract, the entering into the same is governed or controlled by any of the provisions of the Companies Act, like Sections 295, 297 etc."[43]

It is the duty of the directors, when it is brought to their notice that a loan has been advanced in contravention of

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43. S.M. Ramakrishna Rao v. Bangalore Race Club Ltd., (1970) 40 Com.Cas.674 (Mys.).

the provisions of the Companies Act, to immediately terminate the transaction irrespective of whether the period for which the loan is given had expired or not.[44] The Registrar of Joint Stock Companies also should, when it is brought to his notice that a loan has been given in contravention of the Act, take action against the directors or at least warn them not to repeat such illegalities in future.[45] For the purpose of this provision there is no difference between any loan or deposit and when the relationship of debtor and creditor is established, both these cases require the Government approval.[46] In Totalal v. State,[47] the director of a company was convicted for violation of the provisions of Section 295(4) of the Companies Act. The accused pleaded that the 'deposit' taken by the company cannot be treated as 'loan' for the purpose of Section 295. The Court disallowed this argument and said:

"It is to be remembered that both in case of a loan and a deposit there is relationship of a debtor and a creditor and the amount is repayable to the creditor ... the distinction ... has no bearing so far as the provisions of S.295 of the Companies Act are concerned."[48]

Register of Directors

There are a number of other requirements also under the Companies Act 1956, designed to control the activities of

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44. In re Conayan, A.I.R. 1942 Mad.452(1).
45. Id. at p.452 per Horwill, J.
46. Totalal v. State, A.I.R. 1963 Raj.6.
47. Id. at p.7 per C.B. Bhargava, J.
48. Id. at p.7 per C.B. Bhargava, J.

directors. Every company is required to keep at its registered office a register of directors, managing directors, manager, secretary etc.[49] The company should within thirty days from the appointment of its first director, or a change in the director board etc. should send to the Registrar a return in duplicate containing the particulars specified in the register.[50] The return should be accompanied by a notification in the prescribed form of any change among its directors, managing director, manager etc. specifying the date of the change.[51] The Registrar of Companies is also required to keep registers showing all those particulars mentioned above in relation to all companies.[52] The register is open for inspection by any member of the public.[53]

The Act makes the company liable for every default without proof of negligence and therefore no distinction can be made between facts which are available from record and facts which are not.[54] The time within which the director has to perform his duty by reporting a change is a statutory time and that cannot be extended by the Registrar.[55] If there is

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49. The Companies Act 1956, S.303.
50. For the contents of the registers, see Id., S.303(1).
51. Id., S.303(2).
52. Id., S.306.
53. Ibid.
54. Public Prosecutor v. Coimbatore National Bank, A.I.R. 1943 Mad.214.
55. See Chitley, Op.cit., p.59.

a delay in filing the returns, the return is invalid unless the delay is condoned by the Central Government.[56] If all the particulars as required under the section are not furnished in the return, then to that extent there is noncompliance and the persons may be punished.[57]

But the Registrar has no authority to pronounce as to the validity of a meeting electing the directors or to say that a particular office bearer had been duly elected. He has no power to return papers which have been sent to him under Section 303(2). He is duly bound to enter the particulars received by him under Section 303(2) from the company in a register. Where two conflicting returns are filed by two rival groups, the Registrar cannot decide upon the validity or otherwise of the returns filed and should not make entries till respective claims are decided by the Court.[58]

As stated earlier, a default itself entails penalty under this provision and it is not necessary to consider whether it is wilful or not.[59] So in a prosecution of the company for its omission to inform the Registrar of a change among its directors, it is not necessary to prove that anybody connected with the company had knowledge of the change.[60] Thus, in Public Prosecutor v. Coimbatore National Bank,[61]

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56. Ibid.
57. Ibid.
58. Jullundar District Registered Factory Owners Association v. Registrar of Companies, (1961) 31 Com.Cas.673 (Punj).
59. Krishna Mills Ltd. v. State, A.I.R. 1956 Ajmeer 78.
60. See supra n.54.
61. Ibid.

the Assistant Registrar of Joint Stock Companies initiated prosecution against the company for the non-compliance with the provision of S.87(2) of the Companies Act 1913. The accused proved that it had no knowledge of the change and was acquitted by the trial court. On appeal, the Madras High Court held:

> "It is unnecessary for the prosecution to prove that anybody connected with the company had knowledge of the change."[62]

So also a company accused under Section 303(2) cannot be acquitted in the preliminary stages on the strength of the provisions of Section 652 of the Act.[63]

In certain cases it is not necessary to send to the Registrar a notification in this respect. For example, by the re-election of the same directors, there is no change in the directorship and hence no need to file a return.[64] Similarly, the failure to file with the Registrar a notice regarding a change in the branch manager in a company does not attract the penal consequences prescribed by the section.[65]

In Sree Krishna Jute Mills v. Krishna Rao,[66] the directors of a company continued in office after they had been validly removed by a resolution passed at a meeting requisitioned by

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62. Id. at p.215 per Horwill, J.
63. State v. Akal Transport Co., A.I.R. 1959 Punj.22.
64. Krishna Mills Ltd. v. State, supra n.59.
65. Hiralal v. Emperor, A.I.R. 1918 Lah.170.
66. A.I.R. 1947 Mad.322.

the shareholders. The Madras High Court held that this amounted to a contravention of the Act, but an individual shareholder has no right to apply to the Court for issuing a direction to the removed directors to hand over the records.[67] So, if there is a wilful delay, the newly elected directors themselves have to apply for such order and file the returns. In another case, the Madras High Court held that a retired director cannot be held responsible for non-compliance with this provision.[68] Here a director of a company resigned from his post and he gave intimation to the Registrar in this regard. But the company failed to report the matter to the Registrar. On a prosecution for failure to file annual returns by the company, the Court held that the retired director was not liable for the default.

Every company is also required to keep a register showing the number, description and the amount of shares or debentures held by each directors.[69] The register should contain such other particulars also as prescribed in the Act.[70] The register should be open for inspection by the members of the company during the period beginning fourteen days before the date of company's annual general meeting and ending three days after the date of such meeting. The Central Government or the

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67. Ibid.
68. Abdul Haq v. Katpadi Industries Ltd., A.I.R. 1960 Mad.482.
69. The Companies Act 1956, S.307.
70. See ibid.

Registrar may at any time require a copy of this register. Any default in complying with this provisions or the refusal to send a copy of the register to the Government or the Registrar within a reasonable time after so required is visited with penalty.[71] The register kept under this provision should be open for inspection by any person acting on behalf of the Central Government or the Registrar.

Interested Directors

It is a fruitful source of misuse of power by directors to enter into contracts with the company of which they are directors either by themselves or through their relatives or firms or companies in which they are interested. But the Companies Act 1956 makes it obligatory to get the sanction of the board of directors for entering into such contracts.[72] For a company having a paid up capital of not less than twentyfive lakhs rupees, previous approval of the Central Government is also necessary.[73]

The consent or approval is necessary when the contract is for the sale, purchase, supply of goods, materials or services or for underwriting the subscription of any shares in or debentures of the company. However, if the goods are purchased or sold at the prevailing market prices or the contract is one which the company or the person regularly

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71. Ibid.
72. The Companies Act 1956, S.297.
73. Ibid.

trades, the formalities prescribed in the section may not be complied with unless the value of the subject matter of the contract exceeds five thousand rupees in a year. In the case of banking or insurance company, any transaction in the ordinary course of business of the company will not attract the provision. Even when the provision is applicable, contract may be entered into by the directors or their relatives in cases of urgent necessity, if the value of the subject matter do not exceed five thousand rupees. However, it should be got ratified within three months from the date of the contract.[74] By the mere fact that a director has friendliness with a party who enters into a contract with the company, or that a lawyer-client relationship exists between them, does not necessitate the taking of permission under this provision.[75]

Similarly, a contract of employment of a director as a managing or wholetime director does not require such approval.[76] When the facts and circumstances of a case require approval of the Central Government under Section 269 or Section 314(1B) or Section 294AA and also under Section 297, approval of the Government under Section 269, 314(1B) or Section 294AA of the Act would be enough and no separate approval under Section 297 is necessary.[77]

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74. The Companies Act 1956, S.297.

75. See Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holdings Ltd., A.I.R. 1981 S.C.1298.

76. See the Circular No.13/75 dated 5.6.1975 of the Department of Company Affairs, Government of India.

77. See the Circular No.18/76 dated 29.6.1976 of the Department of Company Affairs, Government of India.

The restriction is not confined in its application to contracts which are to be performed at some future time. It applies even to a sale or purchase or contract which is to be performed and completed at the moment it is entered into.[78] The intention is to ensure full disclosure of the facts of particular contracts of a director with the company so that they may apply their mind to the effects of such contracts on the company and then to give or withhold their consent. So a general disclosure is not enough for the purpose.[79]

A director of a company who is concerned or interested in a contract or arrangement entered into by the company, whether directly or indirectly, should disclose his concern or interest at the meeting of the board of directors.[80] This disclosure should be made in the first meeting of the board held after the director becomes concerned or interested.[81] A general notice to the board to the effect that he is interested in the particular transaction by his position as director of a private company or member of a firm etc. is sufficient.[82] Non-compliance with these provisions involve serious consequences like liability for prosecution, cessation

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78. Fateh Chand v. Hindsons (Patiala) Ltd., A.I.R. 1956, Pepsu 89.

79. Karnal Distillery Co. v. Ladli Parshad, A.I.R. 1960 Punj.655; See also Albert J. Judah v. Rama Pada Gupta, A.I.R.1959 Cal.715.

80. The Companies Act 1956, S.299.

81. Ibid.

82. Id., Sub-Section(3).

of the office of directorship and liability to refund all remuneration received by him as the director of the company.[83]

An interested director is prohibited from voting on any contract or arrangement in which he is so interested. His presence would not be considered even for the purpose of forming a quorum. They cannot take part in the proceedings of the board meeting. Penalty is provided for contravention of this provision.[84] However, the Central Government may exempt any company from the operation of this provision, if it is of the opinion that such exemption is in the public interest.[85] The public interest in this respect will be determined taking into account the desirability of establishing or promoting any industry, business or trade. Moreover a third party would not be put to suffer because of the non-compliance of the provisions by a director.[86]

Every company is required to keep one or more registers in which particulars of all contracts or arrangements in which some of its directors are interested are entered.[87] The register should contain particulars like the date of the contract, names of the parties to the contract, principal terms

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83. M.O. Varghese v. T. Stephen, (1971) Tax.L.R.965 (Ker.).
84. The Companies Act 1956, S.300.
85. Id., Sub-section (3).
86. Narayandas v. Sangli Bank, A.I.R. 1966 S.C.170. See also T.R. Pratt Ltd. v. M.T. Ltd., A.I.R. 1938 P.C.159.
87. The Companies Act 1956, S.301.

and conditions of the contract, date on which the matter was placed before board meeting etc.[88] This register should be open for inspection by the members of the company.

Directors Holding Office of Profit

Consent of the company accorded by passing a special resolution is necessary for a director to hold a place or office of profit in the company carrying a monthly remuneration of rupees five hundred or more.[89] The restriction applies to the director, a partner or relative of such director, a private company in which the director is a director or member etc. However, holding the position of a manager, managing director or wholetime director does not require such consent. Where the office or place of profit carries a total monthly remuneration of three thousand rupees or more, approval of the Central Government is necessary in addition to the consent of the company expressed by passing special resolution.[90] If a person holds office of profit in contravention of these provisions, he should be deemed to have been vacated his office and any amount received by him by way of remuneration should be refunded to the company. The company cannot waive the recovery of such money unless permitted by the Central Government. The provision prohibits a director of a company from holding office or place of profit in a subsidiary company also.

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88. Ibid.
89. Id., s.314.
90. Ibid.

A place or office by which any profit is derived would be considered as place of profit, and hence the office of sole-selling agent was considered as an office of profit.[91] The word 'office or profit' includes an office of profit which is not subsisting, substantive or permanent also. Moreover for appointing a director as a technical adviser etc., he should have some technical qualifications.[92]

Managing Agents, Secretaries and Treasurers

The offices of managing agent, secretaries and treasurers etc. had been abolished by the Companies (Amendment) Act 1969.[93] However, to prevent the re-entry of erstwhile managing agents and secretaries and treasurers into companies they managed previously under the pretext of other officers such as sole-selling agents, secretary etc., the Companies Act still contain provisions restricting their appointment. They can be appointed to the offices of secretary, consultants, adviser etc. only with the previous approval of the Central Government and with the decision of the company in general meeting. Any appointment made before the commencement of the Act has to be terminated within six months unless approved by the Central Government.[94]

Sole-Selling Agents

Sole agents of a company are treated as managerial

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91. C/o.National Co.Ltd. v. Shaligram Shaiharia, 1979 Tax. L.R.1629 (Cal.).

92. Madhura Hindu Permanent Fund Ltd. v. Govt. of India, 1977 Tax.L.R.2255 (Mad.).

93. The Companies Act 1956, S.324A.

94. Dalmia Cement (Bharat) Ltd. v. Union of India (1980) 50 Com.Cas.18(N.D.).

personnel of the company. The sole-agency system is controlled to attain different purposes. It tries to ensure fair distribution of products of the company and to control unhealthy trade practices prejudicial to public interest. It also tries to avoid diversion of company funds to the personal benefit of managerial men under the guise of sole-selling agreements.

Under the Companies Act 1956, the Central Government has the power to prohibit the appointment of sole-selling agents in respect of goods the demand for which is substantially in excess of production or supply of such goods.[95] The prohibition may be for a period specified in the notification issued by the Government in the Official Gazette. No individual, firm or body corporate who or which has a substantial interest in the company cannot be appointed as sole-selling agent of the company without the previous approval of the Central Government. In the case of a company having a paid-up share capital of rupees fifty lakhs or more, the appointment of sole-selling agents can be made only with the prior approval of the Central Government. For appointment of sole-purchasing or sole-buying agents also similar restrictions are applicable.[96] The Central Government has, by the Rules made under Section 294AA, prescribed the particulars that a company seeking approval under this Section should furnish.[97]

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95. The Companies Act 1956, S.294AA.

96. Ibid.

97. Id., Sub-Section (5); See also the Companies (Appointment of Sole Agents) Rules 1975 (G.S.R.137-E).

A company is prohibited from appointing a sole-selling agent for any area for a term exceeding five years at a time. But such agents can be reappointed for further periods not exceeding five years at any occasion.[98] Approval of the company in general meeting is necessary for such appointments or reappointments.[99] The board of directors cannot appoint a sole agent except subject to the condition that the appointment shall be invalid if it is not approved by the company in the first general meeting held after the date on which the appointment was made.

Approval of the Central Government is necessary for appointment of erstwhile managing agents as sole-agents of the company within a period of three years of the termination of managing agency system.[100] A special resolution should be passed in the general meeting approving the appointment of sole-agents.[101] If the appointment of the sole agent was made before the commencement of the Companies (Amendment) Act 1974 (41 of 1974), the approval ought to be obtained within six months from the commencement of the Act. On a failure to obtain such approval, the appointment would stand terminated on the expiry of the period of six months.[102]

Approval granted by the Central Government under this provision does not prohibit the Monopolies and Restrictive

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98. Id., S.294.
99. Ibid.
100. Ibid.
101. Id., Sub-Sections (3) & (7).
102. Id., Sub-Section (6).

Trade Practices Commission from making an order under the Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969). It can, after hearing the parties, decide whether the agreement relates to any restrictive trade practice or not.[103]

When a company has appointed sole-agents for an area, the Central Government can require the company to furnish information regarding the terms and conditions of the appointment in certain cases. Before issuing such an order, the Government should satisfy itself that there is good and sufficient reasons for issuing such orders. The Government may, on the basis of the information furnished by the companies, determine whether the terms and conditions are prejudicial to the interests of the company. If the company fails to furnish the required information, the Government can appoint a person to investigate and report the terms and conditions of appointment of the sole-agents. The Government may make variations in the terms and conditions of the appointment of sole-agents if the same is, in the opinion of the Government, prejudicial to the interests of the company. On such variation, these matters would be regulated by the terms and conditions as varied by the Government.

When a company has more than one selling agent in any area, the Government can require the company to supply information regarding the appointment of all selling agents for the

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103. Registrar of Restrictive Trade Agreements v. Mysore Kirloskar, 1976 Tax.L.R.1579 (MRTPC).

purpose of determining whether any of those selling agents should be declared as sole-selling agents for that area. The Government may appoint a suitable person to investigate these matters if the company neglects or refuses to supply such information. The company is under an obligation to give all assistance in connection in connection with the investigation which the company is reasonably able to give. Refusal or neglect of the company to furnish informations as required under this Section or to provide assistance to the inspectors in making the investigation is severely punished.[104]

Before the Central Government can investigate the terms and conditions of appointment of sole-agent, it is necessary to see that sole-agency relationship exists between the company and the person so appointed. The expression 'sole agent' or 'sole selling agent' is not defined under the Companies Act 1956 (1 of 1956). The Calcutta High Court took the view that if an individual or a firm or a company is given exclusive rights to sell goods of another person in a particular area, it is a sole selling agency in that particular area.[105] Here, a particular agent alone is given the selling rights in respect of all classes of goods or particular kinds of goods or a particular commodity manufactured by the company.[106] He may

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104. Id., S.294; punishment provided under the Section is "fine which may extend to five thousand rupees and with a further fine of not less than fifty rupees for every day after the first, during which such refusal or neglect continues."

105. Shaligram Jhaiharia v. National Co.Ltd.,(1965) 1 Comp.L.J. 112 (Cal.).

106. See National Co.Ltd. v. Shaligram Jhaiharia, 1979 Tax. L.R.1629 (Cal.).

even be a buyer with an exclusive right to sell the products manufactured by the company.[107] When any relationship of this kind is established, the Government may initiate action to implement the object of this provision.

A company cannot pay any compensation to its sole-selling agents for the loss of his office in the following cases:[108]

1) When the company in general meeting refuses to approve the appointment of sole-selling agents and thereby appointment ceases.

2) When the sole-agent resigns his office in view of the reconstruction of the company or of its amalgamation with any other body corporate and is appointed as the sole-agent of the reconstructed company resulting from amalgamation.

3) When the sole-agent resigns his office on any other manner.

4) When the sole-agent is guilty of fraud or breach of trust in relation to or of gross negligence in the conduct of his duty as the sole-agent.

5) When the sole-agent instigates or takes part, directly or indirectly, in bringing about the termination of the agency.

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107. Shaligram Jhaiharia v. National Co.Ltd., (1965) 1 Comp.L.J. 112 (Cal.).

108. Id., S.294A; See also Sugar Selling Agency Pvt.Ltd. v. R. Kannan, I.T.O., (1981) 51 Com.Cas.583 (Bom.).

The maximum amount of compensation payable to them is also specified. It is fixed as the total remuneration which he would have obtained for the unexpired portion of his appointment or three years, whichever is less. This is calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which his office ceased or terminated.[109]

The object of the provision is to place restrictions or curbs on power of the board of directors in the appointment of sole agents.[110] When the board of directors enter into a contract for the appointment of sole agents which is prejudicial to the interests of the company or its shareholders, the Central Government or the Company Law Board can intervene and vary the terms and conditions of the contract so as to make them no longer prejudicial to the company, notwithstanding the fact that the contract had been approved by the general meeting.

Section 294AA specifically deals with the appointment of sole-selling agents. In addition to the restrictions on the term for which such appointments can be made, it also provides for approvals of the company in general meetings to such appointment. It also confers on the Central Government the power to exercise supervision and control over such appointments by entitling the Government to vary the terms and conditions of the agency so as to remove its prejudicial effects on the company

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109. Id., Sub-section (2).

110. Arantee Manufacturing Corporation v. Bright Bolts Ltd., (1967) 37 Com.Cas.758(Bom); A.I.R. 1967 Bom.440.

and the shareholders. The Bombay High Court opined that since the appointment as sole-agent is highly lucrative, it is dealt with separately and restrictions imposed are more elaborate than in the cases of other offices and places of profit.[111]

The Division Bench of the Bombay High Court in Nanavati and Co. v. R.C.Dutt,[112] held that the order of the Company Law Board under this provision is administrative in its character and not quasi-judicial. However, the provisions are not discriminatory. The class of companies concerned are those that have sole selling agents with terms and conditions of appointment prejudicial to the interests of the company. This is a well defined class to the exclusion of other companies.[113] Moreover, guidelines can be found within the provision itself.[114] The authority has to consider the entire material that has reached it. It must honestly decide the matter on merits and without reference to expediency or policy. The sole-selling agent is entitled to know not only the nature of the changes proposed but also the reasons thereof together with the material on which the authority desires to act.[115] But for sufficient reasons, the Central Government can even completely abrogate a sole-selling agency contract. However, the Calcutta High Court was

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111. Firestone Tyre & Rubber Co. v. Synthetics & Chemicals Ltd., (1970) 2 Comp.L.J.200(Bom.).
112. Nanavati & Co. v. R.C. Dutt, 1974 Tax.L.R.1893 (Bom.).
113. Ibid.
114. The Companies Act 1956, S.394(5)(c).
115. Nanavati & Co. v. R.C. Dutt, supra n.112.

of the opinion that:

"Where a company while appointing another company as its sole selling agents by agreement also provide in that agreement for a renewal thereof for a further period of five years, the company could not be said to have contravened any provision of the Act in providing for a renewal of agency agreement."[116]

The Act limits the terms of sole agency for the benefit of the company and its shareholders. Then will it not be prejudicial to the interests of the company to allow to evade this limit? Is it not proper for the Government to intervene here and remove the prejudicial effects? It appears that the provis for reappointment after five years should be allowed only after obtaining the approval of the Central Government.

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116. Nanavati & Co. v. R.C. Dutt, (1967) 37 Com.Cas.171(Bom).

CHAPTER - 12

Borrowings and Lendings

The most common form of company funds is share capital. But the whole of the capital required for a company cannot be raised by issue of shares. So debentures and deposits also form part of the company's capital. The legal relationship between the two categories, share holders and the others are different. The fund raised by issuing debentures and accepting deposits can be more properly called 'loan capital.' Like the issue of shares, the acceptance of loans are also subjected to strict surveillance by administrative agencies. The Capital Issues Control Act 1947 (29 of 1947), the Foreign Exchange Regulations Act 1973 (46 of 1973) and other related laws are applicable in this case also.

The Central Government exercises as much control over the disbursement or diversion of corporate funds as that of borrowing by companies. Thus the disbursements by way of dividends, investment, loans to directors and employees, politic or charitable contributions, even the remuneration of directors, auditors and employees of the companies are also regulated. Controls over accounts and auditof companies tries to ensure full disclosure of company's affairs for the benefit of investor creditors and the community.

Debentures

Debenture denotes the document issued by a company acknowledging indebtedness in a specified sum and payable with interest on a specified date.[1] These documents do not carry voting powers.[2] Debentures includes debenture stock, bonds or other securities of the company whether constituting a charge on the assets of the company or not.[3] For issue of debentures, all the formalities as that of issue of shares are to be complied with. Thus the issue of prospectus, registration of prospectus and permission of the Controller of Capital Issues and the Reserve Bank etc. are common to both shares and debentures. In the case of debentures listed in stock exchanges, the dealings in debentures should conform to the stock exchange requirements also.

In the United Kingdom, borrowing of money, other than borrowing of money by any person in the ordinary course of business from a banker, require the Treasury's consent, where the aggregate of amount borrowed by the same person in the previous twelve months exceeds £10,000. This requirement is subject to wide exceptions and exemptions.[4]

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1. The term 'debenture' is defined in different ways. In Levy v. Abercorris Slate and Slab Co., (1888) 37 Ch.D.260, Chitty, J. defined it as "a document which either creates a debt or acknowledges it." See also Topham, Company Law, (12th Ed.) p.168; Viscount Maugham, in In Re Knights Lower Bridge Estates Ltd., [1960] A.C.613.
2. The Companies Act 1956, S.117.
3. Id., S.2(12).
4. See the Borrowing (Control and Guarantees) Act 1946, S.1(1) Proviso; the Control of Borrowing order 1958, Clause 1(2)(p) 'Person' here includes a company also.

Approval of the Government for Conversion of Debentures into Shares

When the terms of issue of debentures or the terms of raising loans by a public company includes a term providing for an option to convert such debentures or loans or part thereof into shares of the company, this can be done only with the approval of the Central Government or in conformity with any Rules made by the Government in this regard.[5] The Central Government has made rules specifying the conditions under which the approval of the Government is not necessary.[6] The issues should conform to the following requirements to get exempted from the requirements of obtaining approval from the Central Government.

1. The debentures or loans may be issued or raised either through public subscription or through the issue of a prospectus to the public;

2. A financial institution either underwrites or subscribes to or sanctions the whole or part of the issues of such debentures or the raising of loans as the case may be;

3. When and where necessary, the consent of the Central Government under the provision of the Capital Issues (Control) Act 1947, is obtained for the issue of shares consequent upon the conversion of debentures or loans into equity capital;

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5. The Companies Act 1956, S.81(3)(a).

6. See the Public Companies (Terms of Issue of Debentures and of Raising Loans) Rules 1977.

Having regard to the financial position of the company, the terms of issue of debentures or the terms of the loans, as the case may be, the rate of interest payable on the debentures or loans, the capital of the company, its loan liabilities, its reserves, its profits during the immediately preceeding five years and the current market price of the shares of the company, as may be applicable, the financial institution provides for the terms including the term providing an option to convert such debentures or loans or any part thereof into shares in the company or to subscribe for shares therein, either at par or at a premium not exceeding twentyfive percent of the face value of the shares.[7]

Acceptance of Deposits: Reserve Bank Controls

The Reserve Bank of India exercises considerable controls over the acceptance of deposits by all classes of companies.[8] Special rules are framed for regulating the invitation and acceptance of deposits by banking companies, non-banking financial companies and those accepting deposits for financing their own business such as manufacture or trade, known as non-banking non-financial companies. The Companies (Amendment) Act 1974 (41 of 1974), for the first time, empowered the Central Government to frame Rules in consultation with the Reserve Bank of India for regulating these deposits.[9] The Rules made under

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7. Id., Clause 3.
8. See the Reserve Bank of India Act 1934, Chapter III B.
9. See the Companies Act 1956, Ss.58A & 58B.

these provisions may provide the limit upto which, the manner in which and the condition subject to which deposits may be invited or accepted by a company either from the public or from its members.[10] The Companies (Acceptance of Deposits) Rules 1975, made by the Central Government regulate the acceptance of deposits by companies, not being a banking company or a financial company. Under these Rules deposits includes all kind of loans taken by the company except those specified in the Rules.[11] The subscriptions for shares, bonds, debentures, stock etc. are included in the list of exempted items.

Whether the renewal of deposits in excess of the limits violate these Rules? This question was considered by the Madras High Court in Saiani Textiles Pvt.Ltd. v. Assistant Registrar of Companies.[12] In this case, a criminal complaint had been filed against the company by the Assistant Registrar of Companies, Madras, under Sections 58A(4) and 58A(5) of the Companies Act 1956. The deposits received by the company including the deposits which were renewed by the company exceeded the statutory limit. The company argued that the renewed deposits should not be counted for the statutory limits. The Court held that the renewal of deposits also amounted to receiving fresh deposits. The Court said:[13]

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10. Id., S.58A.
11. The Companies (Acceptance of Deposits) Rules 1975, Clause 2(b).
12. 1981 Tax.L.R. 2419 (Mad.).
13. Id. at p.2421 per Suryamurthy, J.

> "This renewal amounts to receiving fresh deposits. The word "renew" also means 'to acquire again.' Therefore, the renewal amounts to receiving fresh deposits within the meaning of Section 58-A of the Act."

The major objective underlying these provisions is to protect the depositors by providing adequate disclosure requirements. The Central Government has power to decide in consultati with the Reserve Bank of India the question whether or not the Rules are applicable to a particular company.[14] The Government should decide these matters. Every company should file with the Registrar of Companies a return in the prescribed form duly certified by the auditor of the company. Such returns should contain information as on 31st day of March of that year and should be submitted on or before 30th June of that year. A copy of the return should be submitted to the Reserve Bank also.[15]

The Rules substantially reduce the limits upto which a company can accept deposits. There is also provision for maintaining liquid assets equal to a sum which shall not be less than ten percent of the amount of deposits maturing during the year ended on the 31st day of March in the form of bank deposits, unencumbered securities of State and the Central Governments, or unencumbered approved securities. The scope

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14. The Companies (Acceptance of Deposits) Rules 1975, Clause 9.

15. Id., Clause 10.

of the contents of advertisements to be made for accepting deposits have been made very wide. All these protect the investing public.

Deposit Insurance Scheme

To do justice to the depositors, the need to introduce deposit insurance scheme in line with the insurance coverage given to bank deposits cannot be overemphasised. But, both the Raj Committee[16] and the Sachar Committee [17] rejected the proposal. The reasoning given was that the deposits by commercial banks is under the scrutiny of and subject to regulation by the Reserve Bank of India, whereas no such controls are there with regard to company deposits. Again the risk involved in the company deposits vary from company to company depending upon its financial soundness.[18] Though the reasoning seems sound, it does not justify to leave the depositors to their destiny. Effective measures ought to be taken to see that company deposit also conform to the scrutiny of an independent agency like the Reserve Bank, and facility of deposit insurance given to company deposits also.

Mortgages and Charges

The borrowing power of a company is determined in terms of its memorandum. In the case of trading companies, however,

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16. The Study Group constituted by the Reserve Bank of India in 1974. They submitted a report in 1975.

17. The Report of the High-power Committee on Companies Act and MRTP Act, 1978, para 10.9.

18. The Sachar Committee Report 1978, para 10.9.

they have implied powers to borrow and this power includes the power to mortgage company's assets or create a charge upon them. Section 125 of the Companies Act 1956 makes it compulsory to register the charges within thirty days after the date of its creation. But, the Registrar of Companies is authorised to grant an extension of seven days time if the company satisfies him that it had sufficient cause for not filing the particulars and instrument or a copy of it within that period.[19] The following charges are to be registered:[20]

1. A charge for the purpose of securing any issue of shares.

2. A charge on uncharged share capital of a company.

3. A charge on any immovable property, wherever situate, or any interest therein.

4. A charge on any book debts of the company.

5. A charge, not being a pledge, on any movable property of the company.

6. A floating charge on any movable property of the company including stock-in-trade.

7. A charge on calls made but not paid.

8. A charge on a ship or any share in a ship.

9. A charge on goodwill, on a patent or a licence under the patent.

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19. The Companies Act 1956, Proviso to S.125(1).
20. Id., Sub-section(4).

In case of charges created out of India and solely comprising property situate outside India, the statutory time will be counted from the date on which it would have arrived in India by post, if despatched with due diligence. Where a charge is created in India, but comprises of property outside India, registration may be done by presenting a verified copy of the instrument.

The Registration of Charges

The Registration of charges is provided as a protection to the public. An unregistered charge is not void for all purposes and binds the company as long as it is a going concern.[21] But it is void against the liquidator and creditors of the company.[22] The delay in registration does not render registration ineffective.[23]

The duty of the Registrar here is very important. One of the objects of registration of charges under the Act is to provide information to persons dealing with the company with a view to prevent fraud. Of the other objects, one is to give solemnity of firm and legal importance to certain classes of documents which may afterwards be of legal importance. The

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21. T.R. Tyagaraian v. Official Liquidator, A.I.R.1959 Mad. 538; Aung Ban Zaya v. Chettiar Firm, A.I.R.1927 Rang.288; Lipping v. Buckingham, [1913] 1 Ch.D.241.

22. Calcutta National Bank v. Rangaroon Tea Co., A.I.R.1967 Cal.294; M.M. Maryappan v. Jayanthi Filing Madurai (Pvt) Ltd., A.I.R.1964 Mad.134; Dhramchand v. Francis Ranjan, A.I.R.1963 Assam 56.

23. Benares Bank v. Bank of Bihar, A.I.R. 1947 All.117.

general purpose appears to be, to ensure a record of the rights and obligations relating to immovable properties.[24] As the registration of charges created on the assets of a company is designed as a protection to the public, the Registrar is bound to avoid all unnecessary delays in registering a charge of which notice has been given to him.[25]

The duty of the Registrar to observe the principles of natural justice while refusing to register a satisfaction of charge was considered by the Gauhati High Court in Walford Transport (Eastern) India Ltd. v. S.K. Mandal.[26] In this case a company had entered into an agreement with a bank for over-draft facilities covered by a charge of company's assets. The charge was registered with the Registrar of Companies. The bank refused to honour the agreement and the company made a petition to the Registrar for recording satisfaction of charge. The Registrar gave two weeks time to the bank to show cause why the satisfaction of charge should not be registered. Within this notice period the company received a notice from the Registrar communicating it that the satisfaction of charge was registered. Thereafter, the Registrar send another letter to the company cancelling the order recording the satisfaction of the charge and containing the order for initiating proceedings for the purpose of adjudicating afresh the question whether

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24. Ibid.
25. Official Liquidator v. Sri Krishna Das, A.I.R. 1959 All. 247.
26. (1980) 50 Com.Cas.600(Gauhati).

the charge was satisfied or not. The company challenged this order. Dismissing the petition the Court observed:

> "...the Registrar is a judicial authority and was bound to observe the principles of natural justice in making any order affecting any right of the parties.... As such I have no difficulty in arriving at the conclusion that the communication and/or letter which purported to create rights in favour of the petitioner destroying some valuable rights of the respondent-bank is invalid as violative of the principles of natural justice and being an order rendered incomplete disregard of the provisions of the said principles fused in S.138 of the Act and, as such, is liable to be declared as invalid unless it can be shown that the invalidity of the pre-hearing notice has been insulated or cured by a full and fair de novo hearing/or post facto hearing."[27]

The Court upheld the order of the Registrar on the ground that the defect in the earlier order can be cured by a de novo hearting.[28]

If a property which is subject to a charge is purchased by a company, it may register such charge within thirty days from the date on which the acquisition is completed.[29] The omission of the purchasing company to give notice to the Registrar of the charge to which the purchased property is

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27. Id. at pp.607, 608 per K. Lahiri, J.
28. Id. at p.611.
29. The Companies Act 1956, S.127.

subject cannot free the property from the charge and make it available to the creditors of the company free of such charge.[30] When a series of debentures, subject to some charge are issued, or if such debentures are sold in more than one series, a return should be made to the Registrar.[31]

The Registrar, on receipt of the document should register in the prescribed form, all charges requiring registration. On payment of the prescribed fee he should enter in the register particulars specified in the relevant provisions of the Act. These particulars include the date of creating the charge or the date of acquisition of the property depending upon whether the charge is created by the company or the charge was existing on the property acquired by the company. It should also include the particulars of amounts secured by the charge, brief particulars about the property charged and the persons entitled to the charge.[32] The Registrar should keep a chronological index of the charges registered with him in pursuance of this provision. After this is done, he should give a certificate stating the amount secured by the instrument.[33]

If after the issue of debentures relating to immovable property by a company, the debenture holder gets them registered under the Companies Act and obtains a proper certificate for the same, nothing done subsequently by way of alteration by

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30. T.R. Tyagarajan v. Official Liquidator, A.I.R.1959 Mad.538.
31. The Companies Act 1956, S.128.
32. Id., S.130.
33. Id., S.131.

the Registrar of his own accord can affect the validity of the instrument as between the company and debenture holder.[34]

In Imperial Bank v. Bengal National Bank,[35] the Bengal National Bank had issued some debentures to the Imperial Bank and they were duly registered. But after the registration, the Registrar cancelled the registration on his own accord on the ground that the issue and acceptance of the debentures in question were ultra vires the memorandum of the Bengal National Bank. Regarding the validity of the action of the Registrar, the Calcutta High Court observed:

> "...(It) is clear that the plaintiffs did in fact register the debentures at the proper time with the Registrar of Companies, and they received from him the proper certificate showing that such registration had taken places, and, by the terms of S.114, Companies Act, that certificate is conclusive. Therefore, it must be taken that all necessary formalities in regard to the registration of the documents were complied with. It is quite true that subsequently the Registrar of Companies, owing to a mis-understanding, did make an alteration or even made a cancellation in the register with regard to these particular documents. I am, however, of opinion that nothing done by the Registrar of his own accord, after the plaintiffs had properly registered the documents, affected their validity as between the plaintiffs and defendants."[36]

Similarly, after registration certificate is granted, it is no longer open to challenge any of the mechanical steps

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34. Imperial Bank of India v. Bengal National Bank, A.I.R.1930 Cal.536.

