# The Companies Amendment Bill 1972

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**"Free Enterprise was born with man and shall survive as long as man survives."**

**—A. D. Shroff**
1899-1965
Founder-President,
Forum of Free Enterprise.

# The Companies Amendment Bill 1972

## I

### Provisions Detrimental to Public Interest *

by

N. A. Palkhivala

The provisions of the Companies (Amendment) Bill, 1972, if enacted into law, would spell a degree of Governmental control over the day-to-day working of the corporate sector which is unknown to any other country of the world. If these proposed strangulating controls were really in the public interest and served a useful public purpose, they would not be objectionable. But they are bound to prove grossly detrimental to public interest. They will hinder the growth and development of corporate enterprises without resulting in any public good.

The bureaucratic seizure of all levers of power and the confluence of all controls in the hands of the politicians made Galbraith observe that today the greatest enemies of socialism are the self-styled socialists themselves.

The new definition of companies "under the same management" is absurd beyond belief. Psychologists have remarked that distortion of language precedes distortion of thought. Many expressions which are in current circulation represent distortions of language and result in distortion of public opinion and Governmental reactions. The concept of companies under the same management as

* Based on a public lecture delivered under the auspices of the Forum of Free Enterprise in Bombay on September 15, 1972. The author, well-known authority on taxation, constitutional law and company legislation, is the President of the Forum of Free Enterprise.

contemplated in the Bill is so distorted that even companies which may have never heard of each other are deemed to be under the same management, merely because one director of a company is on the Board of another company.

Private companies will virtually become extinct under the Bill. The most indefensible provision is that a private company having 10 per cent of the paid-up capital of a public company is itself converted into a public company.

Every sensible Government must safeguard the interests of depositors, but the Bill chooses to adopt the most cumbersome way of achieving the objective. A company has to issue a prospectus before accepting deposits just as it would issue a prospectus before issuing shares or debentures. Shares and debentures are issued only at a particular point of time, whereas accepting deposits is a continuous activity. It is incomprehensible how the very expensive and cumbersome procedure of issuing a prospectus can be called in aid for securing the interests of depositors. The Bill is silent on the question as to how many prospectuses would have to be issued by a company over a period of months or years. Besides, shares and debentures are long-term investments, whereas deposits are for limited periods of one or more years. And there are so many more efficacious ways of securing the interests of depositors than the issue of prospectuses.

The provisions to prevent take-over bids have, again, a laudable object behind them. But the provisions themselves are too onerous and cumbersome. They would deter investments and inhibit young entrepreneurs from going into new businesses for fear that they may not be able to sell off the businesses if and when they want to at a later date.

The restriction on declaring dividends out of accumulated profits of past years is grossly detrimental to the interests of shareholders. It will deter companies from accumulating profits and encourage the distribution of larger dividends, since reserves cannot be used in future for

dividend distribution without compliance with Governmental rules.

The provision that an auditor cannot be continued in office for more than three years is a gratuitous interference with the right of the shareholders to have an auditor of their choice. If the idea is to give work to new entrants in the profession, one may equally have a provision, justified by the same reasons, for preventing a company from having the same lawyer, doctor, architect or consulting engineer for more than three years. An auditor's job requires a well-equipped office and an adequate staff, and unless continuity of work can be reasonably expected, it would be impossible for big firms of auditors to continue the burden of overheads. The Bill will result in substituting mediocrity, in place of meritocracy, in the accountancy profession.

One of the most reprehensible features of the Bill is the provision for taking away the power of the Court in various fields and vesting it in the Government. For example, the power to permit a company to diversify by enlarging the objects clause in the memorandum and the power to permit shifting of the registered office from one State to another is hereafter to be exercised by the Government, which will mean substitution of bureaucratic bungling for a fair and judicial determination.

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## II

### Small and Medium Companies Will be Hit *

by

R. G. Saraiya

The broader implications of the Companies (Amendment) Bill 1972, to the smaller or medium range of entrepreneurship in particular, and company management in general, need to be studied.

* Based on the lecture at a Discussion Meeting in Bombay on 10th October 1972. Mr. Saraiya, well-known co-operator and industrialist, was Chairman of the Banking Commission.