35. Ibid.

36. Id. at p.537 per Costello, J.

of registration including the delivery of particulars or payment of the prescribed fees.[37] In Banaras Bank v. Bank of Bihar,[38] there was some dispute as to the fee eventhough the particulars of the charge were sent to the Registrar within the proper time. Due to this, registration was delayed for two years. Regarding the validity of a certificate issued thereafter, the Allahabad High Court said:

> "... in face of the certificate it is no longer open to the Banaras Bank to challenge any of the mechanical steps of registration, including the delivery of particulars and the payment of the prescribed fee."[39]

On payment or satisfaction in full of any charge relating to a company and requiring registration, the company should give intimation to the Registrar within thirty days.[40] The Registrar on receipt of such intimation should send a notice to the holder of the charge to show cause why the payment or satisfaction should not be recorded as intimated by the company. If no cause is shown within the stipulated time, he can enter a memorandum of satisfaction in the register of charges. If some cause is shown, he should intimate the matter to the company. The Registrar may if he

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37. Banaras Bank v. Bank of Bihar, A.I.R. 1947 All 117
38. Ibid.
39. Id. at p.122 per Braund, J.
40. The Companies Act 1956, S.138.

is satisfied that the debt for which the satisfaction is given have been paid or satisfied in full or in part or the part of the property or undertking charged has been released from the charge or has ceased to form company's property or undertaking, enter in the register of charges a memorandum of satisfaction in whole or in part, even if no intimation is given by the company.[41] He should furnish a copy of the memorandum of satisfaction to the company.[42]

In the United Kingdom also, a company is required to register charges of certain categories with the Registrar of Companies.[43] This should be done within twentyone days after creating the charge. The power to extend the time for registration is conferred on the Courts. The non-compliance of these provisions makes the charge void against the liquidator and any creditor of the company.[44] But the omission to register does not prejudice any contract or obligation for repayment of the money secured by the charge and, where the charge becomes void for want of registration, the money secured by it becomes payable immediately.[45] It is the duty of the company to send to the Registrar for registration the particulars of every charge created by it and of every issue of debentures of a series requiring registration. Default in this respect is visited with penalty.

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41. Id., S.139.
42. Id., S.140.
43. The Companies Act 1948, S.95(1),(2)
44. Id., S.95(1); Independent Automatic Sales Ltd. v. Knowles and Foster, [1962] 3 All E.R.27.
45. Id., S.96(3).

The Registrar's powers in respect of registration and release of charges are similar to the Indian position.[46]

The function of the Registrar in these matters are of great importance requiring legal skill. The procedure, especially procedure relating to the release of charges, is of a judicial nature. It seems to be better if the powers of the Registrar in this respect except the process of registration, be transferred to an independent tribunal.

Rectification of the Register of Charges

The Companies Act confers a wide judicial discretion on the Company Law Board in ordering rectification of the register of charges of a company. The scope for interference by the Company Law Board is very wide. The company or any aggrieved person may make an application to the Company Law Board for this purpose.[47] When there is an omission to file with the Registrar the particulars of charges created by a company or of any charge subject to which any property was acquired by the company, the Company Law Board may grant an extension of time for registration. The power includes cases of omission to register modification of charges and the failure to intimate the payment or satisfaction of a charge. But relief would be granted only if the omission or mis-statement is accidential, or due to inadvertence or to some other sufficient cause. The failure should not be

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46. Halsbury's Laws of England, (4th Edn.), Vol.7, para 872 et. seq.

47. The Companies Act 1956, S.141.

of a nature prejudicing the creditors or the shareholders of the company. The Company Law Board should be satisfied that it is just and equitable to grant the relief.

The law confers a wide discretion on the administrative body. In the exercise of this discretion it is not material even to consider "the solvency or otherwise of the company, the presence or absence of any judgement against it or the pendency of a winding up petition."[48] But when a winding up order is made no order for extension of time could be passed,[49] the reason being, the petitioner may be able to enforce an unregistered charge against the liquidator and may thus acquire priority over the other creditors of the company, if such an order is passed. Similar is the situation when after a winding up order has been passed and liquidator appointed, the Central Government by order takes over the management with the leave of the Court.[50] However, there is no jurisdiction to order the deletion of the whole of the registration,[51] or grant interim relief[52] under these provisions.

Payment of Dividend

Every shareholder of a company has a right to get a share in the profits of the company. But until the declaration is made, the enjoyment of the benefit is delayed.[53] Nothing in the Companies Act 1956 specifies the rate or priorities of

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48. Thuppan Nambudiri v. Sankara Menon, A.I.R. 1955 Mad.35.
49. In re Dinshaw & Co. A.I.R. 1937 Oudh.62.
50. In re Krishna Silicate and Glass Works, 1975 Tax.L.R. 1253 (Cal.).
51. Re. C.L. Nye Ltd., [1970] 3 All E.R.1061 (C.A.).
52. Re Healthstar Properties Ltd., [1966] 1 All E.R. 628.
53. Bacha F. Guzdar v. Commissioner of Income-tax, Bombay, A.I.R. 1955 S.C. 74.

dividend or the manner in which it is to be declared and paid. But when dividend is declared, it becomes a statutory debt from the company to its share holders and should be paid within fourtytwo days.[54]

Declaration and payment of dividend by a company is subject to certain statutory restrictions. Administrative regulations are also provided to control company's discretion in these matters. The fundamental principles underlying these controls are that dividend shall never be allowed to be paid out of the capital of the company and that it shall be paid only out of profits.[55]

Legally available sources for the payment of dividends are (1) the profits of the company for the year for which dividends are to be paid; (2) the undistributed profits of the previous financial years; and (3) any money provided by the Central or a State Government for the payment of dividends in pursuance of a guarantee by the Government concerned.

After the Companies (Amendment) Act 1960 (65 of 1960), it is obligatory on the part of all companies to provide for depreciation, out of the profits, before declaring or paying dividend.[56] The depreciation shall be provided not only for the financial year for which dividend is to be declared but also for any previous year (after the companies(Amendment) Act 1960), for which provision for depreciation was not made.

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54. The Companies Act 1956, S.205A
55. Id., S.205
56. Id., S.205(1)(a)

If the company had incurred any loss during any previous financial year, the amount of loss or an amount which is equal to the amount provided for depreciation for that year, whichever is less, should be set off from the profits of the company.

The Act incorporates a precise and equitable mode of ascertaining depreciation.[57] The provision for depreciation may also be made on any other basis approved by the Central Government. But for the approval, the method should have the effect of writing off by way of depreciation ninetyfive percent of the original cost of the company of each depreciable asset on the expiry of the specified period.

The Central Government may allow any company to declare and pay dividend for any financial year without providing for depreciation. But such payment shall be allowed only when it is satisfied that 'public interest' demands such a course.

Compulsory Reserves

The Companies (Amendment) Act 1974, brought further restrictions on the payment of dividends. Now it is obligatory for all companies to transfer a certain percentage of profits (not exceeding ten percent) to the compulsory reserves of the company before declaring or paying any dividend.[58] Moreover,

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57. See id., Ss.205(2) & 350
58. The Companies (Amendment) Act 1974, S.18

when the company has declared a dividend, but not paid within fourty two days from the date of declaration, the unpaid dividend should be deposited in a scheduled bank in a special account called "Unpaid Dividend Account". This should be done within a period of seven days from the date of expiry of the statutory period. In the case of unpaid dividend in the hands of the company at the commencement of the Amendment Act 1974 (41 of 1974), it should be transferred to the "Unpaid Dividend Account" within a period of six months from the commencement of the Act. If any money transferred to the "Unpaid Dividend Account" of a company remains unpaid or unclaimed for a period of three years from the date of transfer to the account, the company should transfer such amount to the "General Revenue Account" of the Central Government. At the time of such transfer, the company should submit a statement in the prescribed form setting forth in respect of all claims included in the transfer, the nature of the sums, the names and the last known addresses of the persons entitled to receive the sum, etc.

Refund of Money Transferred to the General Revenue Account

For any money transferred to the "General Revenue Accoun the Reserve Bank of India would issue a receipt to the company. Any person entitled to any money so transferred, may apply to the Central Government for an order of payment of the money claimed. On such application the Central Government would, after making proper enquiries, order for payment. The Central

Government should satisfy that the person claiming the amount is entitled to receive it. Further it may take suitable security from him.[59]

Declaration of Dividend Out of Accumulated Profit

The Central Government may permit any company to declare dividend out of the accumulated profits earned by the company in the previous years but transferred to the reserve fund. Such permission will be granted when owing to inadequacy or absence of profit, the company is unable to declare any dividend for a particular year.

Capitalisation of Profit

The company may, if so authorised by its articles, transfer a larger percentage of its profits to the reserves. It is also lawful for a company to capitalise profits, issue fully paid-up bonus shares to its members or pay up any amount for the time being unpaid on any shares held by the members of the company. But for the capitalisation of profits, a resolution of the company in general meeting is necessary. As a general rule, only such funds can be capitalised as would be available for dividend distribution.[60]

For the issue of bonus shares, all the restrictions for the issue of shares would apply. A bonus issue is not exempted under the Capital Issues (Exemption) Order 1969, and the Governments' approval is to be obtained.

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59. Id., S.19

60. See id., Table A, Article 96; Dimbula Valley (Ceylone) Tea Co. v. Laurie, [1961] 1 All E.R.769.

Rules Relating to Reserve Fund

The Central Government has framed Rules governing the transfer of profits to the reserve fund,[61] declaration of dividend out of reserves,[62] and transfer of unpaid dividend to the "General Revenue Account" of the Central Government.[63] Accordingly, the percentage of profits to be transferred to compulsory reserves are as follows:[64]

Proposed Percentage of Dividends	Amount to be transferred to Reserves
Less than 10%	Nil.
Between 10% & 12.5%	2.5% of the current profits
Between 12.5% & 15%	5% of the current profits
Between 15% & 20%	7.5% of the current profits
Above 20%	10% of the current profits

Conditions are also laid down regulating the voluntary transfer by a company of a percentage higher than ten percent of its profits to its reserves for any financial year. There should be a minimum distribution sufficient for the maintenance of dividends to shareholders at a reasonable rate.[65] The rate of dividend payable to shareholders shall not be less than the rate at which dividends were declared by it for the three years immediately preceeding the year.

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61. The Companies (Transfer of profits to Reserves) Rules 1975
62. The Companies (Declaration of Dividend out of Reserves) Rules 1975.
63. The Companies Unpaid Dividend (Transfer to General Revenue Account of Central Govt.) Rules 1978.
64. The Companies (Transfer of Profits to Reserves) Rules 1975 Clause 3
65. Id., Clause 3

Declaration of Dividend when there is Inadequacy of Profit

In the event of inadequacy or absence of profits in any year, dividend may be declared by the company for that year with the approval of the Central Government out of the accumulated profit earned by it in the previous years and transferred by it to the reserves.[66] But, the following conditions should be satisfied :-

1) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the five years immediately preceding that year or ten percent of its paid up capital, whichever is less.

2) The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed an amount equal to one tenth of the sum of its paid up capital and free reserves and the amounts so drawn shall first be utilised to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared; and

3) The balance of reserves after such drawal shall not fall below fifteen percent of its paid up capital.

Returns to the Registrar

When a company is required to transfer its money held

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66. The Companies (Declaration of Dividend out of Reserves) Rules 1975, Clause 3.

in 'Unpaid Dividend Account' to the "General Revenue Account" of the Central Government, it should be transferred to any of the branches of the Punjab National Bank, specified in the Rules.[67] A statement in the prescribed form should be furnished to the Registrar.[68] Every company along with the annual report, should furnish to the Registrar a certificate to the effect that the whole amount of dividend remaining unpaid or unclaimed for a period of three years from the date of transfer to the special account has been transferred to the "General Revenue Account" of the Central Government. Thereupon the Registrar of Companies would maintain in his office, separate accounts in respect of each company whose unpaid dividends and interests thereon are transferred to the "General Revenue Account" of the Central Government.[69] Claims for repayments should also be made in the form of application to the concerned Registrar. The mode of dealing with the application is prescribed.[70]

The purpose of these stringent controls over payment of dividends appears to be to prevent misuse of money due to the shareholders, by the management. If the accumulated reserves are used as a plough back for furtherance of the

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67. The Companies Unpaid Dividend (Transfer to General Revenue Account of Central Govt.) Rules 1978, Clause 3.
68. Id., Clause 4.
69. Id., Clause 5.
70. Id., Clause 4.

company's business, it would be prejudicial to the public interest. So, it is necessary to control the payment of dividends out of reserves. But, why should the unclaimed dividends be transferred to the "General Revenue Account" of the Central Government? It appears to be an unfair way of robbing companies of their money, a type of 'escheat'. It could be left with the company as a special reserve, with a condition that this special reserve shall be maintained with the same sanctity of share capital.

Contribution to Charitable and Other funds

As a rule, company's funds cannot be diverted to any kind of charity even if there is an unrestricted power to that effect in the company's memorandum. According to Eve, J. to make a charitable contribution valid, the following three conditions should be satisfied:[71]

1. The transaction should reasonably be incidental to the carrying on of the company's business.
2. It should be a bonafide transaction.
3. It should be done for the benefit and to promote the prosperity of the company.

Thus, charity is allowed only to the extent to which it is necessary and reasonable in the management of the affairs of the company. There must be a proximate connection between

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71. Re Lee, Behrens & Co. Ltd., [1932] 2 Ch. 46

the gift and the company's business interests.[72]

The Companies (Amendment) Act 1969 (19 of 1969) completely prohibited contribution to any political party or for any political purpose. But the Calcutta High Court held that payment of advertisement charge in a political journal is not a political contribution. The Court said:

> "A contribution is an aid or payment without any consideration. Admittedly, the payment for insertion of an advertisement cannot be deemed to be a contribution as some benefit by way of publicity is being derived. By advertisement, company can draw attention of the public towards their products with the ultimate object of selling or marketting them. Therefore, an advertisement not being a contribution, the ingredients of section 293A cannot be deemed to have been attracted."[73]

Though the prohibition under section 293-A is wide enough to include any direct or indirect donation, subscription or other payment or provision for any services or assistance etc. to a political party, the decision in this case opens a new outlet. The loophole created by the above decision needs to be averted. Even the payment for advertisements shall be subject to approval of the Central Government, if the advertisement is made in a journal published by or under the direct control of a political party.

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72. Evans v. Brunner, Mond & Co., [1921] 1 Ch.359, See also the Companies Act 1956, S.293(e)

73. Graphite India Ltd. v. Dalpat Rai Mehta, (1978) 48 Com. Cas. 683 (Cal.)

Companies are expressly authorised to make contributions to the National Defence Fund, or any other fund approved by the Central Government for the purpose of national defence.[74]

Investments and loans

"If the private enterprise is to be regulated in the public interest, a proposition which commands wide acceptance in the country," observes Hazari, "intercorporate investments has to be regulated to prevent anti-social use of the opportunities available and to direct or redirect investments in accordance with plan."[75] Restrictions on intercorporate loans and investments are made mainly to control undue concentration of economic power in a few hands.[76] However, it is also used as a method to prevent dissipation of company's resources.

Under the Companies Act 1956, the board of directors of a company is entitled to invest in the shares or debentures of another body corporate only upto ten per cent of the latter's subscribed capital. This itself is subject to the following conditions:-[77]

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74. The Companies Act 1956, S.293-B.

75. R.K.Hazari, "The structure of the Corporate Private Sector - A study of concentration, ownership and control", Asia publishing Co., Bombay, (1966), p.359.

76. A detailed discussion is made in the Chapter 9.

77. The Companies Act, S.372.

1. The aggregate of such investments made in all such other body corporate does not exceed 30% of the subscribed capital of the investing company.

2. The aggregate of such investments in all other bodies corporate in the same group as the investing company does not exceed 20% of the latter's subscribed capital plus reserves.

These limits can be exceeded only by a resolution of the company and with the approval of the Central Government.[78] Exceptions are provided in cases of (1) investments in right shares; (2) investments by companies whose business is to invest in other companies; (3) investments by financial institutions duly recognised by the Central Government; (4) investment by holding companies in their subsidiaries etc.

While granting approvals[78A] for investments or loans

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78. Ibid., But the Calcutta High Court has held that for purchase of shares of another company, previous approval of the Central Government is not a condition precedent under Section 372(4), See Mathura Prasad Saraf v. Company Law Board, 1979 Tax. L.R. 2123 (Cal.).

78A. The following table shows that approvals for intercompany loans are not granted as a matter of course:

Year	Total applications received	No.of cases where permission is granted	No.of cases where permission is rejected.	Cases withdrawn	Pending
1961-62	28	10	-	-	-
62-63	33	20	6	-	7
63-64	30	20	8	-	2
67-68	91	46	8	4	33

in excess of the limits laid down by the statute, the Company Law Board should take into account the following matters :-

1. Financial position of the investing company, (2) financial position of the borrowing company, (3) the security offered, (4) the rate of interest on loans, (5) the terms and conditions for repayment of loans, (6) the purpose for which the loan is proposed to be given and (7) the position of the loans and investments of both lending and borrowing companies.

Where a company had made any investments or loans in excess of the limits before the commencement of these provisions without observing the formalities laid down in the section, it should dispose of excess investments within six months from the commencement of the Act.[79] However, investment made by a holding company in its subsidiary does not require Government's approval.[80] In M.Velayudhan v Registrar of Companies,[81] the Kerala High Court considered the need to observe the requirement of the Government's approval while a holding company is making investments in

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79. The Companies Act 1956, S.372(6)

80. M. Velayudhan v. Registrar of Companies, (1980) Com. Cas. 33 (Ker.)

81. Ibid.

its subsidiary. The Registrar of Companies had initiated prosecution against the directors of a company for not taking prior permission of the Government for making investments in excess of the limits. But the complaint was quashed by the Court on the ground that the investment was in its subsidiary and there is no obligation for the holding company to take prior permission for making the investment. Similarly, in Oriental Industrial Investment Corporation v. Union of India,[82] the Delhi High Court held that when a company has power to appoint majority of directors of another company, an investment made by the former in the latter company is not required to be approved by the Central Government.[83]

These decisions creates some difficulty in the control of investments. A company can escape from the obligation to take permission of the Government by making an arrangement with the company in which investment is made. This position needs change.

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82. (1981) 51 Com. Cas. 487 (Delhi)

83. See also M.N.Krishna Aggarwal v. Akhila Kerala Viswakarma Sabha, 1981 Tax. L.R. 2465 (Ker.)

CHAPTER 12

Accounts and Audit

Objectives of Control over Accounts and Audit

The audited accounts of a company ought to be simple and objective providing adequate and meaningful disclosure for the benefit of shareholders, the workers and the community at large. That means the accounts shall not be a confusing mass of figures but should assist the uninformed in drawing meaningful inferences.[1] Proper administration of corporate accounting is the interest not only of the creditor or the shareholder but also of the general public and the Government; and public morality is involved in the mal-administration of corporate funds.[2] Another policy of the Government in relation to company accounts is that the shareholders should know fully about the affairs of the company in which they are investing money. For the purpose of achieving the above objectives, a

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1. See the Sachar Committee Report, (1978), Para 8.2
2. Basudev Banerjee, 'Company Law and Accounts', contained in Proceedings of the Seminar on current problems of Corporate Law, Management and Practice, (Ed.) Indian Law Institute, New Delhi, (1964), p.326.

number of administrative control measures are provided in the Companies Act 1956.

The requirements of keeping proper books of accounts and compulsory periodical audit are some of the major techniques to prevent the misuse of company's funds by the management. The Central Government is given powers in relation to these matters. In addition to the insistance on the regular filing of returns and other statements, the Registrar or any officer authorised by the Central Government has power to inspect the books and accounts of a company. The Government may order a special audit or a cost audit, whenever it is deemed necessary.

The function of accounting under the company law is not merely chronological recording of transactions. As a social institution, companies are accountable to the community at large and the accounting function is essentially a mechanism to attain this object. A more manifest aspect of accountability is audit. Audit under company law ensures that the large stakes involved in companies are subject to expert scrutiny. But the appointment of auditors, their relationship with the management, their conditions of service and a number of other incidental matters dilute the controls over accounting and audit in our present system.

Different Types of Accounts to be Kept by A Company

The Companies Act 1956 (1 of 1956), makes it obligato for companies to keep two kinds of accounts (1) Original

books of accounts in which transactions are entered as they occur. There should be proper accounts for the receipts, disbursements, sale, purchase, assets, liabilities etc. The Central Government may, in addition, require any specified class of companies engaged in production, processing, manufacturing or mining activities to maintain prescribed cost records of particulars as to the utilisation of material or labour or other items of cost;[3] (2) Annual accounts showing the results of the company's trading during the period to which they relate and the company's assets and liabilities at the end of that period. Manufacturing companies are required to keep book showing particulars relating to utilisation of materials, labour and other items of cost.[4]

These accounting requirements are intended to benefit all classes of people interested in the affairs of the company. For example, it supplies to directors the information as to company's financial position so that they may better plan its trading activities and may avoid committing irregularities such as the payment of dividend out of capital or borrowing beyond the limits set forth in the articles. This enables the shareholders to judge whether the affairs of the company are being competently managed and to estimate approximately the value of their shares. To the creditors, it enables to judge

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3. The Companies Act 1956, S.209(1)

4. See the Manufacturing and Other Companies (Audit Report) Rules 1975

whether the company will be able to pay their debts and whether they may safely afford it further credit. In the event of winding up, it provides information to the liquidators as to what assets he may realise and what claims against the company he has to meet. To the community, it helps to assess the performance of the company in relation to environmental cleanliness, consumer protection, labour relation, increasing employment potentials etc. However, it can be seen that these interest groups have no effective remedy if they do not approve the accounts presented by the company.

Books of Accounts

The board of directors of the company should keep the books of accounts of the company in its registered office. But they may decide to keep these books of accounts at a place in India, other than the registered office of the company. For doing so, they should give a written notice to the Registrar describing full particulars of that place, within seven days of their decision. If a company has branch offices, whether within or outside India, it would be enough if such offices maintains these accounts separately. They are required to forward to the head office proper summarised returns at intervals of not more than three months. No intimation to the Registrar is required in this connection.

The maintenance of proper books of accounts and relevant records is the responsibility of those incharge of the management of the company. All employees, officers, directors

and other persons are also responsible for such maintenance.[5] The company is required to preserve its records for a minimum period of eight years so that non-availability of records might not hamper any investigation that may be instituted into its affairs.

Inspection of Books and Accounts

The books of accounts and other books and papers should be open to inspection by any director during business hours.[6] The Registrar of Companies or any duly authorised officer of the Central Government is entitled to inspect all books and accounts of the company. They may call for any information or explanation as may be deemed necessary. They can even compel production of books before them at a specified time and place.[7] The Reserve Bank of India has also a right to inspect the books and papers of companies including all non-banking companies.[8]

The articles of association of a company usually contains provisions for keeping of accounts. This may provide the conditions and circumstances under which a member other than a director can inspect the books of a company. As a general rule, shareholders have no right to inspect the books of accounts of a company, unless such inspection are expressly

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5. The Companies Act 1956, S.209(4)A.
6. Id., S.209(4).
7. Id., S.209A.
8. The Reserve Bank of India Act 1934, S.45 N.

provided in the articles.[9] However, statutory right to inspect specified books, registers, minutes etc. of the company has been given to the shareholders under various provisions of the Companies Act.[10] But this is not sufficient for him to ascertain whether the accounts of the company are kept in the proper manner.

The directors have a statutory right to inspect all books and papers of a company.[11] Though it is a personal right of a director for the discharge of his function as a director, the Bombay High Court has expressed the opinion that he may even inspect the books of accounts through an agent.[12]

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9. Usually articles of association leave this matter to the discretion of the board of directors. For example see Schedule-I to the Companies Act 1956, Table-A, Regulation 93, which reads "(1) The boards shall from time to time determine whether and to what extend and at what time and place and under what conditions or regulations the accounts and books of the company or any of them shall be open to the members, not being directors; (2) No member (not being a director) shall have any right of inspecting any account or book or document of the company except as authorised by law or authorised by the board of the company in general meeting."

10. See infra Chapter 15.

11. The Companies Act 1956, S.209(4)

12. Vakharia v. Supreme G.F. Exchange Co. Ltd., (1948) 50 Bom. L.R. 140.

If this position is taken as a good law, the denial of the right of inspection to shareholders would seems to be unjustified. The right of inspection by the directors extends only to account books and other connected papers only and does not extend to any other paper like nomination paper or other scripts.[13]

In England also, the law relating to keeping books of accounts of a company and the powers of shareholders and directors for inspection[14] is not much different. But the right of inspection is not given to the Registrar or the Board of Trade.[15] Moreover, the Courts have held that the purpose of law is to impose criminal sanctions. So the directors have no civil right enforceable by injunction, but merely implicit recognition of an existing common law right. But the failure to keep proper books of account may subject the directors and other officers to punishment for false accounting and publishing of false statements or accounts under the Theft Act 1968.

Under the present conditions, the powers enjoyed by the Registrar or other administrative authorities are salutary. If the company fails to maintain proper books of accounts as

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13. Kanagasabapathy v. T.M.Shanmugham, (1972) 42 Com. Cas. 596.
14. See Halburys Laws of England, (4th edn.) Vol.7, Op.Cit. para 625 ff.Op.Cit.
15. See the Companies Act 1948, S.147.

are necessary to give a true and fair view of the company's affairs, the interest groups in the company, like the shareholders, creditors, environmentalists, consumers, labour etc. have not even a chance to know the matter except when the auditor has revealed it in his report. But interference can be made by administrative agencies.[16] It is the only check to see that the responsibility of managerial personnel for compliance with the requirements of the Act is not easily evaded. This is more so because of the following observation by the Bombay High Court. The Court said :

> "[The directors who] appear to have been on the public register of this company as directors for some period of time for which the accounts are compiled by the auditors and explanations are sought, they would be liable to answer [the queries for the period during which they were acting as directors]."[17]

The object of inspection of books and accounts of the company is not limited to keep a watch on the performance of companies. This should also enable the authorities to evaluate precisely the level of efficiency in the conduct of the affairs of the company concerned. It would enable the Government to ascertain the quantum of profits which have accrued but not adequately accounted for taxation purposes; concealment of income by falsification of accounts, misuse

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16. See supra nn.6, 7 & 8; See also Conway v. Petronius Clothing Co. Ltd., [1978] 1 All E.R.185.

17. In re Bhavnagar Vegetable Products, Ahmedabad, 1977 Tax. L.R. 2225 (Guj.) at p p.2228, 2229

of fiduciary responsibilities by the management for personal aggrandisement, misapplication of funds when the company itself is in a state of perpetual crisis etc. If such irresponsible and fradulent activities are not prevented by taking effective and emergent remedial measures, the company may go into liquidation causing distress to the workers, consumers and community as a whole.

Annual Accounts

For the purpose of annual accounts, companies are classified into profit making companies and non-profit making companies. The former should lay before the annual general meeting a profit and loss account and balance sheet. The latter should present an income and expenditure statement and a balance sheet.[18]

The Registrar's Power to extend the Financial Year

The profit and loss statement for the first annual general meeting should indicate the transactions right from the date of incorporation. The period shall end with a day which does not precede the day of the meeting by more than nine months. For the subsequent meetings, the account period should start with the day immediately after the period for which account was last submitted. The period shall end with a day which should not precede the meeting by more than six

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18. The Companies Act 1956, S.210(1).

months. If any extension under Section 166(1) is granted for holding general meeting, the prescribed period shall also be extended by the period of extension so granted. The profit and loss accounts should show the revenue transactions for the financial year. The period of financial year shall not exceed fifteen months. But the Registrar of Companies can extend the period upto eighteen months.[19]

Form of Accounts

The accounts should be presented in the prescribed form[20] or as near thereto as the circumstances may permit. However, the Central Government may give approval for using other forms also.[21] In any case, the balance sheet should show a true and fair view of the state of affairs of the company as at the end of the financial year.[22] A holding company should annex with its balance sheet the following documents of its subsidiary:[23] (1) copy of the balance sheet; (2) copy of the profit and loss account; (3) copy of directors report; (4) copy of auditor's report; (5) a statement detailing holding company's interest in the subsidiary at the end of the previous financial year of the subsidiary company; (6) the details showing the profits or loss made by the subsidiary

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19. Id., Proviso to S.210(4)
20. Id., Part-I of Schedule VI.
21. Id., S.211
22. Ibid.
23. Id., Ss. 212 & 213

since the date of becoming a subsidiary to the holding company and the net aggregate amount of profit or loss made by the subsidiary company in the previous financial year, but not reflected in the accounts of the holding company. This requirement is very important considering the view expressed by the Kerala High Court in M.N. Krishna Asaari v. Akhila Kerala Viswakarma Sabha.[24] In this case the Court held that the inclusion of a debt in a balance sheet duly prepared and authenticated would amount to an admission of a liability;[25] (7) where the financial year of the holding company and the subsidiary company is not the same, a statement should be incorporated detailing the change in interest of the holding company in the subsidiary together with records of any material change in the assets and liabilities of the subsidiary company, its investments, money lend by it and money borrowed; (8) if the directors cannot provide this information, a statement indicating their inability to do so should also be incorporated.

Duty to Send Reports

Every balance sheet of a company should be complemented with a profit and loss account and a report by the auditors.[26] It should also contain a report by the board of directors reflecting the working of the company during the last financial

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24. 1981 Tax.L.R.2465 (Ker).
25. Id. at p.2468 per Janaki Amma, J.
26. The Companies Act 1956, S.216.

year with respect to the state of company's affairs, the amounts proposed to be carried to reserves, the amount it recommends by way of dividends, material changes and commitments which have affected the company's financial position etc.[27] These documents, the balance sheet and profit and loss account are to be signed by at least two directors and the secretary or manager or managing director.[28] The balance sheet with all its enclosures are to be send at least 21 days before the scheduled date of the meeting to all its members, debenture holders, trustees for debenture holders, persons eligible for a share resultant on the insolvency of a member and the company's auditors.[29] It is the duty of all officers of the company to make fullest possibl disclosure and provide all the necessary information they possess to the auditors of the company as well as to the company itself.

Administrative Control over Annual Accounts

Administrative controls over annual accounts of a company are exercised by the following methods: (1) Requirement as to registration. Every company should file with the Registrar, three copies of the balance sheet and profit and loss account duly signed by the managing director, manager or secretary within thirty days of the annual general meeting.

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27. Id., S.217.
28. Id., S.215.
29. Id., S.219.

(2) Prescribing or approving the form in which the balance sheet and the profit and loss accounts are to be presented; (3) Giving directions, on application of the board of directors of a company, that the provisions relating to subsidiaries need not apply or apply only to specified extent and (4) extending the financial year of the holding or subsidiary company for the purpose of submission of accounts to the general meeting.

Liability for Non-Filing of Balance Sheet with the Registrar

Failure to hold the annual general body meeting is not a defence to non-filing of balance sheet. The Orissa High Court observed:

> "Holding of the Annual General Meeting; laying the Balance Sheet and the Profit and Loss Account before the Annual General Meeting and filing of the Balance Sheet and the Profit and Loss Statement in triplicate are three independent points in the connected process."[30]

The provision is applicable even where no general meeting was held.[31] This is especially so after the Companies (Amendment) Act 1977.[32] Earlier, atleast some of the High

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30. Registrar of Companies, Orissa v. R.P.Nanda, 1977 Tax. L.R. 1610 (Orissa)

31. Assistant Registrar of Companies, West Bengal v. Saharanbhatoon, 1979 Tax. L.R.2094 (Cal.)

32. After the amendment, S.220(2) reads, "If the annual general meeting of a company before which a balance sheet is laid as aforesaid, does not adopt the balance sheet or if the annual general meeting of a company for any year has not been held, a statement of that effect and the reasons therefore shall be annexed to the balance sheet and the copies thereof required to be filed with the Registrar."

Courts had taken the view that the liability for non-filing of accounts arises only where the balance sheet had been placed before the general meeting and not where it had not been so placed.[33]

However, if the default is made because of circumstances beyond the control of the directors, for example where accounts books of the company was lying with the enquiry commission for a long time, relief could be granted under Section 633 of the Companies Act.[34] Consequently, where the company made default in filing accounts relying upon a circular issued by the Company Law Board and the company had acted honestly and reasonably, the Court held that the delay may be excused.[35] In another case, the company failed to lay accounts in its annual meeting. The meeting was adjourned and the accounts were passed in the adjourned meeting. The Calcutta High Court held that this procedure was justified.[36]

Prosecuting for Non-filing of Balance Sheet

It is not necessary that the Registrar should lodge a

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33. In re Narasimha Rao, A.I.R.1937 Mad. 341; Ajithkumar Chatterjee v. Emperor, A.I.R. 1934 Cal.63.

34. The Companies Act 1956, S.633 empowers the Court to grant relief in appropriate cases.

35. See Harrison and Crossfield (India) Ltd. v. Registrar of Companies, (1980) 50 Com. Cas. 426 (Kar.), M.D.Mundhra v. Asst. Registrar of Companies, (1980) 50 Com. Cas. 346 (Cal.)

36. Sudhir Kumar Seal v. Assistant Registrar of Companies, (1979) 49 Com. Cas. 462 (Cal.).

complaint for prosecuting a company or a director for non-filing of accounts.[37] But the Lahore High Court has taken the view that where the Registrar alone is authorised by the regulations framed under the Companies Act to make a complaint regarding wilful default in filing the accounts and balance sheet, any proceeding taken by the Magistrate on a complaint by the clerk of the Registrar and counter-signed by the public prosecutor is ultra vires.[38] Joint trial of directors is permissible.[39]

When a prosecution against a company or directors has already started, it cannot be dropped merely because the company went into liquidation after the prosecution was started.[40] In Bhagirath v. Emperor,[41] prosecution was launched against the directors of a company for failure to hold annual general meeting. After this prosecution was instituted, the company went into liquidation. The accused persons claimed that since the company had went into liquidation, the proceedings against them ought to be dropped. But the Calcutta High Court did not accept this view.[42]

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37. Bhagirath v. Emperor, A.I.R. 1948 Cal.42 at p.44.
38. M. Chibley, op.cit., p.765.
39. Madan Gopal v. State, A.I.R. 1968 Cal.79.
40. Bhagirath v. Emperor, supra n.37.
41. Ibid.
42. Id. at p.45 per Lodge, J.

The Circumstances When the Financial Year of A Company is Extended

The Registrar of Companies has power to extend the financial year of a company under two circumstances (1) The proviso to subsection 4 of section 210 empowers the Registrar to grant permission to prepare the accounts of a company for a period covering upto eighteen months; (2) Section 213 of the Act empowers him to extend the financial year of a holding company so that the subsidiary company's financial year may end with that of the holding company.

In the former case, the exercise of the power is discretionary. He may have to consider all the relevant circumstances before granting extension of time. But in the latter case, where the directors have resolved the matter for achieving the purpose stated in the section, it appears to be obligatory for the Registrar to grant the extension.

The Registrar's power of extension is exercisable both with regard to the period during which the accounts should be laid before the general meeting and the period for which it should be prepared.[43] The Madras High Court has gone further in In re Ramanuja Appalaswamy, to say that when the Registrar had endorsed delay in holding general meeting, he should be

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43. Dalmia Cement (Bharat) Ltd. v. Registrar of Joint Stock Companies, A.I.R. 1954 Mad.276. See also Registrar of Joint Stock Companies v. Dalmia Cement (Bharat) Ltd., A.I.R. 1955 Mad.28.

deemed to have condoned the delay in filing balance sheet also.[44] In this case, the directors of a company were prosecuted for default in holding annual general meeting of the company within 18 months from the date of incorporation and for default in filing annual returns. One of the defences of the petitioners was that the Registrar had condoned the delay in holding meeting and hence the delay in filing the annual returns should also be deemed to have been condoned. The Court said:

> "...the Registrar condoned the delay in holding a general meeting. He must therefore be deemed to have condoned the delay in filing a balance sheet before the general body at its meeting."[45]

This reasoning, it is submitted, does not hold good especially in the light of the 1977 Amendment which makes it obligatory on the companies to file balance sheet even in the absence of holding general meetings.

Another extreme view is taken by the Calcutta High Court.[46] There the Court held that the Registrar acting under these provisions "can neither condone the failure to hold a general meeting in any particular year nor the failure to lay the accounts before the general meeting."[47]

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44. In re Ramanujam Appalaswamy, A.I.R. 1941 Mad.504.
45. Id. at p.504 per Horwill, J.
46. Bhagirath v. Emperor, supra n.37.
47. Id. at p.44.

But the present Act expressly empowers the Government to "postpone the submission of the relevant accounts to the general meetings."[48]

An evaluation

The easiest way of checking the performance of companies is the scrutiny of the balance sheets and profit and loss account filed by them with the Registrar. For this purpose, the Registrar may elicit more information or explanation with respect to any matter to which such document purport to relate.[49] The power of inspection enjoyed by the Registrar[50] together with the power to enforce production of books of accounts, enables him to evaluate precisely the level of efficiency in the conduct of the affairs of the company. Such knowledge about the management of the business of the company would enable the Government to take effective and emergent remedial measures before the company goes into liquidation. Such action is necessary not only in the interest of the trade and industry but also to prevent distress to the employees, workers, consumers and community.

Audit

A company auditor's duty in reporting on the company's account is to act as a watch-dog on behalf of the shareholders. He should satisfy himself and certify that the accounts provide

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48. The Companies Act 1956, S.213(1).
49. The Companies Act 1956, S.234.
50. Id., S.209(4).

a true and fair view of the state of the company's affairs in accordance with the established statutory formulae. By the process of auditing it should be possible to give an account of the way in which directors and managers have dealt with the capital entrusted to their care. Realising these objectives, the company law provides elaborate provisions for auditing of company's accounts. The administrative authorities are empowered to interfere as and when it becomes necessary.

Appointment and Qualification of Auditors

Every company should appoint an auditor at its annual general meeting. The appointment of the first auditors should be made within one month of the registration of the company. The matter of appointment should be intimated to the auditor within seven days. The auditor should in turn inform the Registrar about the appointment within thirty days as to whether he has accepted or refused the assignment.

The auditor should be a qualified person.[51] The company should obtain a certificate from the auditor showing that the appointment or re-appointment would be in accordance with the provisions of the Companies Act. Ordinarily, a company must reappoint a retiring auditor. But another person may be appointed if the retiring auditor is disqualified, unwilling

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51. Id., S.226.

or a resolution not to reappoint the retiring auditor or to appoint some other person, has been passed by the company.

A special resolution is necessary for appointment or reappointment of an auditor in a company in which a government company, the Central Government, State Governments, the General Insurance Company, a nationalised bank or any financial institution hold fifty one percent of the subscribed shares. If such special resolution is not passed, it would be considered as non-appointment of an auditor and the Central Government can appoint any other person as auditor.

If the person appointed or reappointed as auditor of a company holds appointments as auditor of the specified[52] or more than the specified number of companies, he should intimate the company and the Registrar his unwillingness to act as auditor.[53] Where no auditor is appointed or reappointed in an annual general meeting, this fact must be notified to the Central Government within a period of seven days. On receipt of such intimation the Central Government can appoint a person as auditor.

To remove an auditor from office before the expiry of his term of appointment previous approval of the Central Government and a resolution in the company's general meeting is

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52. Explanation I to Section 224 of the Companies Act 1956, prescribes the maximum number of companies in which a person can act as auditor. The maximum number is twenty of which at least ten should be having paid-up capital of less than 25 lakhs rupees.

53. In R. Manekhoy v. Union of India, 1983 Tax.L.R.2637 (Delhi) the Court held that the imposition of restrictions by the Company Law Board on the number of audits that can be undertaken by an auditor is ultra virus of its powers.

necessary.[53a] The remuneration of auditors should be fixed by the board of directors or the annual general meeting, if he is appointed by the company in general meeting. But if the appointment is made by the Central Government, the remuneration shall also be fixed by the Central Government.

Rights of Auditors

An auditor of a company has a right of access to all books and accounts and vouchers of the company. The officers of the company should give such informations and explanations as the auditor may require for the performance of his duties as an auditor.[54] For companies having branch offices, branch accounts should be audited by the same person responsible for the head office audit or by another qualified auditor. The head office auditor is entitled to check the books of account maintained by the branch. The Central Government may exempt the requirement of branch audit in certain conditions.[55] The auditors have a right to attend and speak in general meetings. The Central Government may prescribe the form and contents of the audit report. In addition to these, the Central Government may direct a special audit[56] or a cost accounts audit[57] under certain circumstances.

Administrative Controls Relating to Audit

The administrative control relating to the audit of a

53a. The Companies Act 1956, S.224(7).
54. Id., S.227 deals with the rights of the auditor.
55. See id., S.228(4).
56. Id., S.233A.
57. Id., S.233B.

company covers most of the audit operations. This may be classified as (1) appointment, remuneration and removal of auditors (2) prescribing qualification of auditors (3) granting branch audit exemptions (4) prescribing the form and contents of auditor's report (5) directing the appointment of a special auditor (6) directing to conduct cost accounts audit (7) intimation to the Registrar to be given by the auditors.

In the ordinary course, the Government has power to appoint an auditor only when the company in general meeting fails to appoint or reappoint an auditor[58] or the failure to pass special resolution in certain cases. The Department of Trade and Industry in England has also similar powers. The power to fix remuneration of auditors would be exercised only when the appointment is made by the Government. The duty cast on auditors to intimate the Registrar about the acceptance or otherwise of the appointment can be used to prevent the auditor from taking more assignments than he is legally entitled.[59] For the proper discharge of his functions, it is necessary to fix a ceiling to the number of auditorships a person may be allowed to hold. Even the present ceiling[60] ie. twenty companies, does not serve the purpose since the auditor may not be able to check effectively half of the present ceiling limit.

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58. Id., S.224(3).

59. For the recent change, see supra n.53.

60. Explanation I to Sub-section (1)C of Section 224 id., states: "...specified number means (a) in the case of a person or firm holding appointment as auditor of a number of companies each of which has a paid-up capital of less than rupees twentyfive lakhs, twenty such companies; (b) in any other case, twenty companies out of which not more than ten shall be companies each of which has a paid up share capital of rupees twentyfive lakhs or more."

The requirement of taking prior permission of the Central Government for removing an auditor before the expiry of his term, gives protection to auditors to discharge their functions without fear or favour. On removal or resignation of auditors, the directors of the company are empowered to fill the casual vacancy. But if this power is transferred to the Central Government, the managements could be restrained from taking recourse to removal of auditors on flimsy grounds.

The power of the Central Government to prescribe qualifications for appointment as auditor[61] and the power to direct what all statements and matters are to be included in the auditor's report[62] could be used as an effective means to ensure that effective audit is conducted. The Central Government has framed Rules[63] prescribing qualification and regulating the conduct of certified auditors.

Branch Audit Exemption

In exercise of the powers conferred on the Central Government to grant branch audit exemption,[64] the Government has framed rules[65] governing the conditions under which such exemptions would be granted. The rules also prescribes the procedure to be followed for obtaining such exemption.[66] The conditions under which such exemption is granted are:- (1) where

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61. The Companies Act 1956, S.226(2).
62. Id., S.227(4A).
63. The Certified Auditors Rules 1961.
64. The Companies Act 1956, S.228(4).
65. The Companies (Branch Audit Exemption) Rules 1961.
66. Id., Clause 5.

the company is carrying on any manufacturing, processing or trading activity and the average quantum of activity of the branch does not exceed rupees two lakhs or two per cent of the average of the total turn over of the company; (2) where the company is carrying on any other activity and (i) there is satisfactory arrangements for the scrutiny and check of branch office accounts by a responsible person (ii) the company has made arrangements for the audit of the accounts of the branch office by a person otherwise qualified for appointment as branch auditor, eventhough such person is an employee of the company; (iii) the possibility of getting the services of a branch auditor at reasonable cost, having regard to the nature and quantum of activity of the branch, is rare; (iv) the Central Government is satisfied that, for any other reason, the exemption should be granted.

The Central Government may revoke the exemption granted after giving the company a reasonable opportunity of being heard. The reason for such revocation may be any contravention of the terms and conditions subject to which the exemption was granted, material alteration in the circumstances relating to the scrutiny, check or audit of the accounts of the branch office or any other reason by which the Central Government is satisfied that the exemption is no longer necessary or justified.

Where a branch audit exemption is allowed, the audit report of the company should refer to such exemption.

Special Audit

The Companies (Amendment) Act 1960, empowered the Central

Government to direct special audit of a company's accounts in the following circumstances:[67]

1) When the affairs of the company are not managed in accordance with sound business principles or prudent commercial practices;

2) When the company is managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains;

3) When the financial position of the company is such as to endanger its solvency.

The special auditor may be either the company's auditor himself or any other chartered accountant. But instead of submitting the report to the members in general meeting, the special auditor should submit his report to the Central Government.[68] The report of the special auditor should include all the matters required to be included in an auditors report in all possible cases. It should also contain statement on any other matter which the Government has referred to him. The expenses for the special audit and any matters incidental thereto would be determined by the Central Government, but should be paid by the company. The Government may take any action on the report of the special auditor in accordance with the Companies Act 1956 or any other law in force. If the Central

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67. The Companies Act 1956, S.233A.
68. The Companies Act 1956, S.233A(3).

Government chooses not to take any action within four months from the date of receipt of the report, the Government should send a copy of the report or relevant extract therefrom to the company. The Government may require the company either to circulate it among the members or to read it before the company general meeting.

There is nothing in the Act to indicate that the Central Government should, before appointment of the special auditor, give the company an opportunity of being heard. Some are of the opinion that the clause "the Central Government may at any time by order direct that a special audit of the company's accounts for such period or periods as may be specified in the order shall be conducted"[69] shows that before ordering special audit, the Central Government is not bound to give the company an opportunity of being heard.[70] But the Depart of Company Affairs has instructed that the power is not to be used as a matter of routine but should be exercised only in special circumstances and after making such enquiry as the Central Government might consider necessary on the facts and circumstances of the case.[71] Sound business principles include not only the keeping of proper accounts, presenting clear balance sheets, distinguishing between expenditure on capital accounts and current accounts, making of adequate allowance for depreciation etc., but also an adherence to a business code of conduct

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69. Id., S.233(1).

70. W.W. Chitley and V.B. Bakhale, op.cit., p.779.

71. Department of Company Affairs, Letter No.8/61 dated 9.5.1971 on the subject of special audit, as contained in W.W. Chitley & V.B. Bakhale op.cit., p.779.

like integrity, fair dealing, efficient service and absence of bad faith and malpractices in the management of the business of the company. Similarly 'prudent commercial practice' indicate the taking of efforts to carry on the business in a manner conducive to efficiency and good and harmonious relation with the workers and other employees, shareholders, government officials etc. and being good and serviceable to the members of the surrounding community. It also implies that the business is being carried on with cost consciousness and without waste and in a manner conducive to the benefit of all those interested in the enterprise. So in the selection of persons to be appointed as special auditor, the Government has to exercise discretion in a positive and rational manner. This is especially so when the expenditure has to be met by the company as an additional burden.

It is to be noted that special audit is ordered only in a few cases and there is considerable delay in the progress of special audit.[72] If the special audit is to be used as a

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72. Thus the progress of special audits of companies during the year 1967-82 was as follows:

Year	Total cases considered including cases carried over from previous year.	Cases dropped	Pending
1967-68	7	2	5
69-70	5	3	2
72-73	21	18	3
76-77	2	2	-
77-78	7	3	4
78-79	5	3	2
81-82	1	1	0

Source: Annual Reports of the Working and Administration of the Companies Act 1956.

means to save companies from premature death, it is necessary that the special audit work should be completed within the least possible time. It should be developed as an effective remedy against oppression and mis-management. For this selection and training of a team of competent men to act as special auditors is necessary. It is also desirable that the companies should be given an opportunity of being heard, before a special audit is ordered.

Cost Audit

Section 233-B inserted in the Companies Act 1956 by the Companies (Amendment) Act 1965 (31 of 1965) empowers the Central Government to order audit of cost accounts in respect of certain companies for which maintenance of cost accounts was prescribed.[73] When such a direction is given, the board of directors should appoint cost accountants, chartered accountants or other persons possessing the prescribed qualifications to conduct the cost audit. It is necessary to take previous approval of the Central Government to make such appointments.[74] The powers and duties of cost accountants would be the same as those of auditors.[75] The cost auditor should submit his report in the prescribed form to the Central Government within a reasonable time. A copy of the report should be send to the company also. On receipt of the copy of the report, the company should furnish full information and explanations on

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73. Id., S.233-B(2).

74. Id., S.233-B(3).

75. The Cost Audit (Qualification) Amendment Rules 1972, Clause 2.

every reservations or qualifications contained in the report, to the Central Government within thirty days. The Central Government may call for further information or explanations after considering the cost audit report and explanations submitted by the company. It is the duty of the company to furnish such additional particulars within the specified time. After considering all these documents, the Central Government may take necessary action in accordance with the Companies Act 1956 or any other law for the time being in force. The Government may direct the company to circulate the report along with the notice of the next annual general meeting.

There should be some objective criteria to be adopted by the Central Government in ordering cost accounts audit. At present, any class of manufacturing companies may be asked to keep cost accounts records. A company is utilising raw materials and man power to produce goods or to give services. When considerable amount of raw materials or man power is used by a company, it is better to appreciate its performance in the light of cost-benefit analysis. The legislature should lay down the principle in this regard.

The Central Government has extensive powers in relation to costs audit of accounts. In the exercise of powers conferred to it under these provisions, the Central Government has framed the Cost Audit (Qualification) Rules 1970, and the Cost Audit Report Rules. Under the former Rules, it is essential that person for appointment as cost auditor, including chartered

accountants,[76] should have passed the final examination held by the Institute of Costs and Works Accountants of India, or any other examination recognised by the Central Government as being equivalent to the said final examination. The cost auditor should submit the report to the Company Law Board in the prescribed form.[77] The procedure to be followed is also specified.[78] The cost audit report should be sent by the auditor within 120 days from the end of the company's financial year to which the cost audit report relates. Of late, the cost accounts audit is ordered in increasing classes of manufacturing companies.[79] This appears to be a welcome sign. But even after a lapse of nearly two decades after introducing the cost accounts audit provision in the Companies Act, it is not made applicable to all manufacturing companies. It is necessary to insist on cost accounts auditing in all manufacturing companies. However, since the cost audit is likely to reveal certain information which are regarded as

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76. Schedule to the Cost Audit (Report) Rules 1968.
77. See Annexure to the Cost Audit Report Rules 1968.
78. The Cost Audit (Report) Rules 1968, Clause 4.
79. Table showing the increase in companies for which cost accounts audit is ordered.

Year	No. of classes of products for which cost accounts audit ordered	Total reports received
1976-77	5	317
77-78	18	340
78-79	27	414
81-82	28	410

Source: Annual Reports of the Working & Administration of Companies Act 1956.

confidential by companies, directions may be given to the Registrar to keep these reports away from public scrutiny.

Another important matter in relation to cost accounts audit is that, inspite of elaborate procedures prescribed by the Act, no proper control is made to check the possible dilatory tactics which may be practiced by the management. When the direction to perform cost audit is against the wishes of the management, they may delay it by all means. No time limit is prescribed for the board of directors to appoint cost auditor. There is no proper remedy if the board or the staff of the company in collusion with the board, non-cooperate and resort to some evasive, dilatory or other objectionable tactics. Similarly there is no provision regulating conditions like filling up of vacancy on death, resignation or disqualification of a cost auditor subsequent to his appoint. There need provisions regulating the removal of cost auditor. When the maintenance of cost account is made obligatory, the employment of qualified cost accountants who will be responsible for maintaining cost accounts should also be made obligatory. Without this, the cost accounts audit will not serve its purpose.

Budgetary Controls

Control over company's funds is an effective method to check abuses and mis-management in company's affairs. In addition to the existing provisions relating to accounts and audit, it is desirable to introduce budgetary controls in the interests of both the company management and other interest groups.

Most of the prudent management are using budgetting for proper planning and development of the company. But there is no obligation under the Companies Act for a separate budgetary control. If a budget is presented in the annual general meeting of the company describing the expected estimate of income and the mode of expenditure, the shareholders would get a change to consider the policy intended to be followed by the management. The auditor is also benefitted in the sense that he may enquire and report whether there is much deviation from the budgetary proposals. When the shareholders do not approve the proposals laid down by the directors, and directors are unwilling to change it in accordance with the wishes of the members, the shareholders should be given a right to represent it to the Registrar.[80] This would enable the Registrar to intervene in the affairs of the company before a deadlock is created in the running of the company's business. After considering all aspects of the matter, the Registrar should give proper directions which should be binding on both the management and the shareholders. There should be a provision for appeal to some independent tribunal against the order of the Registrar. For effective discharge of this function, the Registrar should be assisted by competent persons specialised in management and accountancy. Services of these men can be usefully utilised in considering the audit reports, cost audit reports, balance sheets and profit and loss accounts that are filed with the Registrar.

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80. When the majority of shareholders disapprove the proposals of the directors, they can remove the directors from office. But when the number is small, the only remedy they can have is to approach the Registrar.

CHAPTER 14

Company General Meetings

Company general meeting is the forum where the shareholders of a company can exercise their corporate membership rights.[1] The Companies Act 1956 envisages three types of general meetings (1) statutory general meeting; (2) annual general meetings; and (3) extra-ordinary general meetings. The Central Government,[2] the Company Law Board and the Registrar of Companies enjoy certain powers and functions to ensure proper conduct of these general meetings. Elaborate procedures are also prescribed in the Act regulating different aspects of general meetings like length of notice, mode of sending notice, motions and resolutions, appointment of chairman etc.

Statutory general meetings

Every limited company with a share capital is required to call a general meeting immediately after the commencement of business. The meeting should be held within a period of not less than one month nor more than six months from the date at

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1. The rights of shareholders may be conveniently divided into two classes (1) corporate membership rights and (2) individual membership rights. The right to elect directors and auditors, the right to remove them, right to speak in general meetings etc. come under the former class. While the right to inspect certain books of account and other papers, right to get notices of general meetings, right to stand as a candidate for election as director etc. comes under the latter class. For a discussion on these rights, see supra Ch.2
2. The powers of the Central Government in this respect is now delegated to the Regional Directors of the Company Law Board at Bombay, Calcutta, Madras and Kanpur.

which the company is entitled to commence business.[3] This is the first meeting of shareholders of a company. The intention is to give the shareholders a chance to understand all important facts relating to the new company. These particulars are made available to them in the meeting and the shareholders get an opportunity of discussing the whole situation, the management, methods and prospects of the company.[4] The directors are required to prepare and to send to every shareholder a statutory report setting out the particulars prescribed under the Act.[5] A copy of this report

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3. The Companies Act 1956, S.165
4. Ibid.
5. The Act prescribes the following matters to be set out in the report:
   1. Total number of shares allotted, giving details whether they are fully or partly paid-up and what consideration has been received.
   2. The total amount of cash received in respect of all the shares allotted.
   3. An abstract of receipts, distinctly setting out the sources, and payments made out of that, balance remaining in hands, estimate of preliminary expenses, commissions or discount paid or to be paid on issue of shares.
   4. Names, addresses and occupations of the directors, managing agents, secretaries and treasurers, manager and secretary and the changes, if any, that have occure since the date of incorporation.
   5. Particulars of any contract to be submitted to the meeting for approval and its modifications done or proposed, if any.
   6. If the company has entered into underwriting contracts, the extent, if any, to which they have not been carried out and the reasons for the failure.
   7. The arrears, if any, due on calls from every director or other managerial personnel.
   8. Particulars of any commission or brokerage paid or agreed to be paid to any of the above mentioned parties in connection with the issue or sale of shares or debentures of the company.

certified to be correct by the managing director and at least one other director and auditors should be sent to the Registrar of Companies also.[6] Any default in this respect results in punishment of directors and officers of the company in addition to the Court's power to order compulsory winding up of the company.[7] In the case of private companies, the statutory meeting should be convened in the manner provided in their articles.[8]

The requirement as to registration of the statutory report with the Registrar of Companies ensures that the relevan provisions are complied with by the companies. However, it can be seen that private companies, unlimited companies and companies limited by guarantee but not having a share capital, are exempted from holding statutory meetings unless so provided in their articles.[9]

Annual General Meetings

The annual general meeting of a company is one of the most important institutions designed to protect the investors. The investors of the company who are divorced from the ownershi

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6. The Companies Act 1956, S.165(5).
7. See id., S.633(6).
8. Gardner v. Iredale, [1917] 1 Ch.700 at p.712. See also In re Brahmanbaria Loan Co. Ltd., A.I.R. 1934 Cal. 624.
9. See the Companies Act 1956, S.165(1) which requires that every company limited by shares and every company limited by guarantee and having a share capital should hold a statutory meeting. By S.165(10), private companies are excluded from this provision.

and control of their property which is in the hands of the company.[10] gets an opportunity to examine the affairs of the company, in these meetings. The previous year's activities are placed before them through the balance sheet, the profit and loss account and the directors report. They can ask any questions relating to the accounts or the affairs of the company. Again they can exercise control over management of the company in these meetings by electing or refusing to re-elect directors whose actions and policy, they disapprove.[11] In order to preserve and protect these rights, the Central Government and the Registrar of Companies are equipped with certain powers.

It is mandatory[12] for all companies to hold annual general meeting every year. Between two consecutive annual general meetings there shall not be a time gap of more than fifteen months.[13] However, when the first annual general meeting of the company is convened within a period of eighteen months from the date of its incorporation, it is not necessary for that company to hold any annual general meeting in the year of its incorporation or in the following year.[14] The

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10. When money is invested in the shares of a company, the investment becomes the property of the company. The investor looses the ownership of the investment, but becomes entitled to some rights and obligation. The control of the invested capital is with the management of the company. As a shareholder, his control over the property of the company is also very limited. For a discussion on these aspects, see Berle, A.A.& G.C. Means, The Modern Corporation and Private Property, (U.S.A., 1933), p.115.
11. Greer, L.J. in Shaw and Sons v. Shaw, [1935] 2 K.B.113.
12. The Companies Act 1956, S.166.
13. Id., S.166(1).
14. Id., proviso to S.166(1).

Registrar is empowered to grant an extension of time for holding annual general meeting upto a period of three months.[1]

The meeting should be called at a time during business hours, on a day that is not a public holiday and should be held at the registered office of the company or at some other place within the company's local limits. To avoid unnecessary inconvenience to non-profit making and certain other companies the Central Government is empowered to allow holding of annual general meetings of such companies at a time and place more convenient to their members. The companies may either by their articles or by a resolution adopted in one annual general meeting fix the time and place of its subsequent annual general meetings.

The Central Government's power to call Meetings

The Central Government is authorised to call or direct the calling of a general meeting of a company on application of any member of the company, if the company has made default in holding annual general meeting.[16] In exercise of these powers, the Central Government may give any other ancillary or consequential directions in relation to the calling, holding and conducting of the meeting. The directions given in this regard may even provide that one member of the company present either in person or by proxy shall constitute a quorum for the meeting.[17]

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15. Ibid.
16. Id., s.167.
17. Ibid.

Default in holding annual general meeting and complying with the directions of the Central Government are visited with penalty.[18] The penalty is imposed upon the company as well as every officer who is in default.

Under the Companies Act 1913, the Court was competent to call any and every kind of meeting. But under the present Act there is a bifurcation of power to call an annual general meeting and power to call a meeting other than annual general meeting.[19] The annual general meeting can be called either by the directors or by the Central Government under Section 167. The Registrar can extend the time for holding annual general meeting upto three months. But the Calcutta High Court has held that general meetings could be called by the Registrar also. In In re Coal Marketing Co,[20] the question for determination before the Court was, how far the Courts can exercise the power to call, hold, conduct or control annual general meetings of companies. An application was filed in the Calcutta High Court, by the Company for an order relieving the directors from liability for non-holding of annual general meeting and for failure in filing balance sheet with the Registrar of Companies. While considering the powers of the Court in this regard, the Court observed,

> "The annual general meeting, therefore, in case of default, can only be called by either the directions of the Registrar

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18. Id., S.168.

19. See the Companies Act 1913, S.79 & the Companies Act 1956, Ss.167 and 186; See also In re Pasari Flour Mills, A.I.R. 1961 M.P. 340 at p.345.

20. In re Coal Marketing Co. (India) Pvt. Ltd., A.I.R.1968 Cal.119.

within the meaning of the exemption under Section 166(1) of the Companies Act or by the Central Government under Section 167 of the Act."[21]

But the second proviso to Section 166(1) reads,

"Provided further that the Registrar may, for any special reason, extend the time within which any annual general meeting (not being the first annual general meeting) shall be held, by a period not exceeding three months."

It does not appear to be a correct view to hold that the power of the Registrar to extend the time for calling of annual general meeting includes the power to call the annual general meeting itself.

Annual general meeting should be held whether or not the annual accounts are ready for consideration at that meeting.[22] So the fact that the statement could not be compiled and got audited within time is no ground for not holding the general meeting within the prescribed time.[23] The only remedy is to get extension of time from the Registrar. The Allahabad High Court has suggested a short cut method. The Court held that when a meeting was called and adjourned without transacting any business, it should be presumed that the meeting was held on that day.[24] The Court said,

"Where a notice of the annual general meeting was issued and it contained the agenda for the meeting

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21. Id. at p.123 per Mukharji, J.

22. Dwodatt Purushotham Patel v. Alembic Glass Industries (1972) 42 Com. Cas. 63 (Guj.)

23. In re Brahmanbaria Loan Co. Ltd., A.I.R. 1934 Cal.624 at p.625.

24. V.S.Mathur v. M.S.Mathur, 1977 Tax. L.R.(Noc) 153(All.)

and some shareholders had assembled at the appointed place and time and also took up the first business of electing the Chairman and the minutes also stated in the definite terms that "the meeting therefore was adjourned," the meeting must be deemed to have been held even though it did not record any resolution on any of the items in the agenda."[25]

It appears more appropriate to presume the holding of general meeting only when the meeting is adjourned for want of quorum.[25a]

A general meeting held at the end of one year but adjourned to the following year and held on the adjourned date do not amount to a general meeting of the following year.[26]

The Nature of the Central Government's Power to Call Meetings

The Central Government's power in relation to calling of annual general meeting is very wide. The power may be invoked even by a single member when there is a failure to call the general meeting. For example, in In Re, Brahmanbaria Loan Co. Ltd.,[27] the Calcutta High Court said,

"The object of the Section is to enable a member of a company, where there has been default on the part of those whose duty is to summon on the meeting, to

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25. Ibid. per Banerji, J.

25a. Otherwise, if there is some inconvenience to hold the meeting, the companies might call the meeting and adjourn it to a future date.

26. Meenakshi Mills Ltd. v. Assistant Registrar, A.I.R. 1938 Mad. 640.

27. In re Brahmanbaria Loan Co. Ltd., A.I.R. 1934 Cal.624.

apply to the Court to direct the calling of a meeting."[28]

In In re Alembic Glass Industries Ltd., Dandatt Purushotham Patel v. Alembic Glass Industries,[29] the Gujarat High Court held that the power to call general meeting is an exclusive privilege of the Central Government.[30]

However, a general meeting called after the due date by the company itself is not void or illegal and the only effect is that the directors will not become exempt from liability for not holding general meeting in time. A general meeting called by the Central Government or subject to any directions of the Central Government would be deemed to be an annual general meeting of the company.[31]

Consequences of Default in Holding Annual General Meeting

When a default in holding annual general meeting is established, the company and the directors or officers in charge of its affairs are liable to punishment.[32] What is the procedure to be adopted when in a prosecution for not holding the annual general meeting, a company and its officers take the plea that the meeting was held? In such cases the

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28. Id. at p.625 per Buckland, J. (emphasis added) The principles applies to the Central Government now, as the power of the Court in this respect is transferred to the Central Government by the Companies (Amendment) Act 1974.

29. (1972) 42 Com. Cas. 63 (Guj.)

30. Id. at p.66 per D.A.Desai, J.

31. The Companies Act 1956, S.167(2).

32. Assistant Registrar of Joint Stock Companies v. Krishnan Nambiar, 1958 K.L.T.173 at p.176.

Registrar of Companies should make every effort to establish that the meeting was not held. For this purpose they may call for from the company (1) its minutes book, (2) its despatch register etc. showing despatch of notices of annual general meetings; and (3) any other document in the custody or in the control of the company showing that the annual general meeting was held. He may produce one or more shareholders of the company as witnesses for the purpose. He may also take any such further steps as may be necessary, according to the facts of any particular case, to establish that the annual general meeting was not held.[33]

The consequences of not holding annual general meeting are heavy. The directors will have to vacate their position on the expiry of the term.

In R.R.Kundra v. Motion Pictures Association Film Colony,[34] the Delhi High Court had to consider this aspect. Here some of the shareholders of the company argued that if there was a default in holding annual meeting by the elected directors, they should be deemed to have retired on the last date on which the annual meeting ought to have been held. The company contended that there was no express provision in the Companies Act in this regard. On this question, the

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33. See the Government of India, Ministry of Law, Justice and Company Affairs, Circular No.42(57) C.L.II/60 dated 25-2-1960 entitled "Prosecutions for not holding annual general meetings."

34. 1975 Tax. L.R. 1852.

Court observed,

> "The object of the legislature here was clearly to see that the directors would not continue beyond the terms for which they were elected and also fixing the maximum time that can elapse between one annual general meeting and another... no defaulting director could take advantage of his own wrong seems a fairly well established proposition."[35]

An ordinary director of a company who was not knowingly and wilfully a party to the default cannot be convicted.[36]

In Gopal Khaitan v. State,[37] prosecution was initiated against three directors of a company for failure to submit annual returns of the company. They were convicted by the trial court. On appeal, the Calcutta High Court examined the liability of ordinary directors for defaults of this kind. The Court remarked,

> "Section 5 of the Companies Act, 1956 defines an "officer who is in default" and lays down inter alia that the said expression means any officer of the company who is knowingly guilty of the default, non-compliance etc. or who knowingly or wilfully permits such default, non-compliance etc. Even in such cases the directors have got a duties imposed upon them by law which cannot be observed in their breach..."[38]

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35. Id. at p.1858 per S. Rangarajan, J.

36. Meenakshi Mills Ltd. v. Asst. Registrar, A.I.R. 1938 Mad. 640; Gopal Khaitan v. State, A.I.R. 1969 Cal.132; Asst. Registrar, Joint Stock Companies v. Krishnan Nambiar, 1958 K.L.T. 173.

37. A.I.R. 1969 Cal. 132.

38. Id. at p.135 per Talukdar, J.

Extra Ordinary General Meetings

All general meetings of a company other than statutory and annual general meetings are called extra-ordinary general meeting. The need for such meetings may arise due to one of the following reasons:

(1) Some matters which are to be transacted in general meetings of a company could not be transacted in the annual general meetings in accordance with the articles of association of the company.

(2) The company wishes to transact certain matters which are so urgent that it cannot be deferred till the next annual general meeting of the company.[39]

(3) A requisition is made by the prescribed number of members for calling a general meeting.[40]

(4) The Company Law Board directs the calling of a general meeting.[41]

The persons entitled to call a valid extra-ordinary general meeting are (1) the directors; (2) the requisitionists and (3) the Company Law Board. Extra-ordinary meeting can be called even though the annual general meeting of the company is not held in time. In such a meeting all acts that can be done in an annual general meeting can be done including the

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39. See the Companies Act 1956, Reg.47 of Table A; Registrar of Companies v. R.P. Nanda, 1977 Tax. L.R. 1610 (Orissa).

40. Id., S.169.

41. Id., S.186.

the passing of balance sheet and appointment of directors.[42] However, the directors or the requisitionists, have no jurisdiction to call an extra-ordinary general meeting without complying with the provisions of Section 169 of the Companies Act 1956 and the relevant article of association of the company.[43]

Requisitioned Meeting

When an extra ordinary general meeting is called on requisition, the requisition should set out the matters for consideration for which the general meeting is called. The requisition should be signed by the requisitionists and should be deposited at the registered office of the company. When the requisition consists of several documents in like form, each of these documents should be signed by one or more of the requisitionists. When two or more distinct matters are specifi in the requisition, each matter should be clearly recorded and got signed by the requisite number of members.[44]

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42. A.J.Judah V. Rama Pada Gupta, A.I.R. 1959 Cal.715.

43. In re Bharat Commerce and Industries Ltd., 1972 Tax. L.R. 2034 (Cal.)

44. See the Companies Act 1956, S.169; The number of members entitled to requisition a meeting in regard to any matter is prescribed under Section 169(4) which reads, "...(a) in the case of a company having a share capital such number of them as hold at the date of deposit of the requisition, not less than one tenth of such of the paid-up capital of the company as at that date carried the right of voting in regard to that matter.

(b) in the case of a company not having a share capital, such number of them as have at the date of deposit of the requisition not less than one tenth of the total voting power of all the members having at the said date a right to vote in regard to that matter."

Where the matters mentioned in the requisition are matters which could be validly considered by the general meeting and they have not been expressed vaguely, the directors cannot exclude some of these matters from the notice calling for the meeting. In Isle of Wight Railway Company v. Tahourdin,[45] a sufficient number of shareholders required the directors of a railway company to call a meeting for transacting two specified matters. The directors issued notice calling meeting but the agenda excluded one of the matters specified by the requisitionists. The Court of Appeal held:

> "(If) the object for which it is proposed to call a meeting is one which can be carried out in a legal way, then, although the notice may be so expressed that resolution following its precise terms would be illegal, it is not right for the directors to limit the notice so as to prevent the meeting from entering into the question simply because the terms of the notice would justify a resolution which would be ultra vires."[46]

This is perhaps the only situation where the members have a right to force the directors to include an item in the agenda for a general meeting.[47] If the board of directors does not call a meeting within 21 days from the date of deposit of the requisition, the requisitionist themselves can call a valid meeting and get all the reasonable expenditure incurred for the purpose reimbursed.

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45. (1883) 25 Ch. D. 320.

46. Id. at p. 330 per Cotton, L.J.

47. In any other case the directors are fixing the agenda for the meeting. Even though they should consider the matters requested for by the members to be included in the agenda, they have no express legal duty to include the matters requested by the members.

Power of the Company Law Board to Call Extra-Ordinary General Meeting

The Company Law Boards' power to call meeting is an alternate remedy when the normal machinery of the company management fails to call a meeting.[48] The Company Law Board has power to call a meeting of a company other than an annual general meeting. This power can be exercised when there is impracticability to call, hold or conduct the meeting.

The power can be exercised under the following circumstances:

(1) by its own motion

(2) on application of any director of the company

(3) on application of any member of the company who would be entitled to vote at the meeting.

Acting under this provision, the Company Law Board may order a meeting of the company to be called, held and conducted in such manner as the Company Law Board thinks fit.[49] It may give ancillary or consequential directions, which may include directions modifying or supplementing in relation to the calling, holding and conducting of the meeting. The operation of the provisions of the Companies Act 1956, or of the company's articles may also be modified or supplemented.[50] The direction may even declare that one member of the company

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48. Bansal and Assam Investors Ltd. V. J.K.Synthetics Industries, A.I.R. 1956 Cal. 658.

49. See the Companies Act 1956, S.186.

50. Ibid.

present in person or by proxy shall be deemed to constitute a meeting. A meeting called, held and conducted by the Company Law Board is deemed to be a meeting of the company duly called, held and conducted.[51]

Till the Companies (Amendment) Act 1974 (41 of 1974), the power to call extra-ordinary general meeting was exercised by the company Courts. The powers of the Court was transferred to the Company Law Board with effect from 1-2-1975.[52]

The power of the Central Government should be exercised judicially, though it is a discretionary one. The mere fact that till the Companies (Amendment) Act 1974, the power was exercised by the Courts makes it clear that the Central Government should also exercise the power judicially. In Bansal and Assam Investors Ltd. V. J.K.Eastern Industries Private Ltd,[53] the Calcutta High Court considered the nature of this power. Regarding the executive character of the power, P.B.Mukharji,J. observed that the power granted by Section 186 was great, irresponsible and also unsuited to the Court because it called upon the Court to discharge a function which was purely executive in character. Hence, the Court must use the power with great caution and in such a manner as to avoid becoming itself in effect a share holder or director interested in the internecine squabbles of the company.[54]

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50. Ibid.
51. Ibid.
52. See the Companies (Amendment) Act 1974, S.14.
53. Bansal and Assam Investors Ltd. V. J.K.Eastern Industries, A.I.R. 1956 Cal.658.
54. Id. at pp. 661, 662. per P.B.Mukharji, J.

The same view holds good in the case of the Company Law Board also. So, before the Company Law Board decides to grant the remedy, it must find that it is impracticable to call a meeting and secondly that to leave the parties to follow their own remedies and rights would put the company in jeopardy.

The Concept of Impracticability

The impracticability contemplated under the law implies an impracticability from a reasonable point of view. In Indian Spinning Mills Ltd. v. H.H.J.Bahadur Rama,[55] some shareholders of a company applied to the Court for calling an extra ordinary meeting of the company. They alleged that due to some dispute which had arisen between the directors and the shareholders, it was impracticable to hold an extra ordinary general meeting. While considering the word "impracticable", the Court observed that the Court should take a common sense view of the matter and should act as a prudent person of business. The Court further remarked:

> "Where the calling of a meeting by the requisitionists would lead to endless litigation and where matters might arise for debate and decision which were already the subject matter of suits, it appears to me that the holding of a meeting would be impracticable."[57]

The Company Law Board is required to take a common sense view of the matter and to act as a prudent person of business.

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55. Indian Spinning Mills v. Maden Shamsher Jang Bahadur Rama, A.I.R. 1953 Cal. 355.
56. Id. at p.357 per Harries, C.J.
57. Ibid.

The impracticability is not confined to the stage of conducting the meeting only; that is after the choice of Chairman. But it applies to stages preliminary to the actual conduct of meeting as well. Thus, in Rathna Valuswmi Chettiar v. Manickavelu Chettiar,[58] it was argued that the term 'impracticability' applies to the stage of conducting the meeting only. Rejecting this argument, the Court said:

> "... the expression "to conduct" in the provision of the statute includes the stage prior to the choice of the Chairman, and the impracticability in the conducting of the meeting did nonetheless exist in the present case because (sic though) in the matter of the assembling of the shareholders at the premises of the registered office there was difficulty."[59]

The term impracticable is not defined anywhere in the Act. Judicial interpretation has given different meanings to it. The Delhi High Court held that the expression 'impracticab should not be considered as "impossible".[60] When there are provisions in the articles of association of a company, and unless those provisions contravene any of the mandatory provisions of the Act itself, the question whether the holding of a general meeting has become impracticable must be decided in the light of those provisions of the articles.[61]

The Company Law Board is given power to modify or

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58. A.I.R. 1951 Mad. 542.