**Clause 5:** Under Clause 5 amending Sec. 43A of the principal Act, it is proposed that companies with a paid-up capital of Rs. 25 lakhs and turnover of Rs. 50 lakhs shall be deemed to be "Public Companies". Further, where one private limited company holds more than 10 per cent of the shares of another private limited company, both will be deemed to be public limited companies. By the deletion of Sub-sections 6 and 7 of Sec. 43A of the Companies Act, both the private limited company and its wholly-owned subsidiary become public limited companies regardless of any other consideration. It is difficult to see how public interest will be involved if the total number of shareholders of both the companies does not exceed 50.

It should be examined how many private limited companies will become public limited companies under Clause 5 of the Amendment Bill, what additional staff will be required by the Company Law Department and by the private limited companies becoming "public". It may also be ascertained how many of these demed public companies will have a total membership of under 50. And, will public interest be served by making them deemed public companies? It should also be examined what will be the requirements to which all these national public companies will be subject and what will be the cost of meeting those requirements like appointment of full-time Secretaries, constant consultation with legal experts to observe the forms, procedures and references to Government required of public companies so as to avoid any breach of the Companies Act; —advertisements for inviting deposits even from their own shareholders, getting Government sanction for a number of appointments of relatives, Directors in the same group, etc. In the Financial Memorandum attached to the Bill it is estimated that the recurring expenses to the Central Government on account of pay and allowances etc. will be Rs. 10 lakhs *per annum*. I would not be surprised if this amount mounts up to Rs. 50 lakhs or Rs. 1 crore within 5 years as an army of officers, inspectors and clerks will be required to take a large number of decisions by Government involved in these amendments.

If it is in public interest to encourage the Corporate sector rather than registered partnerships which are not subject to the same discipline, I am afraid the total effect of these amendments will be to discourage the formation of private limited companies by new entrepreneurs of moderate means, and also to handicap the working of a large number of private limited companies engaged in running small-scale industries as also medium-sized industries. In today's context of the falling value of the Rupee, Rs. 25 lakhs may not be sufficient to meet the needs of even small-scale industries. I would, therefore, urge that the Government should consider the totality of the effect of these amendments on the working of private limited companies so that production required from the small-sized or even medium-sized industries is not only ensured, but more entrepreneurs come in the field and increase production particularly of mass consumption and wage goods. The energies of the persons or management in charge should not be frittered away, to the neglect of the production function. Someone, perhaps a Management institution, should work out the time and talent of the best personnel of a small or medium-industry spent in chasing the various officers of the Centre, State, Municipalities, Company Law Administration, Income-tax, Sales-tax, Excise, labour officers, etc. and consulting lawyers, tax experts etc. Can small entrepreneurs afford all these facilities, and at the same time increase production? Perhaps this is a matter beside the point in this context, but the new company legislation may be the last straw on the small entrepreneur's back.

**Clause 6:** Clause 6(2) of the Bill lays down

"No company shall invite or accept or allow any other person to invite or accept, or cause to be invited or accepted, on its behalf, any deposit unless

(a) such deposit is invited or accepted or is caused to be invited or accepted in accordance with the rules made under sub-sec. (1), and

(b) the company has issued an advertisement, in such form and in such manner as may be prescribed, including therein a statement showing the financial position of the Company."

This means that every company has to issue an advertisement to invite deposits even from its own Directors and Shareholders, who should know the financial standing of the Company.

In connection with the raising of deposits by non-banking companies, attention may be invited to the Report of the Banking Commission which has recommended: "For the purpose of banking regulation, private limited companies accepting 'non-cheaqueable deposits' from their shareholders, companies taking such deposits from their Directors and firms accepting such deposits from their partners need not be brought within the scope of the regulation connected with the acceptance of such deposits. Such exclusion is justified having regard to the limitations as to the number of persons from whom such deposits could be taken and the presumption that people so depositing would be familiar with the financial position and standing of the concerns accepting such deposits.

This recommendation, incidentally, is based on the recommendation of the Study Group headed by Justice P. V. Rajamannar.