59. Id. at p. 545 per Raghava Rao, J.

60. Lord Krishna Sugar Mills v. Smt. Abnash Kaur, (1974) 44 Com. Cas. 210 (Delhi).

61. Bal Krishna v. Uma Shankar, A.I.R. 1947 All 361 (F.B)

supplement the articles of a company or the Act only for the purpose of enabling a company to hold a meeting without contravening the articles or the Act. To exercise that power it should have good reasons. A mere apprehension that the chairman of the board of directors who according to articles has to preside at the meetings may not act fairly or impartially, is not such a reason on which the Company Law Board could intervene and supplant the articles of the company and give directions for the conduct of the meeting.[62]

Similarly the Company Law Board is not required to enter upon a consideration of various allegations and counter allegations against the management of the company. So when no attempt has been made either to call a requisitioned meeting under section 169 or to move the Central Government under Section 167, it cannot be said that it is impracticable to call or hold a general meeting.[63]

The High Courts have held a number of circumstances as cases where calling or holding of meeting is impracticable. Thus where the shareholders who had requisitioned a meeting found the premises of the registered office of the company locked, it was held that the impracticability contemplated in the Act had arisen.[64] Similarly where the meeting of a company could, under its articles, be called by the directors alone

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62. Bengal and Assam Investors Ltd. v. J.K.Eastern Industries Private Ltd., A.I.R. 1958 Cal. 638.

63. In re Ruttonsea and Co. Ltd., A.I.R. 1969 Cal.580.

64. M.R.S.Rathnavelu Sami Chettiar v. M.R.S.Manickavelu Chettiar, A.I.R. 1951 Mad. 541.

but there was a serious dispute as to which of the two sets of persons were the validily appointed directors, the Madhya Pradesh High Court held that there was a situation under which the calling of a meeting in accordance with the articles of the company was impracticable.[65] In another case the situation was like this. If a meeting were called by the requisitionists it would lead to endless litigation and also involve discussion and decision upon matters which were subjudice. The Court held that the holding of meeting had become impracticable.[66] So also, if the time within which a meeting should be called was prescribed by the articles of the company and that time had expired without any meeting being held, there was impracticability for holding meeting.[67]

Limitation of the Powers of the Company Law Board

The power given to the Company Law Board is only to call a meeting other than an annual general meeting. The approving of a balance sheet and such other matters cannot be done in such a meeting as it could be done only in an annual general meeting.[68] But there could be no impediment in conducting election of directors in a meeting called under section 186.[69]

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65. In re Dha Pasari Flour Mills Ltd., A.I.R. 1962 M.P.340

66. The Indian Spinning Mills Ltd., v. M.S.R.M.Rahaduar Rama, A.I.R. 1953 Cal. 355.

67. Bal Krishna Maheswari v. Uma Shankar, A.I.R.1947 All.361(D.

68. The Star Tile Works Ltd. v. N.Govindan, A.I.R.1959 Ker. 254, In re Dha Pasari Flour Mills Ltd., A.I.R.1961 M.P340

69. Lord Krishna Sugar Mills v. Smt. Amaah Kaur, (1974) 44 Com. Cas. 210 (Delhi)

When the share holders wish to remove a director under section 284 of the Companies Act 1956, in a meeting called by the Company Law Board, they cannot dispense with the requirement of special notice in the absence of concrete, precise and specific charges against such directors.[70]

The power of the Company Law Board to call a meeting includes the power to appoint an independent chairman to preside over that meeting also.[71] The Madras High Court went a step further and held that this power extended to appointment of an independent chairman to preside over an annual general meeting to be convened by the board of directors also.[72] But the Karnataka High Court held that an application by the requisitionists for appointment of the chairman of a meeting called for by them was not maintainable, if such application did not include a request to order a meeting to be called.[73]

The Supreme Court also took a similar view in R.Ranganathari v. S.Syamiah.[74] The Court said:

> "The use of the word "and" between the words "held" and 'conduct' in clause (a) of sub-section 1 of Section 2 clearly shows that the Court has no power to make any order regarding the holding and conducting of any meeting which has already been called, without ordering a meeting of the company to be called in place of the meeting already called."[75]

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70. In re Ruttonjee and Co., A.I.R. 1969 Cal.550.
71. Ananthalakshmi v. Tiffins' Barytes, Asbestos and Paints Limited, A.I.R. 1952 Mad. 60.
72. J.M.Dhanjilal v. State of Madras, A.I.R. 1968 Mad. 378.
73. A.D.Chowdhary v. Mysore Paper Mills Ltd., 1976 Tax.L.R. 1051 (Karnat.) at p.1054.
74. R.Ranganathari v. S. Syamiah, A.I.R. 1976 S.C.73
75. Id. at p.76 per Untwalia, J.

Thus, an application for mere appointment of an advocate/ commissioner as Chairman of a meeting already called without there being any prayer to the Court for the order for the calling of a meeting is not maintainable.

The Procedure Followed by the Company Law Board

The nature of the petition and the procedure to be followed by the Company Law Board in an application for calling a general meeting of a company is prescribed under the Company Law Board Bench Rules 1975. Every application in this respect should contain the following particulars.[76]

(1) The status of the petitioner, namely whether he is a member or a director of the company;

(2) The particulars of shareholdings which entitle the petitioner member to vote at the meeting;

(3) Facts making out a prima-facie case that the calling, holding or conducting of the general meeting by the company has become impracticable; and

(4) The purpose of the meeting proposed and the business to be transacted there at.

The procedure to be followed by the Company Law Board Bench is the same as that it should follow on receipt of a petition for alteration of memorandum.[77] A petition can be made by any member. So any member who has a right to attend and vote at any general meeting can file a petition.[78] Even

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76. See the Company Law Board (Bench) Rules 1975, Rule 39.
77. Ibid.
78. In re The Pasari Flour Mills, A.I.R. 1961 M.P.340.

though the articles of association gives the company the first and paramount lien upon shares of members, by this he does not loose this right.[79] A petition under this provision need not be on behalf of the company. Similarly, an application to the Court under sections 397 & 398 is not sufficient for calling a general meeting; and a separate application should be made to the Company Law Board. In Gerar Bastia Irani Case,[80] an application for holding the annual meeting of a company was made to the Court while considering another application under Sections 397 & 398 of the Companies Act 1956. The Court held that such an order cannot be passed under the circumstances. The Court said:

> "In an application under Sections 397, 398 and the connected sections thereto the Court cannot pass an order as contemplated by Section 186 for which a separate application is necessary to be made."[81]

Conduct of General Meetings and Registration of Resolutions

Detailed procedures to be followed in calling and conducting general meetings of public companies are contained in the Companies Act 1956.[82] The same provisions apply to private companies which are subsidiaries of public companies. However, other private companies may adopt different procedures, if such procedures are contained in their articles.[83]

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79. Ibid.
80. See Gerar Bastia Irani v. Property Company (P) Ltd., 1976 Tax. L.R. 1682.
81. Id. at p. 1688 per Datta, J.
82. The Companies Act 1956, Ss. 171-186.
83. Id., S.170.

If the President of India or the Governor of a State is a member of a company, he may appoint any person of his choice to act as his representative at the meeting of the company. A person so appointed shall be deemed to be a member of the company and can exercise the same rights and powers including the right to vote by proxy.[84]

In respect of shares held in trust, the public trustee or a proxy appointed by him has the exclusive right to vote. The proxy so appointed should either be an officer of the Government or the trustee of the shares.[85] He should exercise his rights and powers according to the directions of the public trustee.

In a company meeting, decisions are taken by passing resolutions. The Companies Act 1956 envisages three types of resolutions viz. (1) the ordinary resolution; (2) special resolutions; and (3) resolutions requiring special notice.[86] The following types of resolutions and agreements adopted in general meetings should be registered with the Registrar of Companies within thirty days of its adoption.[87]

(1) Special resolutions

(2) Resolutions which have been agreed to by all the members of a company, but, which if not agreed to would not have been effective for their purpose unless they had been passed as special resolutions.

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84. Id., S.187A.
85. Ibid.
86. Id., Ss.189 & 190
87. Id., S.192

(3) Any resolution of the board of directors of a company or agreement executed by a company, relating to the appointment, reappointment or renewal of the appointment or variation of the terms of appointment of a managing director.

(4) Resolutions or agreements which have been agreed to by all the members of any class of shareholders but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by some particular manner and all resolutions or agreement which effectively bind all the members of any class of shareholders though not agreed to by all those members.

(5) Resolutions passed by a company according consent to the exercise of powers by its board of directors to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking, or to borrow money or to contribute the funds of the company to some charitable purposes.

(6) Resolution approving the appointment of sole selling agents.

(7) Resolutions requiring a company to be wound up voluntarily.

(8) Copies of the terms and conditions of appointment of a sole selling agent or other persons appointed under Sections 294 or 294 AA.

The requirement of registration of resolutions is intended to make the records of the Registrar self contained

and to provide an opportunity to him to scrutinise special resolutions and such other important resolutions passed by the general meeting or board of directors. So the power of the Registrar in this respect is discretionary one and he can, for sufficient cause, refuse to register a resolution. Thus, when the effect of a resolution to alter the articles of association so as to confer power on the company to carry on some activity, which if permitted, would offend the provisions of law, it was held that the Registrar could refuse the registration of that resolution.[88] But in another case it was held that he was bound to register a resolution when the effect of the resolution was to alter a private company into a public company.[89]

Administrative Control over General Meeting - A Comparative Analysis

Under the English Law, every company limited by shares and every company limited by guarantee and having a share capital, other than aprivate company, must hold a statutory meeting within a period of not less than one month nor more than three months from the date at which the company is entitle to commence business.[90] The directors are required to register a copy of the statutory report containing different particulars prescribed under section 130 of the Companies Act 1948, with the Registrar of Companies.[91] If a default is made in

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88. Pioneer Mutual Benefit and Friend-in-Need Society v. Assistant Registrar, A.I.R. 1933 Mad.129.

89. In re Radient Chemicals Co. Ltd., A.I.R. 1943 Pat.278

90. The Companies Act 1948, S.130(2)

91. Id., S.130(5)

delivering the report for registration or in holding statutory meeting, the Court may order the company to be wound up on petition by the Registrar.[92]

All companies must hold a general meeting in each year as its annual general meeting, in addition to any other meeting held in that year.[93] If default has been made in holding an annual meeting of the company, the Department of Trade and Industry may, on the application of any member of the company, call or direct the calling of a general meeting of the company. The Department of Trade and Industry may give such ancillary or consequential directions, as it may think expedient, including directions modifying or supplementing in relation to calling, holding and conducting the meeting, or the operation of the company's articles.[94] Certain resolutions should be registered with the Registrar of Companies within thirty days of their being passed.[95]

But in case of impracticability to call a meeting by the directors, the competent authority to call the meeting is the Company Court.[96]

In the U.S.A., annual general meetings is to be held in accordance with the by-laws of the Corporation. If such meeting is not held within any thirteen months period, the Court may call such meeting on application of any shareholder.[97]

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92. Ibid.
93. Id., S.131
94. Ibid.
95. See Halsbury's Laws of England, Vol.7, Para 590.
96. Id., 135(1); See also Re El Sombrero Ltd., [1958] 3 All E.R.1
97. The Modal Business Corporation Act, para 29.

Under the Indian law, there is no obligation on the part of the directors of a company to call an extra-ordinary meeting of the company except when the requisite number of members make a specific requisition for that purpose. Even when it becomes impossible to conduct the business of the company except at a loss, there is no such obligation. It appears that there should be provision for compulsory holding of extra-ordinary general meeting of a company when there is heavy loss to the company and its continued existence is challenged due to such losses.

PART – XV

INSPECTIONS AND INVESTIGATIONS

CHAPTER - 15

Inspection of Company Documents

The sharpest weapon in the armoury of the company law administration is the power to inspect company's books and other documents and to investigate the affairs of the company. The purpose of inspection as stated by the U.S. Supreme Court is to supervise and control the management of companies and keep them within the legitimate sphere of their operations and to correct all abuses of authority and to nullify all irregular proceedings.[1] The power of inspections and investigations are all the more important considering the facts that the doctrine of ultravires is no longer any significant check upon corporate spending and that the substantial powers of management are vested in the board of directors to the total exclusion of shareholders.

Since the companies affect the life and economy of the nation, it becomes essential that it must be subjected to a special code of conduct. So any reasonable steps taken

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1. Guthrie v. Harkness, 199 U.S.148 (1905).

by the Government to keep the companies within their power can be justified in the public interest. O.K. Freund observed

> "The reality of control can only be found in the action of public opinion and in the organised supervision exercised by Government agencies. Hence the importance of investigations."[2]

Power to Inspect Books of Accounts

Power to inspect books of accounts and other documents of a company under company law may be classified into five categories as under:

1) Any person's right to inspect or ask for copies of documents of a company.
2) Member's right to inspection and get copies of documents.
3) Director's right to inspection and taking of extracts or obtain copies of documents.
4) Creditor's or contributory's right of inspection of documents.
5) Power of the Registrar or any officer appointed by the Central Government to inspect books of account and other books and papers of companies.

The right of any member of the public, member of the company, contributory and creditor to inspect the books and other papers of the company is very much limited. But the powers of directors, the Registrar and officers appointed by

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2. O.K. Freund, "Company Law Reform," (1946) 9 Mod.L.R.235, at p.246.

the Government extends practically to every register, books or paper, including correspondence concerning the affairs of the company and is not restricted to any particular document. The Registrar has power even to search and seize the books and other documents of a company under certain circumstances.

Inspection of Documents by Any Person

In order to ensure that members of the public are not inconvenienced with regard to the right of inspection of documents or with regard to obtaining certified copies of documents, Section 610 of the Companies Act 1956 grants power to them to inspect the books and documents kept by the Registrar of Companies.[3] This provision is in the public interest and for the public convenience. But a Judge trying a case under the Act may require the production of original

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3. The Companies Act 1956, S.610 reads:
"Save as otherwise provided elsewhere in this Act, any person may

(a) inspect any documents kept by the Registrar in accordance with the rules made under the Destruction of Records Act, 1917 being documents filed or registered by him in pursuance of this Act, or making a record of any fact required or authorised to be recorded or registered in pursuance of this Act, on payment of each inspection, of a fee of one rupee;

(b) require a certificate of incorporation of any company, or a copy or extract of any other document to be certified by the Registrar, on payment in advance of a fee of five rupees in the case of a certificate of incorporation, and of one rupee for every one hundred words or fractional part thereof required to be copied in the case of a certified copy of extract...."

documents even if certified copies are produced.[4]

The right of inspection provided for in S.610 is of utmost importance considering the large number of documents to be filed with the Registrar of Companies. These documents include, among other things, the statutory documents, annual returns, balance sheet, audited accounts, resolutions and agreements passed in general meetings etc. which disclose such matters relating to the management and affairs of the company.[5] Fee prescribed by the Act for inspection of documents and for taking extracts or copies of them is also very small.[6] But the right is restricted to a great extent as provided in the Act. Thus the inspection of documents delivered to the Registrar along with a prospectus can be made only during fourteen days beginning with the date of publication of that prospectus. For inspection of this at any other time the permission of the Central Government is necessary.[7] The copy or extract of any document taken from the Registrar certified to be a true copy under the hand of the Registrar is admissible in evidence in all legal proceedings.[8]

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4. Sugandha Rada Battacharjee v. Nalini Mohan, A.I.R.1961 Cal.377.

5. For a complete list of these documents, See Bahl, Secretarial Practice in India, (1967, 8th edn.) pp.683-688.

6. The fee prescribed is one rupee for inspection of documents, five rupees for copy of the certificate of incorporation and one rupee for copy of hundred words or fractional part thereof of any document.

7. The Central Government has delegated this power to the Regional Directors of the Company Law Board.

8. The Companies Act 1956, S.610(3).

In addition to this any person can inspect certain documents from the company also. In case he chooses this method, the fee prescribed is much less for a copy of documents.[9] But the number of documents he could inspect is much less in this case. Moreover, the copies taken from the company will be admissible in a legal proceeding only as a secondary evidence. The documents that a person can inspect by this method include register of members,[10] company's register of charges,[11] Registrar's register of charges[12] etc. Other documents of this category are profit and loss account, register of directors, liquidators account, list of creditors etc.

Procedure to be Followed for Inspecting Documents

Any person desirous of inspecting or getting a copy of a document registered, recorded or filed with the Registrar, should make an application to the Registrar setting out the purpose. He should also pay the prescribed fee. The applicant would be allowed to inspect the documents only in the presence of the Registrar or of a person authorised by him in this behalf; and only during the office hours. He would not be allowed to make a verbatim copy of the documents inspected even though he may take any notes in respect of the contents of the documents inspected.[14]

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9. The fee prescribed is 37 paise only for every hundred words or parts thereof instead of one rupee in the office of the Registrar of Companies.
10. The Companies Act 1956, S.150.
11. Id., S.163.
12. Id., S.143.
13. Id., S.130(3).
14. The Companies Regulations 1956, Regulation 25.

Exemptions to Documents Filed by Private Companies

However, no person other than a member of the company would be allowed to inspect or obtain copies of the profit and loss account of a company which is -

(1) a private company, which is not a subsidiary of a public company; or

(2) a private company of which the entire share capital is held by one or more bodies corporate incorporated outside India; or

(3) a company which has become a public company by virtue of Section 43A,[15] if the Central Government directs that it is not in the public interest that any person other than a member of the company shall be entitled to inspect or obtain copies of the profit and loss accounts of the company.[16]

When two conflicting returns are submitted to the Registrar by rival groups, the position would become difficult. Only after registering one of such returns, the Registrar can allow outsiders to verify that document. Can the Registrar accept one of such returns and reject the other?

The Punjab High Court considered this question in Jullundur District Registered Factory Owners Association v. Registrar of Companies.[17] The Court held that the Registrar

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15. The Companies Act 1956, S.43A, enumerates the circumstances under which a private company would be deemed to be public company.

16. The Companies Act 1956, S.220.

17. (1961) 31 Com.Cas. 673 (Punj.).

should retain both the documents till the conflicting claim was settled by the competent Court. The Court also observed that until the Registrar makes entries regarding one in the register, no person shall be permitted to inspect it or take copies of the same.[18]

Member's Right to Inspect Documents

The members of a company have no right to inspect the books of accounts kept by the company in pursuance of Section 209 of the Act. Though the Section is silent about this, the Calcutta High Court has discussed the right of members to inspect company documents in the light and general background of the Section. In Maharani Lalita Raiya Lakshmi v. Indian Motor Co. (Hazaribagh) Ltd.,[19] a minority shareholder alleged that the affairs of the company was conducted in a manner detrimental to the interest of the minority shareholders It was argued that denial of access to and inspection of the books of accounts of the company amounted to an act of oppression within the meaning of Section 397 of the Companies Act 1956. The Court said,

> "That argument also cannot succeed because to concede such a right will be to permit the directors to do something which the law does not permit them to do or which might be objectionable in law: besides, then every shareholder will claim such right

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18. Ibid. For a detailed discussion on third party's right to inspect documents of a company, See C.V. Narahari Rao, "Company Law, Inspection of Documents-II, Right of Any Person to Inspect or Ask for Copies of Documents," (1974) II M.L.J.13.

19. A.I.R. 1962 Cal.127.

> and to allow some and deny others will lead to discrimination and confusion. Lastly, this argument must, in my view, fail on the simple ground that this cannot be an act of oppression within the meaning of Section 397 of the Companies Act."[20]

In the case of a company licenced under Section 25 of the Act, the company may be directed to include a provision in its articles to the effect that the accounts shall be open to inspection by the members. There are some specific provisions in the Act which allow a right of inspection of certain kinds of books and papers enumerated in those Sections. Apart from these enumerated rights to inspection, taking extracts of documents inspected or requiring copies of such documents, the shareholder has no power to inspect all kinds of books and papers. The documents of which inspection is allowed to a member are mainly certain registers maintained by the company or copies of returns submitted to the Registrar of Companies. However, a provision in the articles of association of the company may entitle a member to inspect the books of account and other papers of the company. But commonly such rights would be allowed only subject to authorisation by the board.[21] In any case, documents like register of members, copies of memorandum and trust deed, register of investments, foreign register, resolutions and agreements, minutes book, balance

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20. Id. at p.129 per P.B. Mukharji, J.
21. See for example the Companies Act 1956, Table A, Regulation 95.

sheet and auditor's report should be open for inspection by members.[22] The register of contracts with companies and firms in which directors are interested, contracts entered into by the company for the appointment of managerial personnel, the register of particulars concerning directors, register of director's shareholdings and register of loans and investments are some other documents available for inspection by members. Members may not be allowed to inspect the documents containing the original contracts. However, the original contracts entered into for the appointment of a manager or managing director should be open to inspection by any member of the company.[23]

Inspection by Directors

Directors' right to inspect the books and other documents of a company is all embracing and not restricted to a few items as in the case of members or other persons. They have a statutory right to inspect the books of accounts and other books and papers of the company.[24] This right extends practically to every register, book or paper, including correspondence concerning the affairs of the company He can do this without payment of any charges. Anyhow, a director cannot demand copies of documents from the company as a matter of right. Any person who has been a director or

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22. See C.V. Narahari Rao, 'Company Law: Inspection of Documents I: Members Right to Inspection and Copies of Documents', (1974) 1 M.L.J.31.

23. The Companies Act 1956, S.302.

24. Id., S.209(4).

officer of a company which is wound up, is entitled to inspect the file of liquidation proceedings free of charge.[25]

A director of a company may inspect the books of account either personally or through an agent. In Vakharia v. Supreme General Film Exchange Co.,[26] one N.V. Vakharia, a director of a company filed a suit for a declaration that he was entitled to take inspection of the books of account and other papers of the company by some skilled agent appointed by him. The Court held that even if the articles of a company prohibited a director from taking inspection of documents through an agent, the article was ultra vires, and hence the director was entitled to make inspection through an agent. Tendolkar J. observed:

> "...a director is entitled to take inspection of accounts not only personally but also through an agent, provided there is no reasonable objection to the person chosen as an agent and the agent undertakes not to utilise the information obtained by him for any purpose other than the purpose of his principal."[27]

But the Courts in England have taken a different view and have held that the right of the director being a personal right cannot be delegated.[28] Considering the fact that right

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25. The Companies Court Rules 1959, Rule 360.
26. A.I.R. 1948 Bom.301.
27. Id. at p.303.
28. See McCollin v. Gilpin, (1880) 5 Q.B.D.360.

of other persons like members, creditors etc. to inspect companys documents is limited, the view expressed by the English Courts seems to be more convincing.

Rights of Creditor or Contributory

Two classes of documents viz., the copies of instruments creating charges and register of charges required to be kept by a company, should be open to inspection by creditors or contributory. They need not pay any fee for this purpose. But they can exercise this right only during normal business hours of the company. They can also inspect books kept by the liquidator, subject to the control of the Court.[29] They are also entitled to inspect the accounts and auditor's certificate in the office of the Court on payment of a fee of one rupee. It is possible to obtain a copy of the above documents on payment of the prescribed charges.

Right of Public Trustee

Under the Companies Act 1956, a Public Trustee is entitled to receive and inspect all books and papers, which a member is entitled to receive and inspect.[30] This is to enable him to exercise the rights and powers conferred on him under the Act. This right is subject to the provision contained in Section 153-B[31] of the Act. However, both

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29. The Companies Court Rules 1959, Rule 461.

30. The Companies Act 1956, S.187-B(6).

31. Id., Sub-Section 4 of Section 153B enumerates the circumstances when the right under this provision cannot be invoked.

these provisions will not apply in relation to a trust (1) where the trust is not created by an instrument in writing; or (2) even if the trust is created by an instrument in writing, where the value of the shares in or debentures of a company held in trust does not exceed one lakh rupees; or (3) exceeds one lakh rupees but does not exceed five lakh rupees or 20 per cent of the paid up share capital of the company whichever is less.[32]

Powers of Registrar or Officer Authorised by the Central Government

An effective method of exercising administrative check on the performance of companies is scrutiny of balance sheet and profit and loss account filed by them with the Registrar of Companies. The Registrar may call for information and explanation with respect to any matter to which such documents relate.[33] The object of inspection by the Registrar is not only to keep a watch on the performance of companies, but also to evaluate precisely the level of efficiency in the conduct of the affairs of the company concerned. The inspection may also enable the Government to ascertain the quantum of profits which have accured but not adequately accounted for taxation purpose. These inspections may also reveal concealment of income by falsification of accounts, misuse of fiduciary duties by management, misapplication of money when the company itself

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32. Id., S.153 B.
33. Id., S.234.

is in a state of crisis etc. Knowledge of these matters may enable the Government to take effective emergent remedial measures before the company goes into liquidation.

The Companies Act provides that[34] the books of account and other books and papers of the company should be open for inspection by the Registrar or any officer authorised by the Central Government. Such inspection may be made at any time during the business hours of the company. Previous notice to the company or any of its officers is not necessary for making inspections. Every director, officer and employee of the company is under a duty to give assistance to the Registrar or the officer making inspection. The extent of the assistance is that which the company is reasonably expected to give. All such persons should produce books of account and other books and papers of the company in his custody or control. He may also be required to furnish any statement, information or explanation relating to the affairs of the company. In that event he should produce such statement etc. at such time and at such place as may be specified.[35] The directors who appear to have been on the register of the company as directors for some period for which accounts are compiled by the auditors and explanations are sought, would also be liable to answer the quarries for the period during which they were acting as directors.[36] Any default made by the officers or employees

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34. After the Companies (Amendment) Act 1974, (41 of 1974).
35. Id., S.209 Sub-Section 1,2 & 3.
36. In re Bhavnagar Vegetable Products, 1977 Tax.L.R.2225 (Guj.).

of the company is punished heavily.[37] The directors or other officers of the company convicted under this provision are disqualified from holding such offices for a period of five years from the date of conviction.[38]

The effect of an inspection made under Section 209A of the Companies Act 1956, was considered by the Delhi High Court in Modi Industries Ltd. v. Union of India.[39] In this case an order was passed by the Company Law Board appointing one Suresh Behari to inspect the books of account and other papers of a company, namely Modi Sugar Mills Ltd. On the basis of the inspection report, the Company Law Board ordered a special audit of the company's accounts. The justification advanced by the Company Law Board for this action was that according to the inspection, certain transactions had taken place which showed that the company was not being managed according to sound business principles and prudent commercial practices. Later, the Central Government decided that no special audit was necessary. But the Company Law Board ordered an investigation of company's affairs under Section 237(b) of the Companies Act. Considering the fact that special audit was dropped after considering the inspection of books and accounts of the company, the Court held that the order for investigation was not sustainable.[40]

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37. See the Companies Act 1956, S.209A(8). The minimum punishment provided is a fine of five thousand rupees. In addition, the person may be imprisoned for a term not exceeding one year.

38. Id., Sub-section(9).

39. (1982) 52 Com.Cas.589 (Delhi).

40. Id., at p.608 per D.K. Kapur, J.

The Registrar or any other person authorised by the Central Government have the same power as the Civil Court in certain matters.[41]

After making the inspection, the person making it should give a report to the Central Government.[42] The Central Government is increasingly resorting to the inspection provisions.[43]

On receipt of the report of the inspectors based on factual appreciation of the position disclosed in the books of accounts of the company, the Central Government can take follow-up actions.[44]

Registrar's power to call for information

A company is required to submit a number of documents and returns to the Registrar. If, on perusing such documents,

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41. The Companies Act 1956, S.209A(5).

42. Id., Sub-section 6.

43. The number of inspections ordered by the Central Government from 1967 to 1982 was as follows:

Year	No. of working companies	Number of Inspections ordered
1967-68	27943	188
69-70	28948	261
72-73	33356	338
76-77	45369	421
77-78	47911	405
78-79	50914	389
81-82	71689	280

Source: Annual Reports of the Working and Administration of the Companies Act 1956.

44. The Companies Act 1956, S.234.

the Registrar considers it necessary, he may call explanation or further informations from the company. The information sought for should relate to matters to which the document purports to relate.[45] When the Registrar serves a written order on the company for this purpose, the company and its officers should furnish the information or explanation called for to the best of their power.[46] A person who has been an officer of the company is also required to furnish the information or explanation, if directed.[47] The Registrar may direct the production of the books and papers of the company before him if (1) no information or explanation is furnished to him in compliance with his direction or (2) the information or explanation produced is inadequate. Any default or negligence on the part of the company or its officers is severely punished.[48] The Court trying the offence may order the company to produce the books and papers before the Registrar.[49] But the order would be limited to the extent what the court considers be reasonably required by the Registrar for the purpose. The Registrar may take copies or extracts of the documents brought to him under the above provisions.

Representation by Members or Creditors

Any member, creditor, contributory or a person interested in the affairs of the company may represent to the Registrar

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45. Id., S.234(1).
46. Id., Sub-Section (2).
47. Id., Sub-Section (3).
48. Id., Sub-Section (4).
49. Ibid.

about the working of the company. If the materials placed before the Registrar by such persons are sufficient to indicate that the business of the company is carried on in fraud of its creditors or of persons dealing with the company, he may call upon the company to furnish information or explanation in those matters. Before making this order, the Registrar should give an opportunity to the company of being heard.[50] If upon enquiry the Registrar is satisfied that the representation was frivalous or vexatious, he may disclose the identity of the representationist to the company.[51]

The Andhra Pradesh High Court held that persons who were aggrieved by the constitution of a company on the ground that it was formed to circumvent the benefits given to them by a statute and that the affairs of the company were conducted to their detriment might seek redress from the Registrar under this provision.[52]

Prosecution of the Company or Its Directors

The discretion of the Registrar in making an order calling information or explanation from a company on representation from a member or other person is very wide. In exercise of power under this provision he may, instead of taking action under the Act, make a complaint to the police.[53]

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50. Id., Sub-Section (7).

51. Ibid.

52. T.V. Krishna v. Andhra Prabha (Pvt.) Ltd., A.I.R.1960 A.P.123.

53. M. Vaidyanatham v. The Sub-Divisional Magistrate, Erode, A.I.R. 1957 Mad.65.

The real subject matter of the section is to facilitate investigation of the affairs of the company and a prosecution by the police for offences connected with the accounts of the company is not barred. The Calcutta High Court has observed that even private prosecutions are not exempted from this provision.[54] The Registrar can initiate proceedings under this provision even after the company goes into voluntary liquidation.[55]

Prosecution can be launched by the Registrar in two circumstances (1) when there is a failure to provide information or explanation as required by him or as directed by the Court;[56] (2) where on examination of the documents and information produced before him, the Registrar is of the opinion that some offence had been committed by the officers of the company.[57] It is not even necessary to give an opportunity to the persons prosecuted for explaining before a complaint is made to the police.[58]

The Extent of Registrar's Power

The power of the Registrar to call for information under Section 324 is with respect to any matter to which documents submitted to him relate.[59] The nature of the

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54. Surendra Nath Sarkar v. Kalipada Das, A.I.R.1940 Cal.232.
55. The Companies Act 1956, S.234(8).
56. Sitaldas Pohumal v. Mihalchand Issardas, A.I.R.1942 Sind.7.
57. Coimbatore Spinning & Weaving Co.Ltd. v. M.S. Sreenivasan, A.I.R.1959 Mad.229.
58. See supra n.53.
59. Golconda Industries (P) Ltd. v. Registrar of Companies, A.I.R. 1968 Delhi 170.

Registrar's duty before he decides to call for information was considered by the Madras High Court in The Coimbatore Spinning & Weaving Co.Ltd. v. M.S. Srinivasan.[60] The Court observed,

> "Neither sub-section (6) nor sub-section (7) requires that the Registrar of Companies should record any finding. Nor does either of the sub-sections say that the Registrar has to be satisfied that the representation is true; it is enough if he is of the opinion that the affairs of the company are being carried on in a manner specified in sub-section (1). "Opinion" does not denote the same state of mind as indicated by the word 'finding' or 'satisfaction.' The three words indicate varying stages of intellectual process."[61]

So, the forming of the opinion by the Registrar is a subjective process. The result is that eventhough the Registrar acts irregularly in hearing the company not before but after he has written his order,[62] the irregularity may not become material in the circumstances of the case.[63] However, the Registrar has a statutory duty to take steps against the company and its directors to correct irregularities in time,

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60. The Coimbatore Spinning & Weaving Co.Ltd. v. M.S. Srinivasan, A.I.R. 1959 Mad.229.

61. Id. at p.232 per B. Ayyar, J.

62. The Companies Act 1956, S.234(7) provides that 'an opportunity of being heard' should be given to the company before issuing an order to submit information or explanation.

63. The Coimbatore Spinning & Weaving Co.Ltd. v. M.S. Srinivasan, supra n.60.

if found necessary, on receipt of a representation. This is obligatory when the allegations in the representation relate to the present affairs of the company.[64] Even if the allegations relate to past conduct, the Registrar cannot brush aside that representation if the allegations suggest a scheme or continued set of operations and the persons who initiated or operated the scheme continue to be in a position to carry on the scheme as they had been doing in the past.[65]

The English Position

In England, the Department of Trade & Industry may at any time give direction to a company to produce its books and papers specified in the direction.[66] The Department or any officer authorised by it may take copies or extracts of the books and other documents. It may require any present or past officers or employees of the company to produce an explanation on any of the documents.[67] If they are not able to produce such information, the Department or officer may require that person to state facts which he knows to the best of his knowledge and belief.[68] Failure to comply with these directions would lead, on a summary conviction, to imprisonment for a term not exceeding three months or a fine not exceeding £200 or both.[69]

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64. The Companies Act 1956, S.234(7) contain the expression 'is being carried on.' This suggests that allegation should relate to the present conduct of the company.

65. The Coimbatore Spinning & Weaving Co.Ltd. v. M.S. Srinivasan, A.I.R.1959 Mad.229 at p.232.

66. The Companies Act 1967, S.109(1).

67. Id., Sub-Section (3)(a).

68. Id., Sub-section (3)(b).

69. Id., Sub-section (4).

Search and Seizure of Documents

Section 234A of the Companies Act 1956, empowers the Registrar to seize documents, books and papers of a company after obtaining the orders of a Magistrate where he has reason to believe that they may be destroyed or tampered with. Power is also conferred on the inspector appointed by the Government to investigate into the affairs of the company, to search and seize documents of a company after obtaining the orders of a Magistrate. The object is to prevent the books or documents of the company from being destroyed, mutilated, altered, falsified or secreted.

When the Registrar has a reasonable ground to believe that books and papers of or relating to a company may be destroyed, mutilated, etc., he may make an application to the Magistrate of the First Class for an order for the seizure of such books and papers.[70] The Presidency Magistrates having jurisdiction may also issue an order under this provision. The Magistrate may authorise the Registrar, to enter any place, search and seize books and papers.[71]

Similar powers can be exercised by Inspectors appointed by the Central Government also in relation to search and seizure of documents.[72]

The Method of Exercising the Power

The search either by the Registrar or by the Inspector

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70. The Companies Act 1956, S.234A(1).
71. Id., Sub-section (2).
72. Id., S.240A.

should be carried out in accordance with the provisions of the Code of Criminal Procedure 1973 (2 of 1973), relating to searches or seizure made under that code.[73] The process of taking decision by the Registrar or the Inspector whether to make an application to the Magistrate for an order for search and seizure appears to be an administrative one. But the order of the Magistrate for search and seizure is not administrative but judicial in character.

In K.Devaraian v. Tamil Nadu Farmers Co-Operative Federation,[74] the Madras High Court considered the nature of an order authorising an officer to search the premises of a company. The Court was examining the conditions for exercise of such power by the Director of Inspection, under the Income Tax Act 1961. There it was held that the Director of Inspection should record reasons for the belief he formed to the effect that the statutory conditions for the exercise of this power existed. The condition for the exercise of the power of search and seizure under the Companies Act 1956, is also similar. So, eventhough the process of taking decision by the Registrar or the Inspector is an administrative one, they should record the reasons for forming such an opinion and should disclose it before the Magistrate.[75]

In the case of a seizure by Registrar, he should return the books and documents as soon as possible. In any

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73. Id., S.234A(4) reads, "Save as otherwise provided in this Section, every search or seizure made under this Section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1898, relating to searches or seizures made under that Code."

74. (1981) 51 Com.Cas.682(Mad.).

case it should be returned not later than the thirtieth day after the seizure. He should inform the Magistrate about the return of the document.[76] When the seizure is made by the Inspector under Section 240A, he can retain the documents seized until the conclusion of his investigation. In this case also the returning of the documents should be intimated to the Magistrate.[77] Before returning the books and papers, the Registrar or Inspector, as the case may be, may take copies of or extracts from them. They can also place identification marks on them or any part thereof.

The English position

In England, the Court may issue a warrant authorising a constable together with any other persons named in the order to enter and search the premises of a company and take possession of any books or papers.[78] The Court will issue such a warrant only on being satisfied that there are reasonable grounds for suspecting that there are, on any premises, any books or papers of which production has been required and which have not been produced. The warrants continues in force until the end of the period of one month after its date of issue.[79] A person who obstructs the exercise of a right of entry or search or a right to take possession under the warrant, is liable to imprisonment for a term not exceeding three months or a fine of £200 on summary conviction.