The Banking Commission has made a strong plea for the establishment of Rural Banks as subsidiaries of commercial banks, and this is being examined by the Government of India. Here again, in order to facilitate the establishment of Rural Banks, enactment of special legislation has been recommended. In the Banking Commission's words: "Rural subsidiary banks, if registered under the Company Law, would have to comply with the requirements applicable to a public company (*vide* also Sec. 43A of the Companies Act, 1956). The legal requirements to be observed by a 'public Company' under the Company Law are too many, and the time, the expertise and the expenses required to comply with

these requirements simply make the Company Law framework unsuitable for a small banking institution having as its prime objective the meeting of the banking and credit needs of a rural area. It may be readily seen that these requirements are too onerous when contrasted with the expertise available and the resources that could be mobilised for setting up such undertakings."

These remarks will apply with greater force if the proposed amendment to Sec. 43A is carried out. These remarks also apply with equal force to small-scale industries in rural and backward areas which will not have the legal and accounting talent available in big cities.

There will be, therefore, public limited companies, controlled public companies, private limited companies and private companies deemed to be public limited companies. It may be worthwhile to study which of the facilities of private limited companies will be taken away when they will be deemed public limited companies. While some restrictions on the private limited companies will remain the private limited companies becoming 'public companies' will have the worst of both the worlds.

**Clause 13:** Clause 13 deals with "benami" holdings. What are considered to be the obligations of the persons holding shares in a "benami" name and the persons for whose beneficial interest the shares are held, as also of the company together with the necessary penalty provisions? The question arises, as a layman, as to whether the shares held in the joint names of husband and wife should be declared as belonging to the wife or husband as owner, and husband and wife as beneficiary, and similarly shares held on account of trusts—whether public or private—should be declared by the shareholder as shares belonging to the trust and all the trustees of the trust as beneficiaries; and that such declaration should be made within 30 days of his acquiring the beneficial interest. If he or the beneficiary or beneficiaries forget, they may have to pay a fine up to Rs. 1,000/- per day, unless they can produce a medical certificate of illness

or may be on visit abroad. Similarly, shares are held for societies like hospitals registered under the Companies Act or the Societies Registration Act; lawyers for their clients or wards; a mortgagee holding in his name on behalf of a mortgagor. The sharp intellect of the people administering may be invoked for the harassment of certain people. I believe the law should be simple, clear and unequivocal, and the net of the term "same management or Group" should not be made too wide. Otherwise why not widen the net so as to embrace the whole world, which is one family?

**Clause 16:** This Clause proposes to insert new sections 205A and 205B. 205A says "whenever any dividend is declared out of the profits of a company, the company shall, within 7 days from the date such declaration, transfer the total amount which is to be distributed to the shareholders as dividend to a special account to be opened by the Company in that behalf in any schedule bank." It also prohibits the distribution of dividend from past reserves except with the consent of the Central Government. Money transferred to the dividend account of a company which remains unpaid or unclaimed for a period of three years from the date of such transfer, shall be transferred by the Company to the General Revenue A/c of the Central Government but a claim to any money so transferred to the General Revenue A/c may be preferred to the Central Government by the person to whom the money is due. These are the broad features of the legislation, and the net effect will be that companies will be forced to distribute maximum dividends by the shareholders; reserves will not be built up; there may also be accounting difficulty as there may be accounting profits from which the compulsory dividend may have to be given but no liquid resources available on the date of declaration of dividend owing to unrealised assets. Section 43 companies will be compelled to distribute a certain percentage of their accrued profits as dividends, and this amount may not be available within 7 days for distribution owing to unrealised assets or dues. So the Company management has to default under the Income-tax law or under this Clause, and in either case invite penalties, possibly imprisonment. The question

is whether all these amendments are in the interests of the shareholders or the Scheduled Banks or the Government.

**Clauses 4, 8, 11 & 12:** The substitution of the decision of the Central Government for the decision of the courts proposed in Clauses 4, 8, 11 and 12 is also fraught with serious consequences; it takes away the powers of the courts and substitutes them by executive authority. The principle of the separation of the judiciary and the executive seems to have been lost sight of in these clauses. The question of the courts' delay has been referred to from time to time. One argument to substitute administrative decisions for court decisions may be that such decisions would be quicker. If the Company Law Administration has to be burdened with hundred and thousands of applications and decisions there may be equal or greater delay and what would be lacking would be the judicial objective approach.