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75. Id. at p.695 per Sethuraman, J.
76. The Companies Act 1956, S.234A(3).
77. Id., S.240(3).
78. The (English) Companies Act 1967, S.110.
79. Id., Sub-Section (2).

Inspection Provisions - An Appraisal

The present position enabling the Registrar or any officer authorised by the Central Government to inspect the books of a company without giving notice to the company is justifiable. On the basis of the inspection report, a special audit or investigation should be ordered if the reports suggest circumstances requiring such an action. It is necessary in the interest of the corporate sector, that the Courts should not ordinarily interfere with such orders. However, the Court may call for the inspection report and satisfy that the action taken is fair and reasonable in the circumstances revealed by the report. Administrative machinery need be strengthened to make effective use of these provisions.

CHAPTER 16

Investigations

The power to order an investigation into the affairs of a company is the most drastic power in the hands of the Central Government in relation to company law administration. This power is primarily intended to check the activities of dishonest and unscrupulous company managements.[1] This is a very serious step as the investigation can shake the credit of the company and thereby adversely affect its competitive position. It may so happen that, at the end, the allegations against the company may turn out to be unfounded or vexatious. But a proper investigation and timely action can save a company from liquidation. So if the mechanism of inspection and investigation are fully developed it could be used as an alternative to winding up in many cases, thereby protecting the interests of the shareholders, the workers, consumers and the community. Power of investigation into the affairs of a company is provided in the Companies Act 1956 (1 of 1956),[2] in the Monopolies and

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1. See the Company Law Committee Report, (1952), p.133.
2. The Companies Act 1956, Ss.235-251.

Restrictive Trade Practices Act 1969 (54 of 1969)[3] and in the Industries (Development and Regulation) Act 1951 (65 of 1951).[4] But the purposes of these investigations are different.[5] We are confining to investigations under the Companies Act.

Appointment of Inspectors

The Central Government is empowered to appoint one or more competent persons as inspectors to investigate the affairs of a company under certain circumstances. After the establishment of the Company Law Board,[6] the power of the Central Government in this regard is exercised by it.[7] The Calcutta High Court in New Central Jute Mills v. Deputy Secretary,[8] held that the effect of delegation of powers by the Central Government to the Company Law Board had been delegation of both power and duty. Here the facts of the case was as follows. The Central Government had delegated its powers under Ss.235-250 of the Companies Act 1956, to the Company Law Board. After this the Central Government appointed some persons as inspectors to conduct investigation of the company. The question was whether,

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3. The Monopolies and Restrictive Trade Practices Act 1956, S.44.
4. The Industries (Development and Regulation) Act 1951, S.15.
5. See infra n.33.
6. Hereinafter referred to as the CLB.
7. For delegation of powers to the Company Law Board, see supra Chapter-III.
8. New Central Jute Mills v. Deputy Secretary, A.I.R. 1966 Cal.151.

by the delegation of its powers, the Government had divested itself of its powers and duties. The Court answered in the affirmative and held that the Company Law Board alone could decide upon investigation and cause the same to be carried on.[9]

The Company Law Board (Bench Rules) 1975, provides that a Bench of the Company Law Board can exercise its powers.[10] So the power to appoint inspectors to investigate the affairs of a company can be exercised by the Chairman of the Company Law Board on behalf of the Board.[11] The Supreme Court had to consider a similar situation in Barium Chemicals Ltd. v. Company Law Board.[12] In this case, the Chairman of the Company Law Board ordered an investigation into the affairs of a company. The question to be decided was whether the Chairman could exercise any such power other than a matter of procedure. The Court held that the Chairman was not a delegate of the Company Law Board and even if he was a delegate, the order made by him would not be invalid since such delegation was permitted by implication. The Court observed,

> "Bearing in mind that the maxim, delegatus non potest delegare, set out what is merely a rule of construction, sub-delegation can be sustained if permitted by an express provision or by necessary implication. Where, as here, what is sub-delegated is an administrative power and control over its exercise is retained by the

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9. Id. at p.166 per Banerjee, J.
10. The Company Law Board (Bench) Rules 1975, Rule 3.
11. Barium Chemicals v. Company Law Board, A.I.R. 1967 S.C.295.
12. Ibid.

> nominee of Parliament, that is here the Central Government, the power to make a delegation may be inferred. We are, therefore, of the view that the order made by the Chairman on behalf of the Board is not invalid."[13]

When the opinion that an investigation should be ordered is formed by the Central Government and not by the Company Law Board, it is not possible for the Board to order an investigation.[14] It cannot also continue an investigation started by the Central Government.[15] The effect will be that the Central Government retain the power to control all aspects of investigations ordered by itself prior to the delegation of authority to the Company Law Board. So also, even after the establishment of the Company Law Board, the Central Government can exercise its jurisdiction to extend time for investigation or to appoint inspectors or co-inspectors.[16]

However, the Company Court exercising jurisdiction under section 237 of the Act has no power to appoint an inspector to investigate the affairs of the company.[17]

Circumstances under which an Investigation is Ordered

Investigation is a very serious matter as far as a company is concerned. The Supreme Court has accepted this

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13. Id. at p.306 per T.R. Madholkar, J. and A.K. Sarkar, C.J.
14. New Central Jute Mills v. Deputy Secretary, A.I.R. 1966 Cal.151.
15. Ibid.
16. Ibid.
17. In re Alembic Glass Industries Ltd., 1971 Tax.L.R. 1838 (Guj.).

view and said that investigation should not be ordered except on good and satisfactory grounds.[18] The circumstances under which the Company Law Board should order investigation into the affairs of a company may be classified into two:

(1) Circumstances where it is mandatory that the Company Law Board should order investigation.

(2) Circumstances where the Company Law Board has a discretion to order investigation.

Mandatory Provisions

When a company by special resolution declares that the affairs of the company ought to be investigated by an inspector appointed by the Central Government, the Company Law Board should appoint one or more inspectors for the purpose.[19] Similarly, the Company Law Board should appoint inspectors if so directed by the Company Court.[20] In Rohtas Industries v. S.D.Agarwal,[21] the Supreme Court held,

> "Under Section 237(a), the Government is bound to appoint inspector for investigation if the company by special resolution or the Court by order declares that the affairs of the company ought to be investigated."[22]

It is not clear from the provisions of Section 237(a)(ii) who is the party competent to apply for a direction from the

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18. Rohtas Industries v. S.D. Agarwal, A.I.R. 1969 A.I.R.1969 S.C.707 at p.713.
19. The Companies Act 1956, S.237(a)
20. Ibid.
21. A.I.R. 1969 S.C.707.
22. Id. at p.707 per Hegde, J.

Court. But the decisions of different High Courts give some directions in this regard. The Gujarat High Court examined this matter in In re Alembic Glass Industries Ltd.[23] In this case, a shareholder of the Alembic Glass Industries Limited, filed a petition for an order for investigating the affairs and the conduct of the company. The jurisdiction of the Court to entertain the petition was challenged by the company. It was argued that the Court could not make an order under Section 237(a)(ii) by entertaining a petition from any person. The Court could give such an order only when examining the affairs of a company in respect of some other proceeding against the same company. In such case, the Court may, in order to give full relief and to effectively adjudicate upon the issues raised before it could direct the Government to appoint an inspector.[24] Rejecting this argument the Court said,

> "[There is nothing in] Section 237(a)(ii) indicating that a petition simpliciter for an action thereunder cannot be entertained, but that power conferred by it can only be exercised by the Court against the company in respect of whom some other proceeding is pending in the Court and the Court considers it proper to direct appointment of an inspector."[25]

In the same case, the Court also observed that the High Court had jurisdiction to entertain a petition under Section 237(a)(ii), notwithstanding the fact that the party invoking

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23. In re Alembic Glass Industries Ltd. 1971 Tax.L.R. 1838 (Guj.).

24. Ibid.

25. Id. at p. 1842 per Desai, J.

the jurisdiction had not approached the Central Government.[26] But the Allahabad High Court took a different view in Rachunath Swarup Mathur v. Harnarayan Mathur.[27] The Court held,

> "As the declaration under Section 237(a)(ii) amounts to a direction to the Central Government, it should only be granted either where a party, having applied to the Central Government for an investigation, has failed despite sufficient grounds shown for it, or, when the Court finds that a proceeding before it, under either Section 397 or 398 of the Act, cannot satisfactorily terminate without such an investigation."[28]

The result of this finding is that where a proceeding under Sections 397 or 398 is not sustainable, a direction under this provision also cannot be given.

It is, however, possible to argue that on the analogy of the decision in Pedley v. Inland Water Ways Association Ltd.,[29] the right to approach the Court for an order under Section 237(a)(ii) should be subjected to the minimum support of members mentioned in Section 235. Then the minimum number

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26. Id. at p.1840.

27. Rachunath Swarup Mathur v. Harnarayan Mathur, (1970) 40 Com. Cas. 282 (All.).

28. Ibid.

29. (1977) 1 All E.R.209. In this case the Court held that though a member has a right to give notice to the company signifying his intention to move a resolution for removing a director, he has no legal right to claim that the resolution should be included in the agenda of meeting. This could be enforced only when the minimum number of members required to call an extra-ordinary meeting of the company supports such a resolution.

of members prescribed under that section should make a joint petition to the Court for an order under Section 237(a)(ii). They should also satisfy the Court that they had applied to the Central Government and had shown sufficient grounds for an order of investigation, but the Government had rejected their petition. In the alternative, they should approach the Court under Section 397 or 398 and satisfy the Court that a direction for investigation of the affairs of the company is needed to meet the ends of justice.

If the other view is taken, ie. even a single shareholder is allowed to approach Court for an order under the provision it may create undesirable burden on the company. The Delhi High Court did not favour such a position and took the view that it was unnecessary to order an investigation merely because a shareholder felt aggrieved at the manner in which the company's business was being conducted.[30] The Court said that there must be some sort of material which would result in proceedings being taken.

However, if the petitioners can make it abundantly clear by adducing strong evidence, that the company's affairs are being carried on in a manner specified in Section 237(b), there could be no harm in giving a direction under this provision. The Calcutta High Court expressed such a view in

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30. In re Delhi Flour Mills Co. Ltd., (1975) 45 Com. Cas. 33 (Delhi).

in one case.[31] In In re, Patrakola Tea Co.,[32] a share-holder of the Patrakola Tea Company Limited applied for an enquiry into the affairs of the company. The petitioner alleged that a large number of shares of the company had been purchased by another company for a very high price with the backing of some secret agency. He relied upon some newspaper report which gave an unconfirmed news about the purchase. The Court asked for some convincing proof for giving an order. It was held that the Court might ask for convincing proof of the allegations made by the petitioners before an order was issued.

From the foregoing discussion it appears that there is no limit on the jurisdiction of the Court to entertain a petition for giving a direction to the Central Government to appoint an inspector to investigate the affairs of a company. The Act provides three distinct methods by which a party desirous of getting the affairs of the company investigated, may get an Inspector appointed by the Central Government; (1) If the requisite number of members are available, application can be made under Section 235; (2) If the share holder is able to canvass the requisite number of members, he can initiate to pass a special resolution for this purpose; (3) If he is unable to collect the requisite number of members for adopting the above two options, he can bring to the notice of the Central Government various malpractices

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31. In re, Patrakola Tea Co. Ltd., A.I.R. 1967 Cal.406.
32. Ibid.

committed in the administration of the affairs of the company and the Central Government may act suo motu under Section 237(b). In this case he can even approach the Court and give convincing reasons and if the Court is satisfied it can give direction to the Central Government for this purpose.

Discretionary Jurisdiction of Company Law Board

The Company Law Board may, in its discretion appoint inspectors for investigating the affairs of a company in the following circumstances:

1. On the application of the prescribed number of members. In the case of a company having share capital, the prescribed minimum number is two hundred members or members holding one tenth of the total voting power. For companies not having a share capital, the number is one fifty of the members on the company's register of members.[33]

In V.A.Sumathi v. Dipvijay Chit Funds,[34] the Kerala High Court examined the power of the Company Law Board to order an investigation, when the number of applicants was below the prescribed minimum. The Court held that the Company Law Board was incompetent to order an investigation in such cases. It appears that if the Company Law Board is satisfied

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33. The Companies Act 1956, S.235.
34. 1981 Tax. L.R. 2423(Ker.).

about the existence of some circumstances for ordering an investigation, it should be allowed to take action under Section 237(b).

2. Suo motu by the Company Law Board. The Company Law Board can order an investigation, if there are circumstances suggesting any of the following conditions:[35]

(a) the business of the company is being conducted with the intent to defraud creditors, members or any other persons, (b) the company's business is conducted in a manner oppressive of any of its members or for a fradulent or unlawful purpose; (c) the company was formed for any fradulent or unlawful purpose; (d) the person concerned in the formation of the company or the management of its affairs is guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; (e) the members of the company have not been given all the information with respect to its affairs which they might reasonably expect. This includes information relating to the calculation of the commission payable to a managing or other director, the manager etc. of the company.

Investigation on Application of Members

The Company Law Board may require the applicants to show that they have good reasons for requiring the investigation The applicants may be required to give security for payment

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35. The Companies Act 1956, S.237(b).

of the costs of the investigation. But, such security demanded should not exceed one thousand rupees.[36]

In the view of the Supreme Court, it is not obligatory for the Company Law Board to direct an investigation under Section 235. In Mool Chand Gupta v. Jagannath Gupta and Co.(P) Ltd.,[37] the petitioner, Mool Chand Gupta, applied for an order of investigation into the affairs of the company, but the Government had not appointed any Inspector. Thereupon the petitioner applied to the Court for a winding up order on the ground that due to the inaction of the Government, he had lost the avenue for seeking redress and it was just and equitable to wind up the company. The Court considered the obligation of the Government to appoint an Inspector and observed that the power of the Government in this regard was only a discretionary one and the Court need not interfere with this discretion in the circumstances of the case. Sarkaria, J. observed:

> "... Under Section 235 [of the Companies Act 1956] it is not obligatory for the Central Government to direct an investigation. It has a discretion to appoint or not to appoint inspectors for investigating the affairs of the company, the word used in the section being 'may'. Before the Government can take such action under Section 235 certain preconditions including those specified in Section 236 must be satisfied... The discretionary power of the Central Government is neither judicial nor quasi-judicial."[38]

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36. Id., S.236.

37. A.I.R. 1979 S.C. 1038.

38. Id. at p.1041. See also Rohtas Industries v. S.D.Agarwal, A.I.R. 1969 S.C. 707.

and acts by the Central Government

Under Section 237(b) of the Companies Act 1956, also, it is not mandatory on the part of the Central Government to order an investigation into the affairs of the company and to call for a report.

In Indian Express, Madurai Ltd. v. Chief Presidency Magistrate,[39] the Madras High Court considered this question. In this case the Company Law Board made an inspection of the books and accounts of the Express News Papers Ltd. and found that some shady and questionable transactions had taken place. Instead of taking action under Section 237(b) of the Companies Act 1956, the Government filed a complaint with the police and the police took prosecution proceedings. This action of the Government was challenged in the High Court. Regarding the obligation of the Government to take action under Section 237(b), the Court observed,

> "It must also be noted that under Section 237(b) of the Companies Act, it is not mandatory on the part of the Central Government to order an investigation into the affairs of a company and to call for a report thereon even if in the opinion of the Central Government, the circumstances mentioned under Sub-Section (6) of Section 237 exist."[40]

In such cases, the Company Law Board has two options: (1) to order an investigation into the affairs of the company, or

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39. Indian Express (Madurai) Pvt. Ltd. v. Chief Presidency Magistrate, 1975 Tax. L.R. 1620 (Madras).

40. Id. at p.1629 per Veeraswami, C.J.

(2) to lay information to the police to investigate under Criminal Procedure Code.[41] There is nothing in the Companies Act 1956, which limits the power of the police to investigate under the Criminal Procedure Code.[42]

Before ordering an investigation into the affairs of a company, the Government should form an opinion that there exist circumstances warranting such an action. Surely, the Government has authority to take proceedings suo motu, but this does not mean that it can act on mere inspiration. It seems necessary that the Government must have before it some complaint, application or representation of a person having a stake in the affairs of the company or its shareholding.[43] The complaint or representation may be from the Registrar, State Government, creditors, or workers. On general principles, it cannot be said that any person, even a man in the street, could seek orders for investigation into the affairs of a company merely because it is a public company and its affairs are in his opinion, being conducted to the detriment of the public interest. In the opinion of Delhi High Court, the interest which such a person may have as a member of the public, in the purity of administration of public companies was too remote and intangible.[44]

The purpose of investigation is to discover something which is not visible to the naked eye. But, it is not related

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41. Ibid.

42. Ibid.

43. See the opinion of the Madhya Pradesh High Court in Sivajeerao Cotton Mills Ltd. v. Company Law Board, (1969) 39 Com. Cas. 856 (M.P).

44. V.V.Puria v. E.M.C. Steel Ltd., 1979 Tax. L.R.95 (MOC); (1980) 50 Com. Cas.127(Delhi.)

to the economic working of the company and is intended to see whether allegations concerning mismanagement, misappropriation or other illegal acts are justified.[45] So, the persons making the complaint or representation should bring out some malpractices in the working of the company which would raise an inference of dishonesty or some such similar ground which would lead to an inference of mismanagement or oppression.[46]

The power conferred on the Company Law Board to direct an investigation into the affairs of a company is a discretionary power. But, this does not mean that it has a complete and unexaminable discretion. In Barium Chemicals v. Company Law Board,[47] the Supreme Court examined the nature of this discretionary power. In this case, the Company Law Board appointed four Inspectors to investigate the affairs of the Barium Chemicals Company Ltd. The order was challenged by the company on various grounds. It was contended that the order was made *malafide* and in making the order the Board had acted on materials extraneous to the matters mentioned in Section 237(b) of the Companies Act 1956. The order was quashed on these grounds. Justice Hidayatullah observed that the

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45. In re Delhi Flour Mills Co. Ltd., (1975) 45 Com. Cas. 33 (Delhi)

46. Barium Chemicals v. Company Law Board, A.I.R. 1967 S.C. 295.

47. A.I.R. 1967 S.C.295.

grounds mentioned in the Section limits the jurisdiction of the Central Government. He said,[48]

> "No jurisdiction outside the Section which empowers the initiation of investigation can be exercised.... the enumeration of the inferences which may be drawn from the circumstances, postulates the absence of a general discretion to go on a fishing expedition to find evidence. No doubt the formation of opinion is subjective, but the existence of circumstances relevant to the inference as sine qua non for action must be demonstrable."

The Madhya Pradesh High Court made the following observation in this regard:

> "... Before exercising power under Clause (b) of Section 237, the Government must first form an opinion that an investigation is necessary. The opinion must be founded on circumstances suggesting the inferences through sub-clauses of clause(b). The Court cannot test the opinion of the Government that an investigation is necessary; but it can always examine the basis for the opinion, and if it can be shown that circumstances suggesting any of the prescribed inferences does not exist or that the circumstances are such that it was impossible for any one or the Government to reasonably have formed any opinion on their basis suggestive of the matters enumerated in Section 237(b), then the action taken under Section 237(b) must fail, since its foundation has been removed..."[49]

From this, it is clear that a Court cannot go into the questions of aptness or sufficiency of the grounds upon which

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48. Id. at p.309.

49. Dakshina Moorthi v. District Signal Telecommunication Engineer, (1969) I L.L.J.351 (Mad.).
See also Asoka Marketing Ltd. v. Union of India, (1981) 51 Com. Cas. 634 (Delhi).

the subjective satisfaction of an authority is based. However, it is necessary that Company Law Board should form an opinion. The Supreme Court observed,

> "... The words 'in the opinion of Central Government' in Section 237(b) indicate that opinion must be formed by the Central Government and it is ofcourse implicit that it must be an honest opinion."[50]

So where the exercise of power is challenged as malafide in a Court, the Company Law Board should show that prima-facie reasons existed and were considered before the order was made.[51] It is not enough to show that it had followed the law in making the order and did not act without any legal excuse.[52] It is also necessary that reasons must exist when the order is made. Reasons found afterwards cannot justify an order in retrospect, if they were not available to the authority exercising its powers in arriving at an opinion in conformity with the provisions.[53] Similarly, when Company Law Board has formed its opinion on circumstances which are irrelevant, it is not possible to hold that it has formed the requisite opinion.[54] The Madhya Pradesh High Court observed,

> "If it be found that circumstances relevant to the inferences specified in sub-clause (ii) of clause(b) of Section 237 did not exist or that the circumstances

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50. Barium Chemicals v. Company Law Board, A.I.R. 1967 S.C. 295 at p.309 per Hidayatullah, J.

51. New Central Jute Mills v. Union of India, A.I.R. 1970 Cal.159.

52. Ashoka Marketing v. Company Law Board, A.I.R. 1967 Cal.159.

53. New Central Jute Mills v. Union of India, supra n.51.

54. Jivajirao Cotton Mills Ltd. v. Company Law Board, (1969) 39 Com. Cas.858 (M.P).

> on which the Government formed its opinion were irrelevant or were not such as to lead to conclusions of 'certain definitions' about fraud, misfeasance or mis-conduct on the part of persons in the management of the affairs of the company towards the company or towards any of its members or that an expert body like Company Law Board could not have reasonably made the impunged order on the basis or the material before it, then it must be held that the Company Law Board did not form the requisite opinion in accordance with Law and the impunged order is invalid."[55]

The position at present may be summarised as follows:

1. The process of taking decision to order an investigation into the affairs of a company is a subjective process. It is of a tentative character to open up a fuller probe to find the truth of allegations and such mental process which form the core of the opinion to be formed by the Company Law Board is not open to judicial review.[56]

2. The power to direct investigation is neither judicial nor quasi-judicial.[57]

3. The Company Law Board should form an opinion that an investigation is necessary. The opinion must be founded on circumstances suggesting the inferences suggested in Section 237(b).[58]

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55. Ibid. at p.856.

56. Ibid.

57. Moolchand Gupta v. Jagannath Gupta and Co. (P) Ltd., A.I.R. 1979 S.C.1013.

58. Indian Express (Madurai) Pvt. Ltd. v. Chief Presidency Magistrate, 1975 Tax. L.R. 1620.

4. The opinion formed by the Company Law Board must be an honest opinion.[59]

5. It is not obligatory on the part of the Company Law Board to disclose grounds in an order for investigation. But, if the order is challenged as malafide in a Court, it should disclose the grounds for the decision.[60]

6. The circumstances on which the opinion is formed should exist at the time when the direction for investigation is made. Any reason found afterwards cannot justify an order in retrospect.[61]

7. The Company Law Board should consider circumstances relevant to the inferences specified in Section 237(b). If an order is based on irrelevant materials, it becomes invalid.[62]

The combined effect of all these is to suggest that though the power of the Company Law Board is not judicial or quasi-judicial, it should be exercised judiciously. The action should be fair, reasonable and taken in good faith.

The extent of Investigations

The investigation under these provisions is about the affairs of the company.[63] The expression 'the affairs of the company' is wide enough to include contravention of any law

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59. Barium Chemicals v. Company Law Board, A.I.R. 1967 S.C.295.

60. New Central Jute Mills v. Deputy Secretary, A.I.R. 1966 Cal.151.

61. New Central Jute Mills v. Union of India, A.I.R. 1970 Cal.163.

62. Jiyajeerao Cotton Mills v. Company Law Board, (1969) 39 Com. Cas. 856.

63. See the Companies Act 1956, S.235(1).

for the time being in force. There is no limitation as regards the period of affairs to be investigated or as regards the persons in management of the affairs of the company or as regards the members of the company.[64] Under the provision, it is not obligatory on the part of the Government to prescribe the manner in which the report by the inspector is to be made.[65] So, any person having a stake in the affairs of the company, who is aggrieved by the constitution of a company on the ground that it is formed for the purpose of depriving him of a benefit conferred on him by a statute or that its affairs are conducted to his detriment can seek redress.[66]

Law makes the investigation comprehensive of all sorts of illegalities. So misdeeds of prior management can be fully investigated, exposed and remedied under these provisions.[67] Similarly, misconduct of promoters or directors which has produced pecuniary loss to the company by misapplication of its assets or other acts can be thoroughly investigated.[68] Similarly, the appropriate remedy for a person alleging manipulation of accounts against a director is an application for an order for investigation. However, the Calcutta High Court

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64. Jiyajiserao Cotton Mills v. Company Law Board, (1969) 39 Com. cas. 856.
See also New Central Jute Mills v. Deputy Secretary, A.I.R. 1966 Cal.151.

65. Ibid.

66. T.V. Krishna v. Andhra Prabha, A.I.R. 1960 A.P.123.

67. In re Saw Mills and Industries Ltd., A.I.R. 1962 Ker. 148.

68. See Barium Chemicals v. Company Law Board, A.I.R. 1967 S.C. 295

held that the affairs of a company cannot be investigated for the alleged fraud or misconduct of some of its shareholders.[69] Similarly, appointments and salaries of employees cannot be gone into in the investigation.[70] Since the investigation relates to management and affairs of the company, the Calcutta High Court holds the view that an investigation cannot be ordered against a company which have gone into liquidation.[71] It also held that where remedy of investigation has been chosen, winding up should not be allowed to be pursued.[72] The Supreme Court also gave a similar decision in Moolchand Gupta v. Jagannath Gupta and Co. (P) Ltd.[73] The Court held:

> "In a case where no inspectors have been appointed under Section 235 or Section 237 and no parallel investigation by the Central Government or its authorities under the Companies Act into the affairs of the company are continuing, nor it is a case where the High Court thinks that for a proper and effectual adjudication of the petition pending before it, it is necessary to get the matter investigated through the agency of the Central Government, [the High Court should not stay the proceeding on the petition for winding up]."[74]

In another case, the Supreme Court has examined the terms 'misfeasance', 'fraud' and 'intention to defraud' appearing in

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69. In re Patrakola Tea Co., A.I.R. 1967 Cal.406.
70. In re Delhi Flour Mills Co. Ltd., (1975) 45 Com. Cas. 33 (Delhi).
71. Priyanath v. State, A.I.R. 1959 Cal.387.
72. Jagannath Gupta and Co. v. Mulchand, A.I.R. 1969 Cal. 363.
73. Moolchand Gupta v. Jagannath Gupta and Co. (P) Ltd, A.I.R. 1979 S.C. 1038.
74. Id. at p.1041.

Section 237(b) of the Act for which an investigation can be ordered. The Court held that 'misfeasance' results from an act or conduct in the nature of a breach of trust or an act resulting in loss to the company.[75] The expression 'with intend to defraud' was interpreted as connoting an intention to deprive by deceit.[76] Similarly, the word 'fraud' was given the meaning actual dishonesty.[77]

Conduct of Investigation

After forming an opinion to the effect that the affairs of a company is to be investigated, the Company Law Board may appoint one or more competent persons as inspectors.[78] At present only natural persons can be appointed as inspectors. The appointment of firm, body corporate or other associations as inspector is prohibited.[79] A company itself may appoint an inspector by ordinary resolution for investigating its affairs.[80] On a complaint made by the Registrar[81] or on private complaint,[82] the police may investigate the matter under the Criminal Procedure Code.[83] The provisions relating to investigation is

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75. Barium Chemicals v. Company Law Board, A.I.R. 1967 S.C.295
76. Ibid.
77. Ibid.
78. The Companies Act 1956, S.235(1)
79. Id., S.238. Previously a firm could also be appointed as inspector.
80. Vakil v. Bombay Presidency Radio Club, A.I.R. 1945 Bom. 475.
81. Indian Express (Madurai) Pvt. Ltd. v. Chief Presidency Magistrate, 1975 Tax. L.R. 1620 (Mad.)
82. Emperor v. Vishwanath, A.I.R. 1942 Sind.9.
83. Indian Express (Madurai) Pvt. Ltd. v. Chief Presidency Magistrate, 1975 Tax. L.R. 1620 (Mad.).

applicable to private companies as well.

The duties of the inspector is neither judicial nor quasi-judicial in their nature. The Madras High Court examined this aspect in Coimbatore Spinning and Weaving Mills Ltd. v. M.S. Sreenivasan.[84] In this case, the Central Government appointed one M.S. Sreenivasan as inspector to investigate the affairs of the petitioner company. His appointment was challenged on the ground that the duty of the inspector was quasi-judicial in nature and since he was interested in the matter he cannot act as judge. But the Court negatived this contention and held that the duties of an Inspector here was not judicial or quasi-judicial. The Court said:[85]

> "It is well settled that where the duties of an Officer are not judicial or quasi-judicial then the question of bias becomes irrelevent and does not disquality."

Since investigation is not of judicial character, considerations of natural justice are irrelevant in its conduct.[86] The inspector must conduct the investigation as quickly and in such a manner as may reduce the threat to the credit of the company to the minimum.[87] From the nature of the work done by the inspector it appears that he may partly delegate, share or even leave it to another person. It is not obligatory on the part of the Central Government to prescribe the manner in which

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84. A.I.R. 1959 Mad. 229.

85. Id. at p.235 per B. Ayyar, J.

86. Ashoka Marketing v. Company Law Board, A.I.R. 1967 Cal. 159.

87. New Central Jute Mills v. Deputy Secretary, A.I.R. 1966 Cal.151.

inspections are to be made. So the non-specification of the manner is not fatal to the appointment of an inspector.[88] The inspector merely probes into the affairs of a company and embodies in the report his opinion. There is no guarantee that the Company Law Board would accept his opinion. The company may always condemn the opinion as a bad opinion.[89]

The inspectors appointed under these provisions have wide powers to investigate the affairs of the company. He may investigate the affairs of other body corporate which has at any relevent time been the company's subsidiary or holding company, if he considers it necessary to do so. Any company which is or has been managed by company under investigation or accustomed to act under its instructions or otherwise been under its influence may also come under the investigation.[90] The inspector should obtain the approval of the Company Law Board for this purpose.[91] The Company Law Board, before giving its approval should give an opportunity to such body corporate to show cause against the proposed investigation.[92] The power of the inspectors for inspection, search and seizure of documents is similar to that of the Registrar of Companies.[93]

The expenses for investigation by an inspector appointed by the Central Government should be met by the Central Government itself in the first instance. But this could be recovered

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88. Ibid.
89. Id. at pp. 163, 164
90. The Companies Act, 1956, S.239.
91. Id., Subsection (2)
92. Id., Subsection (3)
93. For a detailed discussion on this see Ch.15 supra.

from any of the persons mentioned in the Act subject to the conditions laid down there.[94] Thus, any person convicted on prosecution initiated in pursuance of the investigation, the applicants for the investigation etc. may be directed to reimburse the expense to the extent specified therein. If the company is wound up, the Government is not entitled to any priority in payment of this money.[95]

Follow up Actions on Investigation Report

The inspectors should make a report to the Company Law Board on conclusion of the investigation.[96] They should send interim reports to the Company Law Board, if so directed. A copy of the final report should be sent to the concerned company, by the Company Law Board.[97] A copy of any report of the inspectors, properly authenticated, is admissible as evidence in any legal proceeding. The evidentiary value extends only to the opinion of the inspectors to any matter contained in the report.[98]

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94. The Companies Act 1956, S.245.

95. Secretary of State v. Punjab Industrial Bank, A.I.R. 1931 Lah. 351) In this case, the Government on a report made to it by the Registrar, ordered an investigation into the affairs of a bank. On receipt of the report of the investigator, the Government directed the payment of a specified sum as expenses of investigation. When the bank went into liquidation, Government claimed priority in respect of the amount. The Court held that the Government was not entitled to priority of payment.

96. The Companies Act 1956, S.24.

97. After the Companies (Amendment) Act 1965, it is not necessary to send interim reports of inspectors to the company. See Id., S.241(2)

98. Id., S.246.

On the basis of the report, the Government may initiate any of the following actions:

1. prosecute any person who is found guilty of an offence for which he is criminally liable.
2. apply for winding up of the company or for an order under section 397 or 398, if it is expedient to do so.
3. proceed for recovery of damages or property in respect of any fraud, misfeasance or other misconduct.

On the basis of the report of the inspectors, the Central Government may prosecute any person, if it appears that he has committed an offence.[99] The Central Government may take legal advice before prosecuting such person. But obtaining legal advice is not compulsory. The Madras High Court was of the view that this was an enabling provision and only give a discretion to the Central Government to take legal advice or not.[100] So no duty is cast on the Government to take legal advice after reviewing the report of investigation and before prosecuting the offenders. All officers, employees and agents of the company, other than the accused, should assist the Government in connection with the prosecution.[101]

The Registrar of Companies is competent to prefer a complaint for offences punishable under this provision.[102] Prosecution can be made not only for offences under the Companies

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99. Id., S.242.

100. Indian Express (Madurai) Pvt. Ltd. v. Chief Presidency Magistrate, 1975 Tax. L.R. 1620 (Mad.).

101. The Companies Act 1956, S.242.

102. Gopala Pillai v. Registrar of Companies, A.I.R. 1960 Ker. 155

Act, but also under other Acts like the Indian Penal Code.[103]

For launching prosecution under this provision, it is not mandatory that the investigation as provided in the Act should have been made.[104] The company can lodge a complaint to the police directly under the Criminal Procedure Code.[105] When the information discloses and offence under the Companies Act as well as a cognizable offence under the Indian Penal Code, the police officer is not debarred from investigating into both these offences.[106] The Madras High Court had held that since the investigation of an offence by police on a report under this provision did not introduce a discrimination in procedure, it was not violative of the Fundamental Right to Equality.[107] However, the prosecution should be a fair one and there should not be the slightest reason for suspecting that it was inspired by any motive other than securing ends of justice.[108]

The Central Government can apply for the winding up of a company based on the report of the inspectors, when it appears to the Central Government that it is expedient to do so.

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103. Emperor v. Vishvanath, A.I.R. 1962 Sind.9.

104. B.M. Bajoria v. Union of India, 1971 Tax. L.R.1715 (Delhi)

105. Indian Express (Madurai) Pvt. Ltd. v. Chief Presidency Magistrate, 1975 Tax. L.R. 1620 (Mad.)

106. An offence under this provision is non-cognisable! See the Companies Act 1956, S.624.

107. Indian Express (Madurai) Pvt. Ltd. v. Chief Presidency Magistrate, 1975 Tax. L.R. 1620 (Mad.)

108. Priya Nath v. State, A.I.R. 1959 Cal.387.

The Government may authorise any other person to present the winding up petition.[109] Instead of presenting a winding up petition, the Government may move the Court for relief under Section 397 or 398.[110] But if the matter is already been seized by the Court at the instance of any other person, the Central Government should refrain from taking the initiative. The Supreme Court observed,[111]

> "Even where it appears to the Central Government from the report of the investigating inspectors appointed under Sections 235/237 that it is expedient to move the Court for winding up the company on the ground that it is just and equitable to wind it up or that an application for an order under Section 397 or 398 be made, then also it must stay its hands from doing so if the proceedings for winding up of the company are already being taken up by the Court."[112]

The other remedy available to the Central Government on the basis of the inspector's report is to bring proceedings for recovery of damages. The Government may itself bring the proceedings in the name of the company. But the Government should indemnify the company against any costs or expenses incurred by it in connection with such proceedings.[113] The action may

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109. A contributory can also rely on the report of the inspectors in support of a petition for winding up of a company. The reason being, the inspector is engaged in a fact finding enquiry and do not make a report on hearsay evidence. See In re St.Piran Ltd. (1981) 3 All E.R. 270 Ch.D.

110. The Companies Act 1956, S.243.

111. Moolchand Gupta v. Jagannath Gupta and Co. Pvt. Ltd., 1979 Tax. L.R. 2089.

112. Id. at p.2092.

113. The Companies Act 1956, S.244(2)

be for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion, formation or management of the company. It may also be for the recovery of any property of the company which has been mis-applied or wrongfully detained. Even misdeeds of prior managements can be exposed and remedied under these provisions.[114]

Investigation under the English Law

The Companies Act 1948-81 make provisions for the investigation of the affairs of a company by inspectors appointed by the Department of Trade and Industry.[115] The 'Company's affairs' include its goodwill, profits and losses, contracts and assets, investment or other property interests[116] and its control of a subsidiary company.[117] A writ of Prohibition will not lie against the Department of Trade and Industry or an inspector appointed by it to prohibit an investigation.[118] However, an order of Mandamus may be obtained against the Department if it declines to appoint an inspector after the

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114. In re Saw Mills and Industries Ltd., A.I.R. 1962 Ker. 148 at p.152.

115. The Companies Act 1948, Ss.164-171. These provisions have been substantially amended by Sections 86-92 of the Companies Act 1981.

116. See Halsbury's Laws of England, (1974, 4th edn.) Vol.7, para 970 et. seq.

117. R.V. Board of Trade, ex parte St. Martin Preserving Co. Ltd., [1964/2 All E.R. 561.

118. Re Grosvenor and West End Railway Terminus Hotel Co. Ltd., as cited in Halsbury's Laws of England, op.cit. at p.573.

company has passed a special resolution to that effect.[119] Just like in India, the function of inspectors is investigatory and not judicial.[120] But, the inspectors should act fairly and in accordance with the principles of natural justice. They must give a chance to the witnesses to explain or correct any statement prejudicial to him. If these rules are not observed, the Court can give a declaration that the rules of natural justice have not been followed, eventhough it cannot set aside the report.[121] A person is not bound to answer a question put to him by the inspector if it tends to incriminate him.[122] This is necessary because a Court trying an offence upon the inspectors report is entitled to act upon it alone if the allegations in the petitions are uncontested.[123] After the amendment made in 1982, the Department may appoint inspectors in any case on an application of the company. The Department may at its discretion appoint inspectors on the application of a specified number of minority shareholders.[123a] The application need be supported by a statement showing that the applicants have good reasons for requiring the investigation.

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119. R.V. Board of Trade, supra n.117.

120. Re Pergamon Press Ltd., [1970] 3 All E.R.535.

121. Maxwell v. Department of Trade & Industry, (1974), as cited in Halsbury's Laws of England, op.cit., p.575; Norwest Holst v. Secretary of State for Trade, [1978] 3 W.L.R. 73 (C.A.)

122. Re. Clelland, Pope and Langley Ltd. v. Howard, [1968] 1 All E.R. 569.

123. Re Allied Produce Co. Ltd., (1967) 3 All E.R. 399; Re Travel and Holiday Clubs Ltd, (1967) 2 All E.R. 606; Re ABC Coupler and Engineering Co. Ltd. (2) [1962] 3 All E.R. 68

123a. The applicants must consist of 200 members of the company or members holding 1/10 of the shares issued by the company. See the Companies Act 1981, S.86(1).

If during the course of a voluntary liquidation process, it appears to the liquidator that an offence had been committed by the management of the company, the Secretary of State may cause an investigation to be ordered into the affairs of the company.[123b]

Investigation of the Ownership of a Company

The Companies Act 1956, confers powers on the Central Government to conduct investigation into the beneficial ownership of shares.[124] Inspectors can be appointed to investigate and report on the membership of a company and other matters relating to the company. The purpose is to ascertain the true persons who are or have been financially interested in the success or failure of the company or who are or have been able to control or materially influence the policy of the company. While appointing an inspector, the Central Government could define the scope of his investigation. The investigation may be confined to particular matters only or to specified period. It may also be limited to matters connected with particular shares or debentures.

Under the English Act, where an application for investigation with respect to particular shares or debentures of a company is made to the Department of Trade and Industry by the members of the company, the Department must appoint an inspector. This is so even when the number of applicants or

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123b. Id., S.92.
124. The Companies Act 1956, Ss.247-249.

the amount of shares held by them is less than that required for an application for appointment of an inspector to investigate the company's affairs.[125] However, there is no obligation on the Department of Trade and Industry to appoint an inspector when it is satisfied that the application is vexatious.[126] Subject to the terms of his appointment, an inspector's power extends to the investigation of any circumstances suggesting the existence of an agreement or understanding which is relevant to the purpose of his investigation.[127] For the purpose of investigation under these provisions the same rules as to the powers of inspectors to extend their investigation into the affairs of related companies, production of documents, taking of evidence etc. apply as in the case of investigation into the affairs of the company.[128]

The Government is not bound to furnish the company or any other person with a copy of any report by an inspector appointed under these provisions if it is of the opinion that there is good reasons for not divulging the contents of the report or part thereof. But the Government must give a copy of any such report or part thereof which do not contain matters not to be divulged, to the Registrar to be kept by him.

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125. The Companies Act 1948, S.172.
126. Ibid.
127. The Companies Act 1956, S.247 (3)
128. Id., Subsections (4) & (5)

The expense for this investigation should be defrayed by the Government out of the money provided by the Parliament. But the Government may direct that the expenses or any part thereof should be paid by the person on whose application the investigation was ordered.[129]

The Central Government may also investigate the ownership of any shares in or debentures of a company.[130] When the Government considers it unnecessary to appoint inspectors for the purpose, it may require any person whom it has reasonable cause to believe (1) to be or to have been interested in those shares or debentures or (2) to be acting or to have acted in relation to those shares or debentures, to give information which he has obtained.[131] The removal of an employee who assist the Government in the investigation is prohibited under the Act.[132] Any person who fails to give any information required from him under these provisions, or who in giving any such information makes any statement which he knows to be false in a material particular or recklessly makes any statement which is false in a material particular, is liable to imprisonment.[133] Under Section 249 of the Companies Act 1956,

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129. Id., Sub-section (6).

130. Id., S.248.

131. Ibid.

132. The Companies Act 1956, S.635 B; See also Ashoka Marketing Ltd. V. Company Law Board, A.I.R.1967 Cal.159.

133. The Companies Act 1956, S.248.

the Government can appoint inspectors to determine whether a body corporate, firm or individual was or was not an associate of a managing agent of a company.[134] While issuing an investigation order under this provision, the Central Government cannot proceed on mere subjective satisfaction, but has to proceed on grounds which are prima-facie reasonable.[13] Similar provision exists in English law also for investigation of the ownership of companies and demanding information as to person interested in shares or debentures.[136]

An Evaluation of the Investigating Power of the Government

The power of the Central Government to inspect documents of companies and to order investigation would serve useful purpose, if it is used in a judicious manner. It would create and develop a sense of respect for law in the business community which are not scrupulous about business methods and practices. Investigation may cause also needless worry to well managed companies and law abiding managements. Since investigation is ordered usually on the basis of a complaint regarding mismanagement etc., it may cause disrepute to those organisations which do not violate law. The Courts are of the opinion

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134. The institution of managing agents etc. was abolished in 1969 by the Companies (Amendment) Act 1969 (19 of 1969) and hence this provision has only academic interest now.

135. Asoka Marketing v. Union of India, A.I.R. 1967 Cal.159.

136. The Companies Act 1948, ss.172 and 173.

that investigation being of a serious nature, should not be ordered except on good and satisfactory grounds.[137] Probably due to this, the number of cases where investigation is ordered is limited.[138]

It can be seen that except during the year 1977-78, there had not been many instances of investigation. Another feature which ought to be considered along with this is the number of companies going into liquidation. When more and more companies go into liquidation, it affects not only the suppliers of its capital but also the workers and the community

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137. Rohtas Industries v. S.D. Agarwal, A.I.R.1969 S.C.707 at p.713.

138. Table showing the number of Investigations ordered during different years.

Year	Total cases considered			Investigation ordered	Dropped	Pending
	B/F from previous year	Considered during the year	Total			
1961-62	-	-	23	2	7	14
62-63	14	4	18	3	1	14
67-68	13	3	16	4	4	8
69-70	-	-	15	2	10	3
72-73	9	7	15	1	7	7
76-77	14	14	28	8	6	14
77-78	14	41	55	32	13	10
78-79	10	14	24	3	14	7
81-82	24	6	30	2	17	11

Source: Annual Reports of the Working and Administration of the Companies Act 1956.

at large. It can be seen from the following table[139] that the number of companies ceasing to work is increasing. There should be some method by which this high rate of company mortality could be reduced. If there is a proper monitoring agency which can find out sickness in a company in advance, it would be an effective method.

The Central Government has also recognised the need for such a monitoring system, as seen from the Industrial Policy Statements made by it from time to time.[140] In the Industrial Policy Statement dated 23.12.1977, the Government declared that it would in co-operation with the Reserve Bank of India, institute arrangement for monitoring incipient sickness in industrial units. The purpose being to take corrective action as soon as there is evidence of mismanagement or financial or technological weakness. The Government had

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139. Table showing company mortality during different years.

Year	No. of companies under liquidation	No. of companies declared defunct
1963-64	2755	-
65-66	-	916
66-67	-	802
67-68	2841	627
69-70	3085	-
72-73	3389	549
73-74	-	306
74-75	-	269
75-76	-	301
76-77	3216	275
77-78	3402	340
78-79	3512	380
80-81	3650	330
81-82	3694	388

Source: Annual Reports of the Working and Administration of the Companies Act 1956.

140. See the Industrial Policy Statement dated 23.12.1977.

(f.n.contd)

also declared that managers or owners who are responsible for mismanaging and turning their units sick would not be permitted to play any further role in the management of other units. This, no doubt, is a welcome step. But, as evident from the above table, the number of companies going sick is increasing.

The provision relating to inspection and investigation of companies could be developed as an effective alternative to winding up of companies. Companies fear investigation since it puts a stigma of mis-management etc. on them. If there is a routine and periodical investigation into the affairs of all companies there could be no room for fear of investigation. But the cost involved would be very heavy. The cost for periodical inspection of documents of companies would be less costly. When the inspection suggests that there are circumstances suggesting the need for thorough investigation, it should be ordered. The provision relating to expenses may remain as it is at present. Investigation should be ordered on a complaint of members, creditors or workers of the company after making preliminary enquiries about the bonafides of the petition. Security for cost of investigation should be collected from the complainant to avoid vexatious petitions. Courts should intervene and stay investigation proceedings only when malafides or collateral purposes are proved.

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(f.n.140 contd.)

paras 34 & 35 and the Industrial Policy Statement dated 23.7.1980, para 35, Government of India.

PART - V

MISCELLANEOUS ASPECTS

CHAPTER 17

Prevention of Oppression and Mismanagement

Section 397 to 408 of the Companies Act 1956, confer powers on the Court and the Central Government to deal with cases of oppression of minority or mismanagement of the affairs of a company in a manner prejudicial to the interests of the company and its members. When the affairs of a company is managed in such a manner, it is competent for the Court to order winding up of the company on just and equitable grounds. But these provisions enable the shareholders to avoid recourse to such an extreme step at the same time protect the minority shareholders from acts of oppression and mismanagement.[1] The power of Central Government in this respect is manifold. These powers fall broadly under the following categories.

1. Authorising any member or members of the company to apply to the Court under section 397 or 398.[2]

2. Right of the Central Government to apply to the Court for an order under sections 397 or 398.[3]

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1. See the Annual Report of the Working and Administration of the Companies Act 1956, 3rd Report, Chapter-VII.
2. The Companies Act 1956, S.399 (4 & 5)
3. Id., S.401.

3. Right to receive notice of every application made to the Court under these provisions and make representations whenever necessary.[4]

4. Right to appoint directors and to prevent change of board of directors of the company on application by the prescribed number of members or of its own motion.[5]

Authorising any Member to Apply to the Court

Sections 397 and 398 of the Companies Act 1956 give a right to the members of a company who satisfy the conditions mentioned in section 399 of the Act to apply to the Court for relief. Action can be taken under these provisions if the affairs of the company are being conducted in a manner oppressive to any member or members.[6] The object is to put an end to an oppressive management or oppressive conduct of the management in managing the affairs of the company. There is no condition that the relief is available only to minority shareholders; and application by a majority of shareholders is also maintainable.[7] The object is to put an end to acts of oppression and mismanagement promptly and speedily rather than allow the parties and the company to be involved in a costly and protracted litigation.[8] Another intention is to avoid winding up, if possible, and keep the company going while at the

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4. Id., S.400 & 407.
5. Id., S.408
6. Shanti Prasad v. Kalinga Tubes Ltd., A.I.R. 1965 S.C.1535.
7. Ramashanker v. Sindri Iron Foundry, A.I.R. 1966 Cal.512.
8. K.R.S.Narayana Iyengar v. T.A.Mani, A.I.R. 1960 Mad.338; Gaira Bhai v. Patny Transport, A.I.R. 1966 A.P.226; Mohammed Abdulla v. Gopala Pillai, A.I.R. 1952 T.C.243.

same time relieving the minority shareholders from acts of oppression and mismanagement.[9] Hence in a proceeding under this provision, the interest of the company is paramount,[10] eventhough public interest must also be considered by the Court.[11]

The qualification for presenting an application under sections 397 & 398 of the Act are prescribed as under:[12]

1. In the case of a company having a share capital, not less than one hundred members of the company or not less than one tenth of the total number of its members whichever is less or any member or members holding not less than one tenth of the issued share capital is eligible to apply under this provision. However, applicants or applicant must have paid all calls and other sums due on their shares. If share or shares are held in joint names of more than one person, they would be treated as one member only. Any member can obtain the consent of other required number of members and can make the application on behalf of and for the benefit of all such members.

2. In the case of a company not having a share capital, not less than one-fifth of the total number of its members.

The Central Government's power to authorise any member or members of the company to apply to the Court, is an exempt

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9. Ibid.
10. Syed Mohammad Ali v. Sundra Moorthy, A.I.R.1958 Mad.587.
11. Gleitlager (India) Pvt. Ltd. v. Alcock Ashdown & Co. Ltd 1973 Tax. L.R. 1768 (Bom.)
12. The Companies Act 1956, S.399.

to the above rule.[12a] The Government can exercise this right only if it forms an opinion to the effect that circumstances exists which make it just and equitable to exercise this power. Before exercising this power, the Government should require the member or members to give security for such amount as the Government deem reasonable. The amount is intended for the payment of any costs which the Court may order such member or members to pay to any other persons who are parties to the application.[12b]

From the wording of the provision it is clear that the object and reason underlying it are that the Central Government need only have a preliminary look at the application proposed to be made by the member. If the application can said to be a frivolous one made by a disgruntled member, of course, the Government is not to give permission to make such application.

The nature of the Government's power under Section 399(4) was examined by the Delhi High Court in Sri Krishna Tiles and Potteries (Madras) P.Ltd. v. Company Board.[13] The Court held that since no prior hearing need be given to the company before authorising an application under this provision, the power in this regard was an administrative power. The Court observed:

> "Action under Section 399(4) is administrative and not quasi-judicial... Since the function of the Central Government or the Company Law Board under Section 399(4)

12a. Id., S.399(4).
12b. Id., S.399(5).
13. (1979) 49 Com. Cas.409(Delhi).

> is not quasi-judicial and since no prior hearing is to be given to the company management or the company before application under sections 397 or 398 is authorised to be filed, it would follow that the order of authorisation is also to be purely executive order."[14]

Since the Court is hearing the petition on merits and an order would be made only on being satisfied about its necessity, the observation of the Court in this case appears to be fair.

Apart from the Court, the Central Government also has power to prevent oppression or mismanagement as well as the power to prevent change in the board of directors likely to affect the company prejudicially. No doubt, the conduct of the Central Government or its actions or its view in any manner cannot make any inroad on the powers of the Court under Section 397 or 398. But the Central Government itself can apply to the Court for relief under these sections.[15] The minimum number of members required to make an application to the Central Government for relief against oppression or mismanagement is the same as that is required to make an application to the Court.[16] It seems to be more convenient if the provisions are so remodelled that, any member may be able to make an application to the Central Government. If on enquiry the

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14. Ibid.
15. The Companies Act 1956, S.401.
16. Id., S.408.

Government is satisfied that there is substantive grounds for action, it may make an application to the High Court, or allow the members to make such application or grant such relief as it deems necessary under Section 408.

Right to Receive Notice of Every Application Made Under Sections 397 and 398

The Court is bound to give notice to the Central Government of every application made to it under Sections 397 and 398. Similarly, before passing any final order in those application, the Court should take into consideration the representations, if any, made by the Government.[17] The Central Government need not make representations on all cases where it has received notice. The cases where notice is received by the Central Government may be grouped into the following two categories:

(1) those which involve larger interests of society, complicated issues of social and economic policy apart from simple adjudication of legal rights between the contending parties; and

(2) cases which relate to small sized public or private companies not involving public interest to any great extent or cases which do not involve any complicated technical points, but which arises generally as a result of fights between two groupsof directors or shareholders. The Third Annual Report on the Working and Administration of the Companies Act 1956 for the year ending March 1999, contained the following

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17. Id. S.400.

observation:[18]

> "As a rule, it is only in the category of cases where larger interest of the society is involved, that the Central Government consider it necessary to make representations to the Courts under Section 400 of the Act, placing before them material and information available in the records in the Department, relevant to the allegations contained in the petition filed with the Courts. The papers received at the Head Quarters are forwarded to the Regional Directors or Registrars concerned, who have to make every endeavour to collect the material facts available in the papers and documents in their record and it is on the basis of this data that the requisite representation is prepared. While preparing the representation, a purely objective and neutral attitude is adopted and the representation should not contain any tendentious statements. The representation should not give an impression that the Department is a party to the proceedings or is in any way interested in any one of them in power. Wherever the circumstances of the case so require, the Central Government may also explain their views on the important questions relating to corporate investments, company management etc. for the general guidance of the Courts."

So the Government is not intended to involve in any faction fights. It is the duty of the Government to see how much is the public interest involved in each particular cases and make representations only where larger public interest is

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18. The Third Annual Report on the Working and Administration of the Companies Act 1956, Chapter-VII.

involved. But the exercise of this powers appears to be a subjective process, even though it should be based on objective considerations. On perusal of the annual reports it can be seen that the Government makes representation only in a limited number of cases.[19] If the Government fails to make representation in a case in which larger public interest is involved, what is the remedy? The affected person should be in a position to enforce this obligation on the Government through proper actions.

Under the provision, the duty of the Court is two fold (1) to give notice to the Central Government regarding the receipt of an application; and (2) to consider the representations made by the Central Government before passing a final order in the matter.[20] But this does not mean that the

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19. Table showing the number of Notice Received and representations made by the Government under Section 400 of the Companies Act 1956.

Year	Notice received	Representations filed	Left	Pending
1963-64	32	8	24	Nil
67-68	23	6	15	15
76-77	35	1	34	Nil
77-78	29	10	18	1
78-79	36	4	32	Nil
81-82	37	Nil	37	Nil

Source :- Annual Reports of the Working and Administration of the Companies Act 1956.

20. See Sadul Textiles Ltd. v. Raja Textiles Ltd., 1973 Tax.L.R. 2119 (Raj.)

Central Government has any exclusive jurisdiction in the matter of prevention of oppression and mismanagement.[21] The right of the Central Government to receive notice under this provision exists even when the petition is not admitted, but only a notice of such petition is given to the company for hearing.[21a]

The duty of the Court to give notice to the Central Government was examined by the Bombay High Court in Bilagari v. Akola Electric Supply Co.[22] In this case a petition was presented for the winding of the Akola Electric Supply Company and in the alternative a prayer was made for appropriate orders under Sections 397, 398 and 402 of the Companies Act. At the hearing of the petition, it was dismissed and no notice of the petition was given to the Central Government. In appeal, the question arose whether the hearing of the petition without notice being given to the Central Government was proper. The Court observed,

> "...[If a composite] petition is presented to the Court... it would be open to the Court or the Company Judge to dismiss it summarily and not to admit it at all. That would apply both with regard to the prayer for winding up and with regard to the directions under Section 397 and Section 398. But the Court may not want to dismiss it summarily and the Court may want it to be admitted at least for the purpose of giving notice to the company so that

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21. See Kalinga Tubes Ltd. v. Shanti Prasad, A.I.R. 1963 Orissa 169.

21a. Bilagari v. Akola Electric Supply Co., A.I.R.1959 Bom.176.

22. Ibid.

the company should be heard. [In that case also Court should give notice to the Central Government.][23]

Here the Central Government acts as the guardian of the public interest. But the ascertainment of this interest is done by a subjective process; even though for practical purposes the matter is decided by the Regional Directors after pursual of all relevant records. But if this function is entrusted to a tribunal, and taking of decision is subjected to consideration of representations, if any, made by interested person, the provision may achieve its objects better.

Right to Apply under Section 397 or Section 398

The Central Government could, by itself, apply to the Court for an order under Section 397 or 398. It may also empower any other person to make an application under the above provisions on its behalf.[24] Under Section 399, the Central Government can authorise only members of the company to present a petition for relief under Section 397 and 398. But under Section 401 the power is greater as the Government can authorise 'any person' to file a petition on its behalf.

When the Government is resorting to this provision, the Courts can grant relief only on the grounds specified therein. So the Government in this case should prove that -

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23. Id. at p.177 per M.C. Chagla, J.

24. The Companies Act 1956, S.401. See also Shanti Prasad v. Kalinga Tubes Ltd., A.I.R. 1962 Orissa 202 at p.217.

(1) the company's affairs are being conducted in a manner prejudicial to the public interest or in a manner oppressive to any member or members; and (2) to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up.[25]

So the order can be passed only where the facts prove that a winding up order would be the alternate result.[26] The mere loss of confidence between group of shareholders is not enough unless it can be shown that this sprang from a desire to oppress the minority in the management of the company's affairs. An attempt to get a majority in a company by lawful means will not justify winding up of a company. So the Orissa High Court held that where the company was unquestionably a profitable and thriving one, far from being just and equitable that such a company should be wound up, it would be just and equitable to prevent such company from being pushed into winding up by the use or misuse of Section 397.[27]

If the petition is on the grounds of fraud, the applicant must prove the particulars of fraud.[28] So if vague and

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25. See the Companies Act 1956, S.397.

26. Ibid.; See also Rajamundry Electric Supply Corporation v. Nageswara Rao, A.I.R. 1956 S.C.213.

27. Lalitha Naiya Lakshmi v. India Motor Co., A.I.R.1962 Cal.127.

28. In re Bengal Luxmi Cotton Mills, (1965) 35 Com. Cas.187.

general charges are made out without giving any particulars or setting out any material facts, the Court would ignore such charges and would not proceed to investigate them. The reason being, the Court should give an opportunity to the party charged for answering the charges made against him. Thus the Court cannot act unless it knows what the company is charged with. Therefore the question is whether the petition discloses facts which are sufficient to wind up the company on equitable grounds taking an overall consideration of the different facts existing and the different grounds alleged in the petition of the petitioner.

The term 'oppression' and 'prejudicial to public interest' are not defined in the Act. The ordinary dictionary meaning of the word 'oppression' is 'burdensome, harsh and wrongful'. The courts have held that this word should be given its ordinary sense.[29] So the act complained of should involve a visible departure from the standards of fair dealing and violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely.[30] Moreover, there should be persisting course of unjust conduct or continuing mismanagement.[31] The Punjab High Court had held that a denial to shareholders

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29. Thakur Prem Singh V. Thakur Hotel (Simla) Co.Pvt.Ltd., A.I.R. 1962 Punj. 23.

30. K.R.Narayana Iyengar V. T.A.Mani, A.I.R. 1966 Mad.338.

31. Ibid; See also Needle Industries (India) Ltd. V. Needle Industries Newey (India) Holdings Ltd., A.I.R. 1981 S.C. 1298.

a right to vote and receive dividends amounted to oppression.[32] But denial of access to or inspection of books of accounts and declaring of dividends below actual profits cannot be treated as acts of oppression.[33] Even the action of majority shareholders in passing a resolution depriving the minority of their property was considered as an act of oppression.[34]

Another situation where the Government may file a petition under these provisions is where the company is managed in a way prejudicial to public interest. But the concept 'prejudicial to public interest' is also incapable of having any precise definition.[35] The Gujarat High Court has laid down the following principle with regard to this in Wood Polymer Ltd. In re.[36]

> "The expression 'public interest' must take its colour and content from the context in which it

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32. Mohanlal Chandumall v. Punjab Company Ltd., A.I.R. 1961 Punj. 485. But the default in giving notice of an adjourned meeting was held not to constitute oppression. See Pramod Kumar Mittal v. Southern Steels Ltd., 1980 Tax.L.R. 2019 (Cal.).

    See also Amal Kumar v. Clarin Advertising Services Ltd., 1980 Tax. L.R. 2043 (Cal.) where non-functioning of the board of directors was considered as a prima facie case of oppression.

33. Maharani Lalitha Rajya Lakshmi v. Indian Motor Co., A.I.R. 1962 Cal.127.

34. For a discussion on this see supra Chapter 4.

35. Ratnagar Ltd. v. Greater London Council, [1983] 1 All E.R. 437.

36. (1977) 109 I.T.R. 1777.

is used. The context in which the expression 'public interest' is used to permit the Court to find out why the company came into existence, for what purpose it was set up, ... what object was sought to be achieved through its creation...."

So the conduct of the company should be fair and reasonable and should be in the interests of shareholders, employees and the public directly interested in its business. In the absence of this, the acts of the company may be said to be 'prejudicial to the public interest.'[37] In other words, it may be said that any failure or omission to consider the impact of the transactions of the company on the public may be treated as acts 'prejudicial to public interest.'

The procedure adopted for filing a petition under Sections 397 and 398 are not free from doubt. The Allahabad High Court has held that[38] the Company Court had no exclusive jurisdiction to grant relief under these provisions. So other Civil Courts also have power to entertain suits in this respect.

Another difficulty that arises in this regard is due to the observation of the Orissa High Court. It said,

"There is no requirement in the Act to implead any particular party in an application under Sections 397-398 and the Court Rules which prescribe forms for making of applications under the respective provisions do not provide for impleading parties as such. The scheme of the Act and Rules seem to suggest that

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37. See Bank of Baroda Ltd. v. Mahindra Ugine Steel Company, (1976) 46 Com. Cas. 227.

38. Patna Devi v. Hariher Prasad, 1978 Tax. L.R.2292 (All)

a public notice has to be given of applications and persons interested are required to appear and place their representations to the Court."[39]

So, the question arises as to what are the classes of persons entitled to make representation and have a right to hearing. If the right is extended to indefinite classes, the position would be disastrous.

With the decision of the Supreme Court in National Textile Workers Union v. P.R.Ramakrishna,[40] the workers ought to get a right of hearing in a petition for an order under Section 397 and 398 also. The order under these Sections is an alternative remedy to winding up of a company and when the workers have a right to be heard in winding up petition, they should get that right in a proceeding under Sections 397 and 398 also.

It seems necessary that the legislature should clarify the position.

Since the considerations to be taken by the Court are mostly commercial practices, it seems to be proper to transfer the power of the Court under this provision to some administrative tribunal.[41]

Power to Appoint Directors and to Prevent Change in Board of Directors

Section 408 of the Companies Act 1956 empowers the

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39. N.R.Murthy v. The Industrial Development Corporation, 1977 Tax. L.R. 1268 (Orissa) at p.1268 per R.N.Misra, J.

40. 1981 Tax. L.R. 2047 (S.C.); (1983) 1 Com. L.J. 1(S.C.) In this case, the Court by majority held that the workers have a right of hearing in a winding up petition of a company if they so request.

41. See the Report of the Sachar Committee, (1978), Para7.12.

Government to appoint "such number of persons as the Central Government may specify in writing" to prevent oppression or mismanagement in a company. The Government can select any person, not necessarily a member of the company and appoint him as director. The directors so appointed do not require share qualification and do not retire by rotation. They are however liable to be removed by the Government at any time. No change in the board of directors made after the appointment of the government directors can be effective unless it is approved by the Central Government. When action under this section is taken, the Government can issue directions to the company which are considered necessary and appropriate in regard to the affairs of the company. The directors appointed by the Government should report to the Central Government about the working of the company from time to time. The Government can take action under this provision either suo motu or on application of not less than one hundred members of the company or of members of the company holding one-tenth of the total voting power. The term of office of directors appointed by the Government shall not be more than three years at a time.

In an application for the prevention of oppression and mismanagement, there is an overlapping of the field of investigation in the two proceedings, one before the Court and the other before the Central Government.[42] But the

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42. This power is delegated to the Company Law Board now.

purpose of the two groups of Sections as well as the ambit of powers thereunder to be exercised by the Court on the one hand and the Central Government on the other are distinct. There is substantial difference between the powers conferred on the Court and the powers conferred on the Central Government. On the powers of the Court no restrictions or limitations of any kind have been put while restrictions and limitations have been placed on the Government's power to grant relief in cases of oppression and mismanagement. Even the manner in which, the extent to which and the period for which relief could be granted by the Government have been indicated.[43]

There is nothing in the Companies Act 1956 (1 of 1956) to show that when proceedings are commenced in a Court, the Company Law Board is precluded from carrying on investigations or refrain from passing any order under Section 408. But in Swadeshi Polytex Ltd. v. Swadeshi Cotton Mills Ltd.,[44] A.Banerji, J. of the Allahabad High Court made the following suggestions:

> "expediency would demand that there should not be a parallel proceeding in regard to a matter which is pending in a Court of Law."[45]

But the jurisdiction of the Company Law Board to enquire into a matter which is not covered by the pending proceedings before a Court cannot be denied. The Supreme Court, in

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43. See Bennett Coleman & Co. v. Union of India (1977) 47 Com. Cas. 92 (Bom.)

44. 1980 Tax. L.R. (N.O.C.) 47 (All.)

45. Ibid.

Union of India v. Swadeshi Cotton Mills Co. Ltd.,[46] held that the conclusions arrived at by the Company Law Board after proper investigation, was entitled to prima facie respect. In this case the Company Law Board found that the affairs of the company were being conducted in a manner prejudicial to the interests of the company and to public interest. Hence it passed an order under Section 408(1) of the Companies Act 1956 nominating seven directors in addition to the existing directors of the board of directors of the company. The Bombay High Court passed an inter-locutory order staying the operation of the order of the Company Law Board except as regards three of these directors and directed that even these three directors would not vote at the meetings of the board. Nullifying the order, the Supreme Court held that when the Company Law Board investigated and reached a definite conclusion and made consequential directions under Section 408(1), it was entitled to prima facie respect unless there were glaring circumstances to the contrary. The supreme Court also observed that the order of the Company Law Board might be vitiated by infirmities but it might also be that the factual foundations of the order were sound. In such case, benefit of doubt belongs to the specialised body.

The powers of the Government under Section 408 can be invoked only in those genuine cases where minority shareholders can show prima facie, with documentary and such

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46. (1979) 49 Com. Cas.74 (S.C.)

other evidence as the Central Government may call for, that there has been mismanagement or oppression.[47]

The Government usually observes the following criteria in considering applications under Sections 408 and 409.[48]

1. Where the existing Management was not good and there was nothing specific against the incoming person, no order under Section 409 would be issued and that the matter might be left to the decision of the share holders of the company.

2. Where both the existing as well as incoming management were reputedly good, there is no need for interference by the Government under Section 409.

3. Where there is nothing unfavourable against the existing management or against the incoming persons in the records, interim protection might be given to the existing management by issuing an interim order and further inquiries instituted immediately thereafter to enable a final decision be taken.

4. Where the existing management was good and nothing was knownabout the incoming persons, an interim order could be issued and further enquiries instituted.

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47. The Companies Act 1956, S.408(1) provides that the Government should make such inquiry as it deems fit and on such enquiry it should satisfy that it is just and proper to make an order under the Section.

48. See the Annual Report on the Working and Administration of the Companies Act 1956, for the year ended 31st March, 1958.

5. Even if an interim order was issued under Section 409(1) of the Act, the Commission[49] would advise the Government to confirm that order only if the Commission was satisfied that the existing management proved positively that the incoming persons would not be able to manage the company.

6. Where in respect of any company in which action under Section 409 has been prayed for by the applicant, the Court was also seised of the matter and has issued injunctions against any change in the board of the company, the Commission would not advise any action under Section 409.

As described earlier, an action under Section 408 can be initiated either suo motu by the Government or by an application by the prescribed number of members. But under Section 409, the Government acts on a complaint made by the managing director or any other director, managing agent, the secretaries and treasurers or the manager of a company. Even though an enquiry is instituted on the application of the members of the company, they do not become party to the proceedings or assume the role of the prosecutor. Thus their interest in the proceeding is confined to the making of the application and to assist the Company Law Board if and when called upon by it. They can only assist the Board when called upon, but cannot ask for the production of any specific

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49. The earlier Advisory Commission was substituted by the Company Advisory Committee, by the Companies (Amendment) Act 1965 (31 of 1965), S.53(a).

paper or document or to be provided with a copy of such documents or paper.[50]

The power of the Company Law Board under these provisions is very wide. It can nominate any number of directors in the board of the company in addition to the elected directors. Instead, the Company Law Board may direct the alteration of the articles of association of the company for incorporating provisions for proportional representation. Directions can be given to the board of directors from time to time. The directors appointed by the Government are not required to retire by rotation or to take qualification shares. No change in the board of directors made after a person is appointed as director by the Government takes effect unless approved by the Central Government.

The nature of powers exercised by the Central Government in relation to the prevention of oppression and mismanagement was discussed by the Delhi High Court in South India Viscose Ltd. v. Union of India.[51] The Company Law Board appointed two directors on the board of a public company, the South India Viscose Ltd., in exercise of its powers under Section 408(1). It was a suo motu action taken by the Company Law Board on the basis of some irregularities found during the course of an inspection of books and accounts of the company under Section 209(2) of the Act. The order of the Company Law Board

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50. Sundeshi Polytex Ltd. v. Sundeshi Cotton Mills Ltd., 1980 Tax. L.R.(N.O.C)47(All)

51. (1982) 52 Com. Cas. 247 (Delhi); 1981 Tax. L.R.2577 (Delhi).

was challenged by the company. Regarding the power of the Central Government under Section 408, the Court observed,

> "Now an exercise of the power under Section 408 of the Act is circumscribed by the limitation mentioned in the Section itself. The power under Section 408 of the Act is not untrammelled and does not give absolute discretion to the Central Government to appoint directors only on its subjective opinion. The power under Section 408 is dependent on the establishment, in an objective manner of the requisite conditions. The satisfaction of the Central Government cannot be arbitrary or whimsical. Before the power can be exercised the satisfaction has to be established, that it is necessary to make the appointment in order to prevent the affairs of a company being conducted in a manner oppressive to any members of the company or in a manner which is (against, sic.) the interest of the company or to public interest."[52]

In Vinod Kumar v. Union of India,[53] another interesting question was discussed. The Central Government had delegated all its powers under Section 408 to the Company Law Board. Thereafter by a notification dated 7.8.1980, the Central Government took back the power to select the directors to be appointed under Section 408. In the present case, the Central Government in exercise of this power, determined the number of directors to be appointed, on the board of the petitioner company and the period during which they should hold office. The Court held that the only power with the Central Government

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52. Id. at p.253 per R. Sachar, J.
53. (1982) 52 Com.Cas. 211 (Delhi).

had was the power of selection and all other functions should have been done by the Company Law Board.[54] The Court also held that the power of the Central Government under this Section was analogous to the power of the Court under Sections 397 and 398, and it should be exercised judicially.[55]

Considering the vast and far reaching consequences, it appears necessary that the decision should be taken by the Company Law Board judicially. The present Company Law Board being a delegate of the Central Government, is not a fit and proper body to exercise such a function. The functions of the Court under sections 397, 398 and 402 and the functions of the Company Law Board under the present provision need be transferred to some independent administrative tribunal, with a right of appeal to the Court.

In England, the Department of Trade and Industry is entitled to file a petition to the Court to prevent oppression and mismanagement. The Department can present such a petition either on complaint of any member that the company's affairs are conducted in a manner oppressive to some part of members including himself or as a result of an inspector's report or the obtaining of documents of information.[56] If on any such petition the Court is of the opinion

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54. Id. at p.232 per D.K.Kapur, J.

55. See also Baldevdas R. Rohela v. Union of India, (1977) 79 Bom. L.R. 581; Nakhuda Ali v. Jayaratne, [1951] A.C. 66; Rohtas Industries v. S.D.Agarwal, A.I.R. 1969 S.C.707.

56. The Companies Act 1967, S.35 (2).

that the Company's affairs are conducted in an oppressive manner and that to wind up the company would unfairly prejudice a part of the members but otherwise the fact would justify the making of a winding up order, may make such order as the Court may deem fit. But if the real object of the petition is to exert pressure to achieve a collateral purpose, this will be treated as an abuse of the process of the Court and no order would be made.[57]

In America, the prevention of oppression and mismanagement could be achieved by derivative action by shareholders. Since the directors owe fiduciary duties to the corporation with respect to their management functions, any attempt by directors to favour one intra-corporate group to the detriment of another breaches such duties.[58]

Providing effective alternate remedy for winding up in case of oppression or mismanagement is necessary in the interest of the community. If the intracorporate rift is allowed to grow and destroy the company itself, it would cause havoc not only to its members, but also to the workers, consumers and the community at large. So the preventive remedy needs more stress than the winding up. It can be seen that at present there are a number of inconveniences that makes the preventive remedy less effective. The requirement

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57. Re Ballador Silk Ltd., (1965) 1 All E.R.667.

58. See Boyce, "Minority Shareholder in the Nineteenth Century: A Study in Anglo American Legal History" (1965) 28 M.L.R. 317. See also Mc. Pherson, "Oppression of Minority Shareholders"(1963) 36 A.L.J.404; Harcy, "Shareholders Petition in Cases of Oppression" (1962) 36 A.L.J.187.

of minimum number of members to present the petition, the difficulty experienced by members to get sufficient information in proper time etc. reduces the effectiveness of the process. If an independent administrative tribunal is entrusted with the task of dealing with these matters, much difficulties could be remedied. Any member of the company or group of workers should be allowed to present a petition under this provision. Before passing a final order, an opportunity of hearing should be afforded to all those people whose interests are likely to be affected. Every effort should be taken to see that petitions under this provisions are disposed of with least possible delay.