**Clauses 4B & 10:** Clause 4B defines the circumstances under which two bodies shall be deemed to be under the same management. Clause 10 imposes restrictions on the acquisition of shares and restrictions on their transfer by inserting new sections 108A to 108F. Every Company which makes any transfer of shares in contravention of the provisions of this section shall be punishable with fine which may extend to Rs. 5,000/- and the officers in default shall be punishable with imprisonment for a term which may extend to 3 years. The cumulative effect of these provisions will be :

(a) restriction on investment in the shares of public limited companies;

(b) reducing their marketability, and

(c) ultimately a discouragement to the investment market.

Someone—a management or Research Institute — should undertake the exercise of finding out who are the persons who will be concerned or involved in the definition of the term "same management", and whether all would be in a position to know all the operations, holdings and intentions

of the constituents who enter into the concerned transactions. The object of the clause is to debar "take-over" of companies within the corporate sector without the prior approval of the government in a major move to combat the unhealthy trends towards "anonymous and clandestine" take-over of well-established firms by individuals, groups or combines. While the object is laudable, there will be untold difficulties in its implementation.

The net effect of this legislation will be the positive discouragement of small or even medium companies and increased burden on large companies; large Houses will have to employ the various categories of Management required, because each Company will require chartered accountants, cost accountants, qualified company secretaries, legal experts, experts in laws relating to industrial labour relations etc. to comply with the requirements under the law. They will also need staff to run about to the Company Law Administration and a shuttle service to New Delhi to get various sanctions. All these could be enumerated in detail. The energies and the best talent in the country should not be used for controlling more and more people for producing less and less.

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## III

### Detailed Study of Implications is Necessary *

By

M. H. Mody

Company law is a matter of great complexity and the position is constantly evolving as the law interacts with constant changes in business practices and economic conditions. It is for this reason that throughout the history of company legislation in this country as well as in U.K., every

* Based on a lecture at a Discussion Meeting in Bombay on 10th October 1972. The author is a well-known chartered accountant.

major amendment of the Companies Act is preceded by an expert and independent study of the legal position in the light of prevailing business practices by a Commission of Inquiry. In our own case, we have had instances recently of the Bhabha Commission and Daftary & Shastry Committee. In the U.K. there have been the Cohen Committee and the Jenkins Committee etc.

This is the first instance in this country in which the law is being changed without a study by an expert body such as these. The result has been that the amendments have been so hastily drafted that they embody half-baked principles which do not even achieve the government's own confused objectives. The quality of drafting is very poor, no regard has been had to exceptions which are necessary to make any complex legislation workable. It is a form of mental lethargy not to think of all the complications which would result, by saying that all exceptions will be taken care of by administrative action.

Undue haste is displayed in seeking to enact this Bill. Initial period of no more than 15 days was permitted for receiving comments from the general public and thereafter this period was extended by another 15 days. The subject is so complex that by no stretch of imagination can this be considered as an adequate period even by persons who are well versed in company law, to come to any conclusion regarding all the implications of the present amendments. A considerable amount of study, discussion and deliberation is necessary for the public to make any meaningful contribution to the deliberation of our legislators. There is a great need for allowing much greater time for the provisions of the Bill to be studied before they can be enacted.

The next point to which I would like to refer is the provision contained in the Bill regarding take-over bids. Take-over activity first started in the United Kingdom in the early fifties as a result of the fact that in many instances directors of companies were under-exploiting the assets in their hands thereby resulting not only in disadvantage to the shareholders but also the detriment to the interests of

the general public. A new breed of competent businessmen, therefore, came forward, who were able to take over the companies with the hope or promise (which has been largely fulfilled) of being able to make better use of the assets than the directors had been able to do on their own. This gave a severe jolt to thousands of company managements who were under-exploiting their assets or running an inefficient business. The result was that a lot of directors sat up and took notice of take-over activity and tried to improve the efficiency of their own working in order to avoid the possibility of a take-over bid. In the wake of these take-over bids, several situations arose where persons tried to act unfairly and take advantage of the absence of any legal constraint. Attempts initially made by the London Stock Exchange to control such instances failed. The City Code on Take-over Bids was enunciated as a result of a gentleman's agreement between merchant bankers in order to ensure that take-over activity did not go beyond the bounds of propriety and fairness. It was very soon evident, however, that in spite of this several abuses took place. Eventually a high powered Take-over Panel of eminent business and professional men was set up in order to supervise take-over activity. The City Code is itself a frightfully complex document which is read by merchant bankers with the same avidity as we read the income-tax law. The situation is far from settled down and many people recognise that the present system will need to be overhauled in the near future.