CHAPTER - 18

Winding up and Dissolution of Companies

Winding up of Companies

The Companies Act 1956 (1 of 1956) provides for administrative controls in relation to winding up of companies as well. An application to the Court for the winding up of a company can be made by the Registrar or any person authorised by the Central Government.[1] The Registrar is entitled to present a petition for winding up of a company on any of the grounds specified in Section 433 of the Companies Act except that of special resolution by the company.[2] So when there is

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1. The Companies Act 1956, S.439(1)(e) & (f).
2. Id., S.433 reads as under:

   "Circumstances in which company may be wound up by Court - A company may be wound up by the Court:

   a) if the company has, by special resolution, resolved that the company be wound up by the Court;

   b) if default is made in delivering the statutory report to the Registrar or in holding the statutory meeting;

   c) if the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;

   d) if the number of members is reduced, in the case of a public company, below seven, and in the case of a private company, below two;

   e) if the company is unable to pay its debts;

   f) if the Court is of the opinion that it is just and equitable that the company should be wound up."

default in filing the statutory report, default in holding statutory meeting, failure in commencing business or reduction in membership of the company below the statutory minimum, the Registrar can file a petition for winding up. He can present a winding up petition on grounds of inability to pay debts and on just and equitable grounds under certain circumstances. In addition to this, the Central Government has the power to authorise any person to present a winding up petition in a case falling under Section 243 of the Companies Act.[3]

The Government exercises much control over the conduct of winding up also. In the case of a winding up by the Court, the Official Liquidator is conducting the winding up proceedings. In other types of winding up, the liquidators are under strict control of the Registrar and the Central Government. The Central Government has the power to take cognisance of the conduct of liquidators on a complaint of any creditor or contributory.[4]

Dissolution is the final step in a winding up procedure. When a company is dissolved all property and assets remaining with the liquidator at the time of dissolution, or accruing after dissolution escheat to the Government.[5] The Registrar is entitled to get a copy of the order of dissolution.

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3. The Companies Act 1956, S.439(f).
4. Id., S.463.
5. The Companies Act 1956, S.555.

Registrar's Petition for Winding up

The Registrar should obtain the previous sanction of the Central Government for presenting a petition on any of the grounds. The Central Government should afford to the company an opportunity of making representations, if any, before sanction is accorded to the Registrar to present the winding up petition.

A winding up petition on the ground of failure to hold statutory meeting or default in delivering statutory report can be presented by a shareholder, the Registrar or a contributory. For this purpose at least fourteen days should elapse after the last day on which the statutory meeting ought to have been made.[6] There is a difference between the English Law and the Indian Law in this regard. Under the English Law, a petition on this ground can be presented only by a shareholder.[7]

When a company is sought to be wound up for failure to commence business, or suspension of business for a long time, the Central Government may step in to protect public interest. Thus, the Sick Textile Undertakings (Taking Over of Management) Act 1972, provides for the taking over of the management of sick textile undertakings pending nationalisation. When such an action is taken by the Government, no

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6. Id., S.433(5),(6) & (7).
7. The (English) Companies Act 1948, S.224(1)(b).

proceedings for the winding up of a textile company would lie in any court or be continued in any court except with the consent of the Central Government.[8]

Similarly, the Sick Textile Undertakings (Nationalisation) Act 1974, provide for the acquisition and transfer of sick textile undertakings to a Government owned corporation, namely the National Textile Corporation. No proceeding for the winding up of a textile Company, the right, title or interest of which is vested in the National Textile Corporation could be entertained by the Court without obtaining the consent of the Central Government.[9]

The Central Government may direct the Registrar to present a winding up petition on the ground that it is just and equitable that the company should be wound up.[10] The Registrar cannot present a petition for winding up of a company on the ground that the company is unable to pay its debts unless he is satisfied from the financial position of the company, as disclosed in the balance sheet or from the report of the special auditor,[11] or an inspector[12] that the company is unable to pay its debts.[13]

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8. The Sick Textile Undertakings (Taking Over of Management) Act 1972, S.8.

9. The Sick Textile Undertakings (Nationalisation) Act 1974, S.35.

10. Id., S.243.

11. The Companies Act 1956, S.233A provides for the appointment of special auditor in certain cases.

12. Id., Ss.205 & 237 provides for the appointment of inspectors to investigate the affairs of a company.

13. Registrar of Companies v. New Valley View Transport Co. (P) Ltd., (1975) 45 Com.Cas.210(Punj), 1975 Tax.L.R.1367 (Punj.).

Restriction Imposed by the Courts

In addition to the statutory limitations on the right of the Registrar to present a petition for winding up of a company, Courts have prescribed some more restrictions. Thus the Registrar must present the winding up petition within a reasonable time after obtaining the sanction of the Central Government. Unless this is done, the Court would refuse to recognise the sanction as a valid sanction.[14] Without obtaining the previous sanction of the Central Government, he cannot even file an affidavit in support of a creditor's petition and ask the Court to make a winding up order on the additional ground stated in the affidavit.[15] So what the Registrar cannot do directly, he cannot do indirectly also.[16]

Before making an application for sanction of the Central Government to present a winding up petition, the Registrar should form an opinion based on relevant materials that the company is unable to pay its debts. If this is done, the Court would not enquire the sufficiency of materials for the Registrar's opinion and cannot hold that the opinion of the Registrar is invalid as the criteria applied by him are not reasonable.[17] On receipt of such an application from the

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14. In re. Standard Brands Ltd., 1979 Tax.L.R.1613 (Cal.).
15. In re. Thakur Paper Mills, A.I.R.1968 Pat.289 at p.295.
16. See Hoti Prasad, Companies Winding up: Law and Procedure, (1977), Concept Publishing Co., Delhi, p.60.
17. The Power of the Central Government under this Section is now exercised by the Regional Directors of the Company Law Board.

Registrar, the Central Government[18] should give an opportunity to the company to make representations, if any.[19] But, it is not necessary for the Government to give a copy of the report of the Registrar to the company.[20] Similarly, it is not necessary that the order of the Government granting sanction to the Registrar need be a speaking order.[21]

The Regional Director is always required to consider any request from the Registrar to sanction the winding up on such materials as may be disclosed or discovered from time to time in respect of the same company. There can be no question of any estoppel in the exercise of such powers by the Regional Director who is only to grant sanction for presenting the petition for winding up. The ultimate decision is taken by the Court in accordance with the law.[22]

Registrar's Petition for Winding Up of A Company: A Comparison

In England, the official receiver, the Department of Trade and Industry and the Attorney General are entitled to present a petition for compulsory winding up of a company

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18. The Companies Act 1956, S.439(6).

19. Registrar of Companies v. New Valley View Transport Co., 1978 Tax.L.R.1307 (Punjab).

20. K. Gopalakrishnan v. Burdwan, Cutwa Railway Co., 1978 Tax.L.R.1937 (Cal.).

21. Id. at p.1949.

22. Ibid.; See also In re.Golden Chemicals Products Ltd., [1976] 3 W.L.R.1; [1976] 2 All E.R.543.

besides the company, creditor and the contributory.[23] If in the consequence of investigation, the Department of Trade and Industry is of the view that the company is liable to be wound up, it may present a petition to the Court for that purpose. But the state of affairs revealed by the inspector's report that the company ought not to carry on business, is not sufficient to present the petition. The materials should show that it is in the public interest to wind up the company.[24] The power to present a petition under the provision can be exercised through an officer of the Department of Trade and Industry and need not be exercised by the Secretary of State personally.[25] Similarly, the inspector making the investigations cannot be cross-examined on the extent of investigations or why he thought it to be in the public interest that the company should be wound up.[26]

In America also, a winding up petition can be presented by a shareholder, a creditor, the company, the Attorney General or the State.[27]

In Australia, the Minister administering the (Australian) Companies Act 1961, the Official Manager appointed under the

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23. See the Companies Act 1948, S.224(2); The Companies Act 1967, S.35(1) and the Charities Act 1960, S.30(1).

24. The Companies Act 1967, S.35(1); See also Magnus & Estrine, Companies Law and Practice, (5th edn., 1975), Butterworths, London, p.688.

25. In re Golden Chemical Products Ltd., [1976] 2 All E.R. 543.

26. Ibid.

27. The Model Business Corporation Act (1969), S.97; See also George D.Hornstein, Corporation: Law and Practice, (1959), Vol.2, p.358.

Act or the liquidator can file a winding up petition.[28] The Minister can present the winding up petition only on a report of an inspector appointed for investigating the affairs of the company.[29]

Extent of the Powers to Wind Up

The powers of the Registrar and the Central Government to present a winding up petition is very wide. If the provisions of the Companies Act are properly used, the administrative authorities would be able to eliminate most of the malpractices occuring in the corporate sector. Every company has to file periodical returns to the Registrar. The Registrar can cause inspection of company's books and papers if he is of the opinion that some foul things are happening in the affairs of the company as disclosed by these returns. On the basis of such inspection he can cause an investigation into the affairs of the company. When as a result of such investigation, the Central Government is of the opinion that the company under investigation should be wound up, the Government may authorise any person to present a winding up petition on just and equitable grounds. In the alternative the Government may make an application for an order under Section 397 or 398. The Registrar is in a better position to find out almost all the

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28. The Companies Act 1961, S.221(1).
29. Ibid.

grounds for winding up of a company viz. non-holding of statutory meeting, nonfiling of statutory report, failure to commence business and even the inability of the company to pay its debts. So if a proper use of all these provisions is made, the investing public could be protected to a great extent. In the case of a going concern, the alternative to winding up ought to be preferred.

Control over the Conduct of Winding up

When an order for winding up of a company is made, the Court should intimate the matter to the Registrar of Companies and the Official Liquidator by sending notice.[30] In addition to this the petitioner in the winding up proceedings should file a certified copy of the winding up order with the Registrar within thirty days of making such order.[31] In the case of winding up of a company ordered by Court, the Official Liquidator is conducting the winding up.[32] He is appointed by the Central Government.[33] The Central Government can take cognisance of the conduct of liquidators of companies which are being wound up by the Court.[34] If the liquidator is not performing his duties faithfully or not duly observing all the requirements imposed on him by the Companies Act 1956 (1 of 1956), the Government can enquire into the matter and take necessary action.[35] The Government can take such action on a complaint

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30. Id., S.444.
31. Id., S.445. A fine which may extend to rupees one hundred for each day during which default continues.
32. Id., S.449.
33. Id., S.448.
34. Id., S.463.
35. Ibid.

of either a creditor or a contributory. The Government may at any time require the liquidator of a company, which is being wound up by the Court, to answer any enquiry in relation to winding up in which he is engaged. The Government may also apply to the Court to examine the liquidator or any other person on oath concerning the winding up.[36] The Government may also direct a local investigation to be made of the books and vouchers of the liquidators.[37] However, there is no specific provision in the Companies Act for removal of the liquidator by the Court. For example, in In re Indo Burma Wood Products (P) Ltd.,[38] the Calcutta High Court was considering the position of an Official Liquidator and that of a Receiver of a Court. In this case the Official Liquidator of a company in liquidation made an application to the Court for permission to break open the locks put in some of the rooms of the company. Here it became necessary to consider the position and powers of an Official Liquidator. In this regard, the Court observed,

> "The position of the Official Liquidator and that of the Receiver of a Court may be analogus but it will be wrong to assume that they are exactly similar. In the first place, a Receiver is appointed by the Court and is removable by the Court...The Official Liquidator's position under the Companies Act is materially different in this respect. There is no specific provision in the

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36. Ibid.
37. Id., Sub-Section (3).
38. In re Indo-Burma Wood Products, A.I.R.1968, Cal.198.

> Companies Act for the removal of the Official Liquidator by the Court. The Official Liquidator apparently can be removed only under Section 463 and that removal is also not by the Court but by the Central Government."[39]

In the case of voluntary winding up, the person appointed as liquidator should deliver to the Registrar for registration a notice of his appointment within thirty days of his appointment. He should also publish the matter of his appointment in the Official Gazette.[40] Failure in this respect is treated as a continuing offence and a fine which may extend to fifty rupees is prescribed for every day during which the default continues.[41] By disputing the validity of his appointment, he cannot save himself from the penalty prescribed for default in giving to the Registrar notice of his appointment.[42] The liquidator has to file periodical returns to the Registrar and on his failure, the Court can direct the filing of such returns on an application by the Registrar, contributory or creditor.[43] When the winding up procedure is over, the company is dissolved.[44] The liquidator should send a return showing the dissolution to the Registrar for registration within one week after the date fixed for the meeting to be called for dissolving the company. If the liquidator has in his hand or

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39. Id. at p.203 per Mukharji, J.
40. The Companies Act 1956, S.516.
41. Ibid.
42. Satish Chandra v. Emperor, A.I.R. 1917 All.93.
43. The Companies Act 1956, S.556.
44. Id., S.509.

under his control any money representing (1) dividends payable to any creditor which has remained unpaid for six months after the date on which they were declared or (2) assets refundable to any contributory which have remained undistributed for six months after the date on which it has become refundable, he should pay the amount to the Public Account of India in the Reserve Bank of India in a separate account known as the 'Company's Liquidation Account.'[45] Any person claiming such money may apply to the Court or to the Central Government for the same. The Government may order for the payment of the same after obtaining a certificate of the liquidator.[46]

Power of the Registrar to Strike Defunct Company off the Register

When a company is not carrying on business or in operation, the Registrar has power to remove the name of the company from the register of companies after complying with certain procedures.[47] The Registrar can do this on an application of some persons or even suo motu.[48] He should send a notice to the company by post inquiring whether the company is carrying on business or is in operation. If no answer is received within one month of sending this letter, he should send a second letter within fourty days after the expiry of that period to the company. The second letter should give reference of the

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45. Id., s.555.
46. Ibid.
47. Id., s.560.
48. Sukhbir Saran Bhatnagar v. Registrar of Companies, (1972) 42 Com.Cas.408.

first letter and should state that if no answer is received within one month from the date of the second letter a notice should be published in the Official Gazette with a view of striking the name of the company off the register. If the Registrar receives no answer still or even if he gets a reply to the effect that the company is carrying on business or is in operation, he may publish a notice in the Official Gazette. The notice should be to the effect that at the expiry of three months from the date of that notice, the name of the company mentioned therein would be struck off from the register and the company would be dissolved unless cause to the contrary is shown. A copy of such notice should be send to the company by registered post. In the case of a company which is being wound up, the Registrar can exercise similar powers if he has reasonable cause to believe that no liquidator is acting. Similar power exists if he has reasonable cause to believe that the affairs of the company have been completely wound up and any returns required to be made by the liquidator have not been made for a period of six consecutive months. Here also the Registrar should publish the notice in the Official Gazette and send a copy of it to the company or to the liquidator. At the expiry of the period of three months as notified in the Gazette, the Registrar can strike off the name of the company from the register, if cause to the contrary is not shown by the company. He should again publish a notice to this effect in the Official Gazette. From the date of this

notice, the company would stand dissolved.[49]

By dissolving a company by the above mentioned method, the liability of the managerial personnel or the members does not cease. It can be enforced as if the company had not been dissolved. Similarly the Court has the power to wind up a company, the name of which has been struck off from the register.[50] The Court can, before expiry of twenty years from the date of publication of the notice of dissolution, give an order for the restoration of the name of the company in the register on a petition by the company, any member or creditor of the company. For this, the Court should be satisfied that the company was, at the time of striking off, carrying on business or in operation or otherwise it is just that the company be restored to the register. When a copy of such order is delivered to the Registrar for registration, the company will be deemed to have continued in existence.[51]

A company cannot deemed to be a defunct company even if it is not carrying on business, if it is operating as a company for doing something in relation to its past obligations or to avoid future pecuniary liability.[52]

A Critical Appraisal of the Administrative Powers in Relation to Winding Up

The Central Government has many statutory powers and duties in relation to the winding up of companies. It makes

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49. Ibid.
50. Id., Proviso to Sub-Section (5).
51. Id., Sub-Section 687.
52. Bhogilal v. Registrar of Joint Stock Companies, A.I.R. 1954 M.B.70 at p.71.

Rules for winding up and prescribes the forms used in winding up in relation to administrative matters. The Government appoints and removes the Official Liquidators and exercises control over them. The Registrar of Companies is entitled to receive notice of the appointment of a liquidator, of the dissolution of a company and the periodical returns and statements of the liquidator. On pursuing the documents of the liquidator, he can initiate prosecution against promoters or persons who were managing the company.

One of the most important administrative power in relation to winding up of companies is the right of the Registrar or a person authorised by the Central Government to present a petition to the Court for winding up of the company. Unlike in other countries, the Registrar in India can exercise this power on any grounds mentioned in the Act except on the ground of special resolution by the company. He can present a winding up petition on the grounds of inability of the company to pay its debts or on just and equitable grounds. Of course, on other grounds like failure to hold statutory meeting or to file statutory report, reduction of membership below statutory minimum etc., the Registrar would be in a better position to understand these matters and can present a winding up petition. The final decision is always made by the Court. But, is it proper to give him similar powers on other grounds without making recourse to an application for investigation? In such cases it would be better if an investigation is made first and the real position is found out. To protect the

other partners of business, the Government may appoint its own directors to manage the affairs of the company during the course of investigation. The drastic step of winding up should be taken only after making proper investigation.

Another important matter to be considered in relation to winding up is the volume of work to be carried on by the Courts in relation to winding up of companies. It may be seen[53] that nearly half of the total number of liquidations are taking place through the Courts. Do the Courts have the necessary time and expertise for this purpose? Principles of management, accountancy, economics, sociology etc. are to be considered by the Courts along with legal principles relating to winding up. So, if the matter is transferred to some independent quasi-judicial body, it would save the time of the High Courts and also expedite the winding up procedure.

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53. Table showing the number of Company Liquidations during different years.

Year	Total No.of Liquidations	No. of Liquidation		No. of Members Voluntary winding up	No. of Creditors voluntary winding up
		By Court	Under Supervision of Court		
1963-64	2755	1000	28	1205	95
67-68	2841	1023	31	1316	471
69-70	3085	1114	41	1404	526
72-73	3359	1152	47	1542	618
76-77	3216	1265	32	1357	566
77-78	3402	1486	31	1388	563
78-79	3512	1480	29	1414	581
80-81	3650	-	-	-	-
81-82	3694	1599	27	1420	638

Source: Annual Reports of the Working and Administration of the Companies Act 1956.

CHAPTER - 19

Adjudication and Prosecution

The company law creates several rights and obligations some of which are in addition to the common law rights and obligations. There is widespread confusion about the proper forum in which an action is to be taken under the company law.[1] One view is that the company law does not altogether exclude the jurisdiction of civil courts and the court acting under the Companies Act is acting under its ordinary original civil jurisdiction[2] and the Civil Procedure Code is applicable in the trial of such cases. Another view is that where a liability not existing at general law is created by the company law, which at the same time gives a special and particular remedy for enforcing it, the remedy provided in the Act should be followed. It is not competent for the party to proceed by an action at general law.[3] But there is no provision in the Companies Act 1956

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1. Striking examples are seen in the Companies Act 1956, Ss.111 & 155. Both these sections provide for relief to a shareholder whose request for transfer of share is rejected by a company. The Central Government and the High courts have concurrent jurisdiction in this matter. The Company Court will not interfere if the facts involved in such cases are complicated and the petitioner would have to initiate separate action in ordinary civil courts. See Surendra Prakash v. Goel Industries, 1980 Tax.L.R.2007 (All.); In re Dholakhat Tea Co., A.I.R.1957 Cal.476.
2. Chitaley and Bakhale, The A.I.R.Manual, (1970, 4th edn.), Vol.6, p.508.
3. Falshaw C.J. in Munilal Peshawaria v. Balwani Raikumar, A.I.R.1965 Punj.24.

excluding the powers of a civil court in respect of any matter.[4]

Conflicts in the Jurisdiction of Courts

Wherever the 'Court' has been given power under the Companies Act 1956 (1 of 1956), to direct fulfilment of the requirements of any Section, the Court which has jurisdiction to take action is the Court as specified in the Act.[5] However, following the judgement in Sree Krishna Jute Mills v. Krishna Rao,[6] the Kerala High Court has held that the Company Courts cannot be regarded as Courts of exclusive jurisdiction in all matters pertaining to companies. Even where special remedies are provided by the Act, there are many of them which can easily be enforced by a suit in other courts.[7]

The Allahabad High Court has held that a Company Judge has jurisdiction to issue orders to enforce statutory obligations of a company on a petition by a shareholder; even though

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4. Star Tile Works Ltd. v. N. Govindan, A.I.R.1959 Ker.254; Sree Krishna Jute Mills v. Mothey Krishna Rao, A.I.R.1947 Mad.322; Nava Samaj Ltd. v. Civil Judge, 1966 A.I.R. M.P. 286.

5. The definition for the word 'the Court' is given in S.2(11) of the Companies Act 1956. It reads, "the Court means (a) with respect to any matter relating to a company (other than any offence against this Act), the court having jurisdiction under this Act with respect to that matter relating to that company, as provided in Section 10; (b) with respect to any offence against this Act, the Court of a Magistrate of the First Class or, as the case may be, a Presidency Magistrate, having jurisdiction to try such offence"; See also the Companies Act 1956, S.10.

6. Supra n.4.

7. Star Tile Works Ltd. v. N. Govindan, supra n.4; See also Mohideen Pichai v. Tinnevelly Mills Co.Ltd., A.I.R.1928 Mad.571; T.H. Vakil v. Bombay Presidency Radio Club Ltd., A.I.R.1945 Bom.475.

there is no specific provision conferring such powers on the Court.[8]

It is commonly recognised that Civil Courts have a right to entertain all suits of civil nature, unless expressly or impliedly debarred. So if a fact in issue in a case is some matter falling outside the purview of the Companies Act 1956, the Company Court has no exclusive jurisdiction. For example, consider the cases arising out of contracts or mortgages executed by companies. Here the Civil Courts can exercise jurisdiction because the cause of action is something outside the scope of the Companies Act.

Even in matters falling within the Companies Act, only those which are specifically mentioned in Section 10 of the Act are excluded from the jurisdiction of Civil Courts. In Star Tile Works v. N. Govindan,[9] the Kerala High Court examined this aspect. In this case a civil suit was filed against the company for not allowing a proxy to vote in the company's general meeting. The company challenged that the plaintiff had no right to institute a suit of this nature. The Court held that the plaintiff could obtain relief from the Civil Court.[10] The Court observed;

> "We do not find any provision in the Companies Act excluding the powers of a Civil Court in respect of any matter."[11]

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8. British India Corporation v. Robert Menzies, A.I.R.1936 All.568.
9. See supra n.4.
10. Id. at p.264.
11. Ibid. per Vaidialingam, J.

Similarly, the Division Bench of the Madras High Court held that even in respect of matters provided in the Companies Act, the jurisdiction of the Civil Court is not taken away.[12]

In T.H. Vakil v. Bombay Presidency Radio Club Ltd.,[13] a suit was filed by a shareholder of the company for a declaration that a ruling given by the chairman of the club at one of its general meetings was invalid. Relief was granted in that case also.

However, when any provision of the Act requires that an action has to be taken in "the court," the jurisdiction of Civil Courts would be considered as barred and the Company Court alone will have the jurisdiction.[14] Even in such cases the Courts have often held that the jurisdiction of Civil Court is not barred. For example, the Company Court has jurisdiction to entertain suits under Sections 397 and 398 of the Companies Act 1956, for prevention of oppression and mismanagement. In Marikar (Motors) v. M.I. Ravikumar,[15] the Kerala High Court held that the jurisdiction of Civil Courts even in such matters was not barred. In this case a shareholder filed a suit in a Civil Court for relief under the above provisions which was dismissed. One of the questions to be decided by the High Court was whether the Civil Court had

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12. Mohideen Pichai v. Tinnevelly Mills Co.Ltd., A.I.R.1928 Mad.571.
13. A.I.R. 1945 Bom.475.
14. See Nava Samaj v. Civil Judge, A.I.R. 1966 M.P.286.
15. (1982) 52 Com.Cas.362 (Ker.).

jurisdiction to try such a suit in view of the provisions of the Companies Act 1956. The Court answered in the affirmative.[16] Similarly, the Madras High Court had held that the Civil Courts have power to entertain petitions for rectification of register.[17]

The effect of these decisions is that when the Companies Act provides for some special remedies, these rights can be enforced through other courts also.

Another disadvantage in this area is that only summary procedure is prescribed under the provisions of the Companies Act, conferring jurisdiction on the Company Courts. So when there is serious dispute as to fact situations, it may become difficult to invoke the jurisdiction of the Company Courts.

In Surendra Prakash v. Goel Industries[18] such a situation arose. Here two shareholders made a petition to the Company Court under Section 155 of the Act, for rectification of register. There was some serious disputes regarding the claim of the petitioner's shareholding. The Allahabad High Court held that where complicated questions of law or disputed questions of fact arose in a petition under Section 155, it was just and proper that the party should be relegated to

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16. Id. at p.371 per M.P. Menon, J.

17. See Bank of Hindustan Ltd. v. K. Surya Narayana Rao, A.I.R.1957 Mad.702; Mohideen Pichai v. Tinnevelly Mills Co.Ltd., A.I.R.1928 Mad.571.

18. 1980 Tax.L.R.2007 (All.).

seek his relief in a suit in the Civil Court.[19] The effect is that, the power of the Court can be exercised only in simple and clear cases where there is no bonafide disputes or where there is no complexity. But this proposition does not sound good. There is nothing in the provision to show that the power of the Company Court is of summary nature. It is not proper to drive an aggrieved shareholder to different Courts to get relief. In fact, the Courts have entertained applications involving disputed facts.[20]

It can be seen that neither legislation nor judicial interpretation have so far provided a happy solution to the problem of proper forum for settlement of civil disputes.

Penal Provisions

The Companies Act 1956, alone contains more than 200 Sections providing criminal sanctions. This is in addition to a number of similar provisions in the MRTP Act, 1969 (45 of 1969), the Industries (Development and Regulations) Act 1951, (65 of 1951), the Capital Issue (Control) Act 1947, etc. These provisions raise complicated questions involving highly technical aspects of accounting, business management, costing etc. and are having much socio-economic importance.

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19. Id. at p.2010 per A. Banerji, J.

20. See Turner Morrison & Co. v. Shalimar Tar Products, (1980) 50 Com.Cas. 296 (Cal.); Smt. Bina Barua v. Dalowlan Tea Co.P.Ltd., (1981) 51 Com.Cas.660 (Gauhati) etc.

Even then, the administration of them are left to the ordinary courts.

Companies Act 1956, provides that Courts inferior to that of Presidency Magistrate or of a Magistrate of the First Class shall not try any offence under the Act.[21] But this does not mean that the Act creates any special courts or designate a particular person to discharge a judicial function.[22] The Act only defines the limit of the jurisdiction of the Criminal Court and specifies the conditions for taking cognisance of an offence created by it. The provisions of the Companies Act do not exclude the operation of the Code of Criminal Procedure. However, the Central Government is empowered to appoint a separate Public Prosecutor to conduct prosecution under the Companies Act and to authorise him to present appeals against orders of acquittal by the Courts.[23] In the absence of such powers, the conduct of prosecutions under the Act would have been within the competence of the appropriate Public Prosecutor appointed by the State Governments under the Code of Criminal Procedure.

A prosecution by the State at the instance of the Registrar of Joint Stock Companies should be a fair one. In

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21. The Companies Act 1956, S.622; See also id., S.2(ii)(b) which reads, "The Court means .... (b) with respect to any offence against this Act, the Court of a Magistrate of the First Class or, as the case may be, a presidency Magistrate having jurisdiction to try such offence."

22. K. Venkat Rao v. State, A.I.R. 1965 Mys.274.

23. The Companies Act 1956, Ss.624A & 624B.

one case,[24] the Registrar of Companies filed a complaint against the past directors of a company, namely the Retail Textile Dealer's Syndicate for falsification of accounts, misstatements in the balance sheet etc. The State Public Prosecutor made a prayer for permission of the Court for investigation of the case by police. This was objected by the Registrar. The accused persons argued that the action of the Registrar was a gross abuse of the process of the Court. Allowing the contention, the Calcutta High Court observed,

> "A prosecution by the State at the instance of the Registrar of Joint Stock Companies should be a fair one and there should not be the slightest reason for suspecting the same to be inspired by any motive other than securing the ends of justice."[25]

Criminal prosecutions could be initiated only at the instance of specified persons.[26] Only the categories of persons viz. the Registrar of Joint Stock Companies, any shareholder of the company or a person authorised by the Central Government[27] could set the machinery for criminal sanction in motion.[28] A liquidator of the company is also

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24. Priya Nath v. State, A.I.R.1959 Cal.387; N.K. Sen, J. held that if the motive of the prosecution was to meet the ends of justice, the prosecution was valid.

25. Id. at p.389 per P. Chakravartti, C.J.

26. The Companies Act 1956, S.621.

27. Chief Officer, Dy.Chief Officer and Assistant Officers attached to the Department of Non-Banking Companies and the Reserve Bank of India are now authorised for the purpose under this provision in relation to an offence under S.58A(b), see G.S.R.473(E), dated 26.9.1978.

28. Ibid.

treated as an officer of the company for this purpose.[29] However, prosecutions of a company or any of its officers under other penal laws, are not subject to any kind of limitations with respect to their institution or maintainability which is found in the Act. In such prosecutions any body could file a complaint.[30]

Nature of Criminal Prosecutions

Most of the criminal prosecutions launched under the Companies Act, 1956 (1 of 1956) relates to the failure to file returns and other documents to the Registrar, failure to hold annual general meeting, failure to keep proper books of accounts and offences relating to winding up. Punishments provided for these offences are mostly in the nature of fine only. It is submitted that conforming to all the procedural formalities as laid down in the Code of Criminal Procedure is not necessary to meet the ends of justice in these cases. An analysis of the following tables would make the matter clear.[30A]

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29. The Companies Act 1956, S.621(3).

30. Dhirendra Nath Banerjee v. Jamini Kanta Mitra, A.I.R. 1958 Cal.163.

30A. The following table gives the break up of the prosecutions from 1957 to 1982.

(f.n. contd)

Quick disposal of these cases is necessary to build up sound company practice. But the number of pending cases

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(f.n. 30A contd.)

Nature of Company Prosecutions

Year	Total Prose-cutions	Prosecu-tions for failure to submit annual returns	Failure to main-tain Books & Accounts	Failure to submit balance sheet	Failure to hold annual general meeting
1957-58	1877	*	420	*	388
1961-62	3990	1107	471	1489	489
1962-63	3991	887	569	1477	416
1963-64	4588	1419	668	2262	610
1967-68	4952	398	841	2045	330
1969-70	4848	684	1273	1934	389
1972-73	5324	1599	1032	1621	404
1976-77	6537	2052	1064	2569	1064
1977-78	7649	*	3201	3102	968
1978-79	7715	3146	2535	775	736
1979-80	8897	*	*	*	*
1980-81	8738	*	*	*	*
1981-82	14453	4932	2758	5514	758

Source: Figures as shown in Annual Reports of the Working& Administration of the Companies Act 1956, published by Govt. of India, Department of Company Affairs.

year after year is mounting substantially.[308]

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308. Pending Prosecutions

Year	Total No. of prosecutions made during the year	Total No. of prosecutions considered during the year	Pending case as on 31st March
1956-57	572	1310	607
57-58	1877	2484	1335
58-59	2495	3730	1642
59-60	5252	6894	-
60-61	6272	-	-
62-63	-	-	2204
63-64	3991	4195	-
64-65	5591	-	2455
66-67	4872	7291	2419
67-68	4952	6502	2550
68-69	4588	7138	2258
69-70	4848	7406	3125
70-71	5525	8650	3994
71-72	6206	10200	5102
72-73	5324	10426	4986
73-74	5661	10647	5322
74-75	3320	8642	4397
75-76	6073	10470	5929
76-77	6537	12468	6997
77-78	7649	14646	9277
78-79	7715	16992	10873
79-80	8897	19770	13620
80-81	8738	22358	14928
81-82	14453	29381	21713

(f.n.contd.)

The total number of cases to be dealt with by the Criminal Courts are also increasing by leaps and bounds. Another interesting aspect revealed is that most of the prosecutions (more than 85%) end in conviction.[30C]

(f.n. 30B contd.)

Source: Annual Reports of the Working and Administration of the Companies Act 1956; Department of Company Affairs, Government of India, New Delhi.

30C. Percentage of Convictions in Company Prosecutions

Year	Total cases disposed by Courts	No. of Convictions	No. of Acquitals	Percentage of conviction
1966-67	-	4585	16	93
67-68	-	4383	11	91
68-69	-	4199	24	90
69-70	-	3777	44	88
70-71	-	4063	26	87
71-72	-	4278	29	84
72-73	5440	4779	35	88
73-74	5325	4255	251	80
74-75	4245	3336	139	79
75-76	4541	3863	267	85
76-77	5561	4719	149	84
77-78	5369	4641	59	86
78-79	6119	5286	63	86
79-80	6150	5128	98	83
80-81	7430	6668	55	90
81-82	7668	6519	332	85

Source: Annual Reports of the Working and Administration of Companies Act 1956, Department of Company Affairs, Government of India, New Delhi.

This high percentage of convictions is because of the fact that most of the prosecutions are for failure to conform to a statutory duty and the stringent rules of evidence have no importance in these cases.

A proper classification of the two hundred and odd penal provisions contained in the Companies Act can improve the situation. Those penal provisions like failure to do a particular duty, which do not require elaborate procedural formality for conviction, or which are more like a fine should be taken out from the jurisdiction of the ordinary Criminal Courts and should be entrusted to some administrative body. This could not only expedite the disposal of company cases but also lighten, to a great extent, the burden of the ordinary courts.

The Sachar Committee considered this aspect and observed,

> "...(a) Even when the non-compliance with the legal requirement is already on record and hardly require any further proof, the Registrar has to launch a prosecution and after protracted proceedings in the Courts of the Magistrates, the case may be disposed of by the imposition of a small fine and without necessarily ensuring the compliance of the law in future. Generally, prosecutions of this type are covered by the failure to file returns or documents with the Registrar...."[31]

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31. Report of the High powered Expert Committee on Companies Act & MRTP Act (1978) (referred to as the Sachar Committee Report) para 16.15(a).

Another observation of the Committee in this regard is also worth noting:

> "Quite a good number of prosecutions does not involve examination of witnesses and can be disposed of with reference to available records. These records are, however, company records and may require the application of legal and accounting mind rather than the application of the knowledge of the Criminal Procedure Code, the Indian Penal Code or the Indian Evidence Act in any considerable length. It may not be reasonable, therefore, to impose additional burden on the magistrates who are already saddled and are more equipped, by virtue of their training and experience, to deal with crimes of more specific and common nature."[32]

The Committee recommended the transfer of this jurisdiction from the Criminal Courts to some well equipped Administrative Courts.[33] The arguments advanced by the Committee are convincing.

Administrative Adjudication

At present there is no statutory tribunal or Administrative Courts dealing with company matters. The Companies Tribunal was constituted by the Companies (Amendment) Act 1963 (53 of 1963).[34] The Tribunal had all the powers of

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32. Id., para 16.15(f).

33. Id., para 16.17.

34. Ss.10A,10B,10C and 10D inserted by the Companies (Amendment) Act 1963, dealt with the Constitution, powers and procedures of the Tribunal and appeals against its decisions. These sections were repealed by the Companies Tribunal (Abolition) Act 1967, which came into effect from 1.7.1967.

a Civil Court in the matter of production of documents, examination of any person on oath etc. It had power to order a person to produce documents before the inspector or order search and seizure of a company's records by the Registrar of Companies and by the inspector. Applications for relief in cases of oppression and mis-management were also considered by the Tribunal. The power vested in the Central Government to remove a person from positions of management in companies could be exercised only on the basis of a finding after due enquiry, by the Tribunal. There was also a provision for appeal to the High Court on questions of law, against the decisions and findings of the Companies Tribunal. The Companies Tribunal was abolished from 1.7.67. A number of functions in the field of Company law affecting the rights of persons are carried out by different administrative agencies.

Scope of the Administrative Adjudication

All decisions made by the administrative authorities do not constitute administrative adjudication. Only decisions of a judicial or quasi-judicial nature come under this category. According to one classification there are three types of administrative adjudication. They are (1) the licensing power including the power to grant, refuse, review and revoke licences or permits which may statutorily be required for the pursuit of certain professions or trades;

(2) investigating power, ie. the power to issue compulsory process for obtaining witnesses to testify and produce documents for the purpose of acquiring the information needed for effective regulation and settlement of issues. Such cases may occur either between the administration and private individuals or between private parties; (3) the directing power ie. the power to issue, in accordance with the rules of natural justice, administrative orders by which private party is required, in confirmity with the governing statute, to do or refrain from doing some specific things.[35]

Blately and Oatman give a comprehensive list of six types of administrative adjudication.[36] They are (1) advisory administrative adjudication, where the power of final decision is invested in the Head of a Department and a subordinate officer hears the parties, examines their documents and prepares decisions in the form of an "Official Note." Sometimes there may be advisory committees to advise the Head of the Department on matters of adjudication; (2) administrative adjudication as a condition precedent to the performance of an administrative act, like registration of documents; (3) administrative adjudication exercised in connection with licencing activities; (4) administrative adjudication in connection with the settlement of disputes either between the

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35. See Encyclopaedia Britannica, Vol.1, p.165.

36. As quoted by P.C. Jain, in "Administrative Adjudication. A Comparative Study," Sterling Publishers, New Delhi (1981), pp.13-15.

administrative authority and a private party or between private individuals themselves; (5) the administrative adjudication may be combined with legislative and administrative process; and (6) finally an administrative decision may be challenged on appeal to higher administrative authorities or tribunals. There can be provision for a second appeal even.

In the field of the company law in India, almost all of the above categories of administrative adjudication occurs. The most common application is the administrative adjudication as a condition precedent to the performance of different administrative acts under the company law. Thus, the adjudication starts from the incorporation of a company. The certificate of incorporation is granted to a company only after it is duly registered. In the process of registration the Registrar of Joint Stock Companies have to adjudicate on a number of matters like desirability of name, compliance with the relevant provisions of the Act, the validity of articles of association and memorandum of association, etc. There are quite a large number of actions of the company which require licence, prior sanction or approval of the Central Government. These include the licence for dropping the word 'Ltd.' from the name of a company, carrying on or expanding a business, issuing shares, appointing managing or wholetime directors and a number of similar functions.

Another fertile land of administrative adjudication

under the company law is in relation to the investigation and inspection. In a number of circumstances, an inspection or investigation may be ordered by the executive. The Companies Act 1956, provides for the inspection of books of accounts by the Registrar,[37] investigation into the affairs of company for different purposes[38] and different circumstances[39] and appointment of inspectors.[40] The Industries (Development and Regulation) Act 1951 (65 of 1951) and the Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969) also contain similar provisions.[41]

The company law provides for the settlement of disputes between private parties also by administrative authorities. The dispute may be between members interse,[42] members and the company[43] or between the company and outsiders.[44] Many

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37. Companies Act 1956, S.209A.

38. Under the Companies Act 1956, Investigation may be ordered on application by members or on the report of the Registrar (S.235) or suo-motu by the Central Government (S.237(b)).

39. Investigation may be ordered under Companies Act for investigating the affairs of the company under sections 235 - 251; or to determine the beneficial ownership of shares under Section 187D. Investigation may be made under the Industries (Development and Regulation) Act 1951, S.15A and 16. The Monopolies and Restrictive Trade Practices Act 1969 also provides for investigation. See post.

40. Id., S.235.

41. See the Industries (Development & Regulation) Act 1951, Ss.15A and 16; See also the Monopolies and Restrictive Trade Practices Act 1969, S.11 & S.31.

42. For example in the matter of alteration of memorandum of association, amalgamation etc.

43. Like the refusal to register transfer of shares (The Companies Act 1956, S.111) election of Directors; oppression and mismanagement (Ss.397, 398 & 408) etc.

44. The Central Government may authorise any person, not

(f.n. contd)

of these powers involves application of judicial mind and were formerly exercised by the Courts.[45] But now some of these powers are exercised by the delegate of the Central Government[46] and some others by an independent commission.[47]

The administrative authority, the Central Government, is empowered to sit in appeal against the decisions of the board of directors of a company, when they refuse to register a duly executed transfer of shares in the exercise of their discretion.[48] However, no provision is made in Companies Act 1956, for an appeal against the order or decision of the administrative body. The only way out is to approach the Supreme Court or the High Court under the writ jurisdiction.

The English Position

In England, because of the insistance on ministerial responsibility to parliament, independent ministerial agency

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(f.n. 44 contd.)

even a member of the company, to present a petition in the public interest if the management and affairs of the company are carried on prejudicial to the public interest. See Ss.397, 398, 235, 391 etc.

45. Some of the powers and functions exercised by the Court were transferred to the Company Law Board by Companies (Amendment) Act 1974 (41 of 1974).

46. Like the Registrar of Companies, the Regional Directors and the Company Law Board.

47. For example, the Monopolies and Restrictive Trade Practices Commission.

48. The Companies Act 1956, S.111.

is considered as a Constitutional monstrosity. There is no administrative empires like the Federal Trade Commission or the Securities and Exchange Commission of the U.S.A., in England.[49] So a Department of the Government, the Department of Trade & Industry, is entrusted with the duty of administrative adjudication. Regarding prosecutions, all offences under the Companies Acts which are made punishable by fine alone, are triable summarily by the Magistrates' Court.[50] Summary proceedings for any such offence may be taken against a body corporate at any place at which it has a place of business.[51] Prosecution should be taken within three years after the commission of the offence and within twelve months after the date on which evidence, sufficient in the opinion of the Director of Public Prosecutions or the Department of Trade and Industry, to justify the proceedings, comes into its or his knowledge.[52]

The institution of criminal proceedings by the Director of Public Prosecutions will not preclude any person from instituting or carrying on any such proceedings.[53] On a summons for default in making annual returns, a Magistrate's court is not bound to accept the evidence of the Register as

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49. See Bernard Schwats and H.W.R. Wade, Legal Control of Government, Oxford (1972), pp.27-31.

50. The Companies Act 1967, S.49(6).

51. Id., S.49(2).

52. Halsbury's Laws of England, (4th Edn.1974), Butleworths, Vol.7, p.761.

53. The Companies Act 1948, S.445.

conclusive. But he should accept it unless it is clearly proved that the entries and the returns supplied to the Registrar are so false and misleading as notbe a compliance with the Companies Acts.[54]

In England, most of the disputes arising between members interse, or between members and the company are settled through Courts. The jurisdiction in relation to the alteration of memorandum and articles of a company, rectification of register, amalgamation, winding up etc. are conferred on the Company Courts. However, the Department of Trade and Industry is also empowered to adjudicate on certain matters like failure to hold general meeting of a company.[55] Administrative adjudication in the matters of incorporation and licensing of companies, registration of returns and accounts, approvals and sanctions etc. exist in England also.

As a general rule, there is no right to appeal to the Courts from the decisions of the administrative authorities. But directions could be issued by the Courts just like in India. However, there are certain cases where right of appeal to the Courts is expressly given. Any person aggrieved by the decisions of the Department of Trade and Industry in respect of a claim to undistributed assets, may appeal to the

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54. See Re Briton, Medical and General Life Association, (1888) 39 Ch.D.61.

55. Halsbury's Laws England, op.cit., p.559.

Court.[56] When the Department grants or withholds the release of a liquidator, there is a right of appeal.[57] Similarly, an appeal lies to the Court from the order of the Department directing the disposal of a company's books.[58] Such appeals must be made by a motion and should be brought within twenty-one days from the date of the order or the decision appealed against.[59]

The Monopolies and Restrictive Trade Practices Commission, a statutory regulatory body, exercises control over monopolisation of business.

The American Position

In order to achieve the objective of 'specialisation' to deal with specialised problems of economic supervision'[60] independent regulatory agencies are created in the United States. The two giant regulatory agencies, the Securities and Exchange Commission (SEC), regulating the investment business and the Federal Trade Commission (FTC), regulating the unfair trade practices and other practices affecting the industry generally; settle many of the disputes arising under corporate law. These bodies are entrusted with

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56. The Companies Act 1948; S.343(3),(4).
57. Id., S.251(1).
58. The Companies (Winding Up) Rules 1949, R.206(2).
59. Id., R.215.
60. Bernard Schwartz and H.W.R. Wade, op.cit., p.27.

extensive policy making functions.[61] These independent agencies regulate powerful interests and industries and are vested with administrative, legislative and judicial powers. They can make regulation, prosecute for breaches and even decide cases themselves. Though the members of these agencies are appointed by the President, in the absence of any specific provision in the statute governing their service, the President has no power to remove them.[62]

Thus these regulatory Commissions are placed outside the three branches of the Government and are not subject to the direct supervision and control of the President or of any other officers of the executive branch. The powers of the Commission include powers of a judicial nature and they settle disputes affecting the rights and liberties of those who engage in business. This independence is necessary to retain the faith of the citizens that their cases would not be decided to please the political executive. Commercial and economic regulations are thus taken out of politics to a great extent.

In addition to these powerful agencies, the Secretary of State also enjoys much adjudicative power in the matter

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61. The enabling statutes delegate authority to these bodies in the broadest and general terms. For example, the Federal Trade Commission is empowered to eliminate unfair methods of competition and the Securities and Exchange Commission is empowered to apply such concepts as 'maintenance of a fair and orderly market and reasonable rates of commission."

62. Humphrey's Executor v. United States, 295 U.S.602(1935) 79 L.ed.1611.

of incorporation, licencing, registration etc. Disputes between members and the company in relation to the management and affairs of the company could be taken to the Courts.

Is the Company Law Board Competent to Handle These Matters?

It is high time that India should think of, and constitute an effective forum for settlement of dispute in company matters. An independent regulatory committee of the type of the Securities and Exchange Commission was mooted by all committees appointed in India, to look into these matters.[63] The Company Tribunal constituted under the Companies (Amendment) Act 1963 had to be abolished, mainly due to the delay in pursuing the cases in this Tribunal.

Our present Company Law Board would hardly serve the purpose. No doubt, the functions of the Company Law Board, after the Companies (Amendment) Act 1974 (41 of 1974), is far wide. In the exercise of powers and jurisdiction, the Company Law Board is clothed with the powers of a Civil Court in respect of certain matters.[64] The Company Law Board Bench

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63. The Company Law Committee, (1952), recommended the constitution of an independent regulatory agency for administration of the Companies Act. Similarly the Administrative Reforms Committee (1967) and the Sachar Committee (1978) also recommended the constitution of such a body.

64. See the Companies Act 1956, S.10E (4-C) and (4-D) which says, "4-C). Every Bench referred to in sub-section(4-B) shall have powers which are vested in a court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters; viz.

(f.n. contd.)

Rules 1975, lay down self contained rules of procedure to be adopted by the Company Law Board for discharging its functions. The Rules prescribe the procedure to be followed for filing applications and petitions. For its effective functioning, the Company Law Board can issue interim and final orders after giving an opportunity to the parties to be heard.

However, neither the Act nor the Rules provide for any appeal against the orders of the Company Law Board to any appellate authority or a Court of superior status. Moreover, the Company Law Board is a statutory body created by the Central Government as a subordinate authority to function under its supervision and control.[65] Thus there is enough

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(f.n.64 contd.)

a) discovery and inspection of documents or other material objects producible as evidence;

b) enforcing the attendance of witnesses and requiring the deposit of their expenses;

c) compelling the production of documents or other material objects producible as evidence and impounding the same;

d) examining witnesses on oath;

e) granting adjournments;

f) reception of evidence on affidavits.

(4-D). Every Bench shall be deemed to be a civil court for the purpose of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 and every proceeding before the Bench shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code and for Section 196 of that Code."

65. See id., Section 10E(b) which states, "In the exercise of its functions the Company Law Board shall be subject to the control of the Central Government" (emphasis added).

scope for the Government to control and regulate the discharge of quasi-judicial functions by the Company Law Board. Another lacuna in the present set up is that neither the provisions of the Companies Act 1956, nor the Rules, provide that the findings and orders of the Company Law Board is final. The jurisdiction of other Courts to adjudicate on matters where a company or other person is not satisfied with the decision of the Company Law Board is not barred. So they can seek proper relief in a Civil Court by way of an independent suit even where the same issue was adjudicated by the Company Law Board. The Central Government itself can exercise all such powers which are delegated to the Company Law Board, the latter being a subordinate authority of the former. Moreover, the Central Government is not divested of these powers even after making delegation of the powers to the Company Board.[66] Not only this, the Central Government is free to issue executive directions and instructions to the Company Law Board from time to time.[67] It is clear from the foregoing discussion that the Company Law Board is not an independent statutory body and could be subject to executive bias of comparative high order.

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66. Alaka Prakash Jain v. Union of India, 1972 Tax.L.R. 2124 (Cal.).

67. The Companies Act 1956, S.10E(b).

PART - VI

CONCLUSIONS AND SUGGESTIONS

CHAPTER - 20

Towards A Comprehensive Scheme for Administrative Controls

Administrative controls over companies and other forms of business are made tighter day by day, to retain substantial control over the economic activities in the country. Regulations are envisaged not only from the birth of the company but even from its inception and lasts even after the death of the company. The philosophy behind the controls is said to be 'public interest,' where the State is expected to act as a neutral umpire reconciling different competing interests in business. But the concept of 'public interest' itself is very elastic one and it changes with the change in social and political ideology of a given society. Moreover, the State is treated as the custodian and protector of public interest. Hence the State becomes a party-interested to a substantial extent - to the cause in which it is acting as an arbitrator. Here the neutrality turns out to be a positive partiality. So, while trying to control and remedy the evils like inadequate information, monopoly power, excessive competition, inefficiency in industrial management etc., the Government may replace its own wisdom influenced

by partisan or political considerations for 'public interest' or 'national interest.'

But business regulation is necessary to reduce fraud, and unfair practices in the field of industry. In the absence of controls, it would become impossible to secure best investment opportunities, better quality goods and services, preservation of environmental safety, betterment of the condition of workers and similar objectives which a welfare state ought to promote. So there should be business regulation which is fair and reasonable.

The Need for an Independent Administrative Agency

The position would be still worse, if the whole administration of business regulations is entrusted with the judiciary. The strict adherence to procedural formalities in judicial process alone would defeat the regulatory measures due to inordinate delay in the process. Besides, judicial mind may prove to be incompetent to deal with business situations without specialisation and expert training. This expertise and specialisation is of very significance because intelligent business regulation involves the interpretation and application of a wide range of scientific knowledge. The agency for business regulation needs to be a body free from political and judicial pressures. The body should respond quickly to social developments, but should not detract widely from the planned national policies. Or, there should

be sufficient flexibility and freedom of action for these regulatory bodies while functioning within a broad frame work.

The United States is experimenting with this form of regulatory agencies with tremendous success. Many other countries like Japan, France, Australia, New Zealand etc. are following this practice. India too, accepts this in principle and most of the regulatory functions are entrusted with a semi-departmental agency, the Company Law Board.

Eventhough the Company Law Board exercises quasi-judicial functions in relation to many matters, it is under the control of the Central Government in the exercise of its functions. The Central Government can issue directions to the Company Law Board, which it should obey. So it is more or less a departmental regulatory agency, subject to the pull and pressures of the party in power. It will not be possible for such a regulatory body to administer impartially a vital economic legislation like company law. So it is necessary to entrust the administration of company law to a truly independent agency. Even this regulatory body may not be acting in a vacum and may be subject to constant pressure from a number of sources like political pressure, influence of courts and role played by the regulated and those supposedly benefitted by regulation.[1] But here

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1. See R.F. Cranston, "Regulation and De-Regulation: General Issues," (1982) 2 U.N.S.W.L.J.1 at p.18.

these elements would not be formal or coercive and the regulatory agency is influenced only by the general political climate of the society and the mass media. So if the persons selected to key positions in the regulatory body are persons of integrity and free from political bias,[2] the administration of the company law could be fair and effective. The structure of the regulatory body should ensure that it would not pursue trival cases, promulgate weak standards or rules and enforce the law without any laxity. For this purpose definite criteria should be prescribed in relation to admission of complaints, procedure to be followed in dealing with the complaint and the time within which a complaint or application should be disposed of. At the same time the regulatory body should have sufficient degree of freedom of action, of course within the broad pattern laid down by the Legislature.

Multiplicity of Administrative Agencies

When there are more than one regulatory agency exercising jurisdiction over different aspects of the same subject, many inconveniences may follow. This is exactly what is happening in the field of company law administration. From the Government level to the ground level there is

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2. Emphasis is to show that it is not possible to select a man devoid of any political interest, but only thing is that he should not have any strong political commitments.

overlapping of powers. Thus different Ministries like the Ministry of Industries, the Ministry of Finance, the Ministry of Company Affairs etc. are exercising control over the company form of business. The statutory bodies like the Company Law Board and the Monopolies and Restrictive Trade Practices Commission, statutory officers like the Registrar of Companies, the Controller of Capital Issues, the Registrar of Restrictive Trade Practices etc. also exercises control over different fields of company's operations. The activities of the Reserve Bank and of financial institutions are also having heavy impact on the working of companies. So without a proper co-ordination among all these agencies, it is not possible to achieve effective and efficient control over company's activities. Presently there are provisions for consultation among the different Ministries. By this process considerable time is consumed. For implementing a particular Act, a company may have to approach two or even more agencies and wait for their decisions. This may cause unreasonable delay and worry to even well managed companies, thereby retarding country's economic progress. To avoid this all possible matters should be brought under one and the same Ministry. Except policy matters which are to be dealt with by the concerned Ministries, all the administrative powers to control companies ought to be delegated to an independent agency envisaged here.

Dispute Settlement Machinery

Another important aspect of the company law which received attention earlier in the preceeding pages is the dispute settlement machinery. Special courts are provided for taking actions for breach of some provisions of the Companies Act. But for the other violations no special forum is provided. Even in cases where special courts are to be approached, there is considerable overlapping. The Company court, the Company Law Board and the Central Government are having current jurisdiction in some cases. The position is made more complicated by the decisions of various High Courts to the effect that even where special courts are provided by the Act, the jurisdiction of the civil court is not banned. In some cases, the Courts have held that when the Act prescribes a summary proceeding in the special courts and the actual situation demands a decision on complicated questions of fact and law, the parties should approach civil court first to settle the factual questions and then approach the special court for remedy under the Act. The whole scheme works out great inconvenience and create a widespread confusion in choice of jurisdiction.

The position where the Company Law Board and other administrative agencies are exercising jurisdiction to decide disputes is also not satisfactory. As a specialised organ, many of the benefits of an administrative tribunal can be claimed by the Company Law Board. But the scheme of

the Companies Act 1956 proves that it is not an independent tribunal but only a delegate or subordinate of the Central Government. This position of the Company Law Board makes it a judge and prosecutor at the same time. In the case of alteration of memorandum, approval for issue of shares at a discount, rectification of register of charges, prevention of oppression and mis-management etc. the Government is stepping in as the guardian ofpublic interest. It is an active party to the proceeding in which its delegate or subordinate is acting as judge. This is an anomalous position.

The need for an independent regulatory agency in line with those existing in the United States, Australia, Japan and some other countries is greatly felt here also. Considering the nature of the decisions to be taken by the Courts in different matters, it is necessary to transfer some of these responsibilities to some administrative agency. With the creation of this agency the present chaos in relation to the jurisdiction could be minimised. A detailed schedule, as contained in the Criminal Procedure Code 1973, need be prepared showing the jurisdiction of different agencies and courts in Civil and Criminal matters arisingunder the company law. This would serve as the first attempt for a comprehensive company procedure code detailing all procedural matters in relation to companies.

The need for a dispute settlement machinery within the company itself may also be considered. By this process it would be possible to reduce the number of frivalous litigations coming to the Courts or the company tribunals. For small companies which cannot afford such internal machinery for settlement of dispute, district-wise 'grievance cells' may be established under the independent regulatory agency.

The Company law empowers the administrative authorities to intervene in the affairs of a company in a number of circumstances to ensure that shareholder participation in management is effectively made use of. Thus they can intervene where there is a refusal to register transfer of shares, refusal to rectify the register of charges, oppression or mismanagement, refusal to call and conduct annual or extraordinary general meeting, malpractice in a scheme of amalgamation, take over etc. These powers are very important in modern world. Now except in small companies where there may be identity of management and shareholders, the actual investors are devoid of any practical control over the management. Eventhough in theory shareholders have the power to 'hire and fire' the management, the realities of the commercial world shows that this principle has little value. The directors manage the company in their own way and the shareholder has little or no say in this matter. The position is still worse in private companies. There

the company's articles may provide for unequal voting rights giving undue benefits to the management. Many of their dealings are out of public scrutiny. Examined in the light of these circumstances, the administrative powers in this regard is salutary. But a number of considerations are required here. Should a purely executive body be entrusted with such massive powers or need it be transferred to some quasi-judicial authority? Here the wisdom of company management is put to test. This should be done in line with business principles and practices conforming to the accepted legal principles and ideals. For undertaking such duties an independent quasi-judicial authority would be a better choice.

Proposal for a New Machinery

Attempt to evolve a foolproof system for adjudication of matters arising out of company laws is futile, considering its vast scope and application. However, the present writer ventures to suggest a system that would provide for an orderly and efficient working of the law. For evolving such a system, the following considerations are taken.

i) Our system of company law has drawn a curtain which conceals the doings of the directors and managers of a company. Beneath this curtain fraud can be perpetuated on customers, on creditors and on shareholders. The unveiling of this curtain by the Courts occasionally and inquiry reports of inspectors appointed by the Central Government do

very useful purpose. But it seems that these measures are not sufficient to keep the directors within bounds. There should be some body associated or interested in the affairs of the company to keep a constant vigil. Representatives of shareholders and creditors seem to be the best police in this matter.

2) The inevitability of administrative adjudication in a socio-economic legislation like company law cannot be denied. But the havoc that would be caused to the trade and industry and thereby the economic progress of the country would be tremendous, if such adjudicatory powers are exercised capriciously or arbitrarily. So there should be inbuilt safeguards to prevent any abuse of such powers.

3) The burden of the Courts should be reduced to the minimum. Service of experts should be used to the fullest possible extent, so that the life and spirit of the legislation could be retained. However, there should be access to judicial process wherever necessary.

4) The implementation of the scheme shall not cause heavy burden on companies so as to retard the industrial progress of the country.

5) The system should provide best possible control over the management by both the shareholders and the Government. But it should not fetter well-conducted companies. The fullest possible disclosure of the accounts and working of the companies should be ensured.

Constitution of Grievance Cells

To reduce the number of cases coming to the Courts because of individual differences among the shareholders, creditors and directors, there should be a statutory requirement to constitute a 'Grievance Cell' within each company. The form and method of these Grievance Cells may vary, but they should act as domestic tribunals. The Grievance Cell shall consist of three to five members. The company secretary shall always be present in the body. Two members may be elected by members in annual general meeting. The other two may be nominated by the Registrar of Companies, whenever he deems it necessary. There should be a mandatory requirement to refer to this cell, any dispute relating to transfer of shares, rectification of charges, failure to hold meetings, non-payment of dividend, public deposits etc., election of directors, alteration of memorandum or articles of association, amalgamation etc. The cell should examine these questions and give a decision within one month of the presentation of the petition. It should always record the reasons for its decisions, as this would not in most circumstances adversely affect the prospects of the company. There need be provision for an appeal to a judicial tribunal from the decision of the Grievance Cell.

Company Tribunals at the State Level

Many of the powers of the executive and the judiciary could be entrusted to some State level Company Tribunals.

The members of the tribunal need be (a) eminent jurists, specialised in company law, (2) chartered accountants; (3) cost accountant and (4) economists of ability. The functions under allied Acts like the Monopolies and Restrictive Trade Practices Act 1969, the Securities Contract (Regulation) Act 1956, the Capital Issue Control Act 1947, the Foreign Exchange Regulation Act 1973, the Industries (Development and Regulation) Act 1951 etc. can also be transferred to these Tribunals.

The exclusive original jurisdiction hitherto conferred on the High Courts, in matters of winding up, can be transferred to these tribunals. Considering the number of such cases coming up for consideration of the High Courts,[3] such a step is necessary to reduce the work load of the High Courts.

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3. The following table shows the number of cases considered by the High Courts in relation the winding up of Companies.

Company Liquidations

Year	Total No. of Companies under liquidation.	Members volumtary.	Creditors voluntary	Winding up by Courts	Winding up under supervision of Courts
1962-64	2755	1205	95	1000	28
67-68	2841	1316	471	1023	31
69-70	3085	1404	526	1114	41
72-73	3359	1542	618	1152	47
76-77	3216	1357	566	1261	32
77-78	3402	1388	563	1420	31
78-79	3512	1414	581	1488	29
80-81	3650	-	-	-	-
81-82	3694	1430	638	1599	27

Source: Annual Reports on the Working and Administration of Companies Act, 1956.

The powers and functions of the High Courts transferred to the Company Law Board by the Companies (Amendment) Act 1974, could more conveniently be transferred to the Tribunal. Other matters to be transferred to the Tribunal are provisions relating to minority protection and amalgamation of companies. Eventhough the number of cases coming under these provisions are not significant,[4] the Tribunal would be better equipped to deal with such cases.

All appeals from the 'Grievance Cell' of companies within the state could be finally decided by these Tribunals. There may be a second appeal on points of law only to the High Courts.

Regarding criminal prosecutions, it has been shown that most of the prosecutions relate to non-filing of accounts and other returns for which punishment provided is fine only. Such provisions can be modified and the power to impose fine can be conferred on the Registrar of Companies. There can be a provision for appeal to the Tribunal against such actions.

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4. The following table shows the petitions filed under Sections 397 & 398 of Companies Act 1956.

Year	No. of petitions
1963-64	32
67-68	23
76-77	35
77-78	29
78-79	35
81-82	36

Source: Annual Reports of the Working and Administration of the Companies Act 1956.

The finding of the Tribunal shall be final in those cases. Other penal provisions could be enforced through the Tribunals with a provision for appeal to the company division of the High Court.

In addition to these, powers of the Central Government, which are of quasi-judicial nature should also be transferred to the Tribunal. Thus, the grant of licence, calling of annual general meeting, appointment of inspectors, ordering of cost audit or special audit, and grant of approvals or sanctions in several matters etc. should be transferred to the Tribunal. These powers are to be used judicially taking into account various factors.

The powers and functions relating to companies and stock exchanges contained in other related enactments should also be transferred to the Tribunal.

Central Appellate Authority

There should be a Central Appellate Authority as in the case of the Incometax Appellate Tribunal. At least half of themembers of the Central Appellate Tribunal shall be persons qualified to be appointed as Judge of the High Court having good background of company law. In addition, to professionals like chartered accountants, cost accountants, economists etc. there shall be present representatives of the affected interests like associations of industrialists, workers and consumers. The work of the Company Law Advisory Committee shall be entrusted to this body. The Appellate Tribunal shall hear appeals from decisions of the State Tribunals where the latter exercise original jurisdiction.

The success and failure of any regulating statute depends much upon proper enforcement thereof and as long as strict enforcement is ensured much socio-economic offences could be reduced. For this purpose speedy trial of offences is important. The socio-economic crime especially relating to industries, call for urgent and expeditious handling not only because of their nature and content but also because they undermine the material welfare of the whole community and the nation. It is true, special tribunals create a circle within the circle. Such courts have a demoralising effect upon public mind and undermine people's confidence in general administration of justice. Moreover, these courts would be subservient to executive to some extent. But considering the existing machinery for the administration of justice, it is essential to create such courts. Moreover, there could be not much hue and cry against permitting administrative adjudication of minor offence of regulatory nature especially when provision for appeal is provided.

Need for a Rational Basis for Classification of Companies

In India at present, the rigour of administrative controls over a company depends upon its class. Controls are intensive in the cases of public companies and private companies which are subsidiaries of public companies. Lesser control is exercised over 'deemed public companies.' In the case of private companies, the controls are much less.

The government companies and guarantee companies enjoy many privileges. But what is the rationale behind this classification? Certainly, it is not their impact on society. From the foregoing discussion it can be seen that there are a number of private companies investing crores of rupees and employing good number of workmen. They produce goods of vital importance to the society. Yet the control over them is less, mainly on the basis that they are not inviting public deposits. Similarly, because of the amphibian position of government companies control over them is practically very limited. They are not properly controlled under company law as they can be exempted from the provisions of the Act in many cases. Being a separate legal entity and autonomous body, the Government control over them is less than that of the Government Departments engaged in commercial ventures. The position needs changes. The classification and control of companies should depend upon their social importance. Companies should be classified into small, medium and large companies with varying degrees of administrative controls. If the law relating to government companies are also allowed to remain in the present company law itself, the same surveillance should be made into the affairs of those companies also as that of other companies. However, it is better to provide a separate code for control over management of government companies. The procedure relating to selection of name, incorporation, licensing, commencement of business etc. need be simplified by making

changes in the existing laws. These matters have been discussed in the appropriate places.

The Financial Controls

The financial controls over companies is one of the most effective methods of regulating company's affairs. Different methods are used by administrative agencies in this connection. Keeping proper books of accounts, (2) proper audit, (3) filing of accounts and returns etc. are some of them. The administrative authorities are also empowered to order cost audit or special audit, and to cause inspection of books and other papers of the company. Rigorous controls are exercised by the Reserve Bank of India and the Controller of Capital Issues over the acceptance of deposits and raising of money by companies. In spite of all these controls, instances are not rare where public are cheated by companies. Eventhough the risk is heavy in making deposits in companies, there is no scheme of deposit insurance for company deposits as in the case of bank deposits. There are more than one reason for this state of affairs. The number of annual returns and other documents received by each Registrar is too many, so that he would not be in a position to scrutinise each and every documents and find out whether there are some suspicious circumstances. By the time he receives complaints and takes steps after proper verification, the situation may become beyond control. There is no provision or resources for undertaking periodical

inspection and auditing of company accounts by regulatory agencies. Eventhough the provision for cost auditing is made use of in the case of manufacturing companies, the special audit provisions are not properly utilised. The effective use of this provision should be made to check financial malpractices by companies.

There is no provision in the Companies Act 1956, making it compulsory for companies to prepare and present budgets in annual general meetings. Such a provision is useful not only for the shareholders and other partners in business but also for the management itself. The shareholders can assess the performance of management on the basis of the budgetary proposals and get clarifications, if abnormal deviation is made from those proposals. They also get an opportunity to know in advance what are the projects and policies going to be carried on by the company in the following year. They can discuss the matter and take necessary precautions to see that the management is not acting out of the way. The management can analyse the performance of their units and take suitable action to increase the efficiency and change the mode of operation, if necessary. As far as the administrative authorities are concerned, they get an opportunity to assess the performance of companies easily by a comparison of the budgetary proposals with that of actual figures. If there are suspicious circumstances, it could be scrutinised throughly and remedial steps taken immediately. So it is advisable to make provision for

compulsory presentation of budgets in annual general meeting of companies.

To facilitate company deposits and to protect investing public, measures need be taken by the Government. For this, there is the need for a scheme of deposit insurance in companies. This would provide double benefit to the depositors. Firstly, the deposit made to the companies would, at least to a certain limit, be guaranteed by the insurance corporations, and secondly, the accounts and papers of the companies would be scrutinised by the insurance corporations also, leaving less room for malpractice by the company management.

The Management Structure

Another important thing in this connection is to consider the adequacy of the present form of company management structure. Eventhough companies are recognised as separate social units having its own rights and liabilities, it is not reflected in the management practice. The whole management of companies is shared between the directors and the shareholders of the company. The other partners in business, like workers, consumers and community, have no say in the management. It is possible to argue that the Government, as the agent of these interests has enormous power to appoint or remove managerial men of companies. But this is subjected to close judicial scrutiny. In other words, this power is available in cases where there is gross negligence, fraud, oppression or mismanagement in

relation to the affairs of the company. In times of peace or when the investors and management collude to injure other partners of business it is very difficult to invoke these powers.

It is strange to note that in a mammoth legislation like company law, there are only less than half a dozen provisions dealing with the workmen. That too, deals with the obligation of the workmen to assist the administrative authorities in conducting inspections and investigation etc. and the protection for them for doing such functions. Of course, there are provisions relating to the utilisation of provident fund and security deposits of employees and their right to remuneration in case of winding up of companies. The Courts have widened the scope of their rights by holding that employees have locus standi to be heard in a petition for winding up or amalgamation of companies. Even now the scope of their power is very narrow. Truely, there are obvious reasons for this. There are labour laws dealing with the welfare and security of employees. But is it proper to allow the two branches of law, the labour law and the company law, to grow independent of each other? This was the practice till now. A change is inevitable now. To consider an extreme step, the Soviet law on business enterprises devotes many its provisions in describing the relationship, the rights and liabilities of workers in a

business enterprise.[5] Being the social pattern there is, as it is, we need not follow such extremes. But why not we try the pattern followed in the capitalist countries like Germany, U.S.A. etc. In these countries also, the employee's right to participate in the management of companies is well recognised. Along with them other interests like consumers, suppliers of raw materials and community are also brought to the policy making forums. In India, the only provisions in the Companies Act 1956 in this regard is an enabling provision allowing the company to give financial assistance to its employees in purchasing the shares of the company. Even expert committees like the Company Law Committee and the Sachar Committee were reluctant to recommend compulsory participation of workers or other interests in the board of directors of companies. This has been discussed in Chapter 10 supra. As stated there, the arguments put forward by them in rejecting this proposal are not convincing. It is suggested that the proposed regulatory agency should be entrusted with the proper implementation of a scheme of workers participation in the management of companies.

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5. See the Statute on Production Association, confirmed by Decree of the USSR Council of Ministers, March 27, 1974, No.212, SP SSSR (1974), No.8, item 38 and the Statute on the Socialist State Production Enterprise, confirmed by Degree of the USSR Council of Ministers, October 4, 1965. SP SSR (1965), nos.19-20, item 155, as cited by Butler, William E., The Soviet Legal System, Oceana Publications, New York, (1978), pp.135-189.

Exercise of Administrative Powers

The administrative powers in relation to appointment, remuneration and removal of directors and other management personnel is very wide. There is nothing in the Companies Act 1956 to show that these powers are judicial powers or subject to judicial scrutiny. But it is now well settled that eventhough these powers are not judicial or quasi-judicial, the Government cannot use them arbitrarily. Before taking any actions under these provisions, the concerned administrative authority should form an opinion that the circumstances envisaged in the Act for taking recourse to these provisions do exist. The opinion should be an honest opinion based on proper material evidence. In effect these powers are treated as quasi-judicial powers. Here, it becomes necessary to lay down broad policy of action in these fields. Even the latest guideline in respect of remuneration of directors do not seem to be appropriate. Now the directors of a company can receive upto 2.05 lakhs rupees as salary and perquisites excluding fee for attending board meetings and fee for giving professional services. There is no requirement as to any ratio to be maintained between the income of a low paid employee and that of the director. While maintaining the view that to attract special talents in management of companies total remuneration to them may be even higher, it is necessary to see that the highest remuneration paid to them shall not exceed ten times the

total income of the low paid employee of the company. The administrative authorities should ensure that the payment of remuneration in this way does not detrimentally affect the prospects of the company and its business.

Confirmation of the Alteration of the Memorandum and Articles

Providing adequate safeguards to the interests of investors and creditors is one of the major objectives of administrative control over companies. Substantial changes in memorandum of association and articles of association of companies are subjected to administrative scrutiny. Confirmation of the alteration of the object clause in the memorandum of association is a pre-requisite for the validity of the alteration. Any alteration in the memorandum or the articles are to be registered with the Registrar of Companies within a reasonable time. In exercising the power of registration, the Registrar can refuse registration if the alteration is not in conformity with the accepted legal norms. Considering the delay for getting confirmation order from the Company Law Board and the prevalent practices in other countries like England, Australia etc. it is suggested that the requirement of confirmation of alteration be insisted only when an application is made by some shareholders, or when the Registrar, after verifying the documents, is of the opinion that such procedure should be followed.

Administrative Powers in Relation to Prevention of Oppression and Mismanagement

The concurrent power given to the Company Courts and the Central Government in relation to prevention of oppression and mismanagement, inspection and investigation etc. requires re-consideration. It is considered necessary to modify these provisions and develope them as an alternative to winding up of companies. It can be seen that when the Central Government has power to authorise any shareholder or even an outsider to present a petition under Sections 397 and 398 of the Companies Act 1956, the minimum membership requirements is made necessary for making an application to the Central Government for this purpose. Here the actions contemplated are very serious and includes even the removal or replacement of directors. As far as the shareholders and investors are concerned, the action is not less serious than winding up.[6] So it is felt that, the power of the Central Government should be used subject to the confirmation by the judicial authority. When an application for relief is received by the Central Government, it should make preliminary investigation by inspectors. In the meantime the management of the company may be properly watched by appointing a reasonable number of government directors. The final order in this regard should be made only after

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6. See Shanta Genevianve Pommerat v. Sakal Papers Pvt.Ltd., 1983 Tax.L.R.2470 (S.C.).

examining the report of the inspectors and after getting the confirmation from the Company Tribunal or the Court.

There need be provision for periodical inspection of books of accounts and other documents and papers of companies by the Registrar. If on such periodical inspections, or from an inspection made on complaints from the shareholders, employees or other interested persons, the Registrar finds that an investigation is necessary, such investigations should be made expeditiously. Administrative machinery should be strengthened to initiate follow up action on inspection report, without delay. It is felt that by these process, the number of company liquidations can be reduced considerably.

Prevention of Economic concentration

In the field of prevention of economic concentration and the consequent maladies, the administrative controls have failed to achieve the objectives. This is evident from the increasing number of monopolistic undertakings functioning in the country and the margin of profits earned by them. This is mainly because of the defects in the legal provisions and also the defects in implementation machinery as discussed in Chapter 9. It is seen that more than 80 per cent of the applications received by the Government under the Monopolies and Restrictive Trade Practices Act 1969 (54 of 1969) are disposed of without referring to the Commission. This is

because of the absence of any provision in the Act for a compulsory reference to the Commission. Even in cases where reference is made to the Commission, the Government is not bound to accept the report or recommendations of the Commission. This position needs change.

The present study concludes with the hope that it has succeeded in some measure in canvassing a better administrative control of companies in India.

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