I am narrating all this to illustrate that the subject of controlling take-over bids is one of great complexity where hastily drafted provisions are unlikely to meet the public interest and are likely to hinder **legitimate take-over** activity which in fact should be encouraged. Therefore, there is every need for the proposed sections 108A to 108G to be re-examined by an expert body which is conversant with business conditions in order to ascertain how best restrictions be put on take-over bids which ultimately results in benefit to the public interest.

The wide divergence between practice and precept is illustrated in this case by a comparison of the notes on

clauses with the actual draft of the Bill. In the notes on clauses it is stated that take-over bids adversely affect the interest of non-controlling shareholders who are kept in the dark while secret negotiations are carried on for the transfer of control of a company. They are thus deprived of the opportunity of sharing in the bargain that may prove to be profitable and are forced to continue a holding where the management has passed into undesirable hands. In substance, the argument, therefore, is that take-over activity must not be carried out secretly but in the glare of public discussion and knowledge, and secondly that any take-over offer must be available for the benefit of the entire body of shareholders and not merely for some of them. If one looks at the draft of the sections one finds no evidence of either of these apparently sound principles. There is not even a suggestion for any publicity to be given to take-over activity. Secondly, as far as sharing in the fruits of the bargain is concerned, Government's idea of this is that the Government itself should get the benefit, but at the same time, the remaining shareholders who would be unorganised and would be an even more hopeless minority, would derive no benefits whatsoever.

The point which I would like to refer to is the provision for the appointment of auditors. This, in my judgment, sounds the death-knell not only of the accounting profession but is also beginning of attack on all the professions, which are probably the only area of activity in which Government control and regulation has been hitherto absent or negligible. While businessmen have to constantly knock on the doors of civil servants and ministers in order to obtain permits, licences or approvals under one law or another, professional men are able to carry out their professional work without seeking favours or benefits from the Government. These provisions will now oblige all chartered accountants to trudge the corridors of power and to seek favours and benefits from ministers and civil servants.

The bill provides in effect for the rotation of auditors every three years and in the case of companies in which Government's direct and indirect interest exceeds 25 per cent.

for the appointment of auditors only with the Government's approval. One of the reasons advanced in support of these radical suggestions is the fear in Government's mind that auditors have colluded with the management because they have continued to hold office for prolonged periods of time. To me this appears to strike out the whole justification for the existence of an accounting profession, viz., at its independence and integrity. After all, how is it that in spite of the fact that a professional man is voluntarily engaged by his client, whose services can be dispensed with by the client, and whose fees are determined and paid by the client, he is nevertheless in a position to act independently and express his opinion and views **vis-a-vis** his client with objectivity and having regard to public interest? My answer is that this independence of the professional man springs firstly from the background training and traditions of the profession and, secondly, from a strong code of professional ethics which restrains and prevents him from transgressing the rules of his profession. It is for these reasons that in spite of this fundamental dependence upon his client for engagement and for fees it is recognised on all sides that professional men are still capable of independence and integrity. If, however, you proceed on the assumption that a person who has acted as auditor for more than three years is likely to collude with the management, there is no basis for the existence of an accounting profession at all. And the honest thing to do in this event would be to abolish the function of audit. I can see the seeds of this already in several aspects of the Act: firstly, that the function of the cost audit is being taken away from chartered accountants altogeher; secondly, the exclusion of persons who are otherwise professionally qualified from doing the work of company secretaries; and, thirdly, the amendments proposed in the form of Section 209A of the Act. This section confers upon the Registrar of Companies powers of a court of law to carry out searches, seizures and examination of persons. If the notes on clauses relating to this clause is examined, they will prove to be illuminative. "The role of inspection has to be much wider and have the object of ensuring that transactions have been validly entered into in accordance with

the rules and procedures of the company and also ascertaining how far the statutory auditors have discharged their functions and duties in certifying the true and fair view.....".

For all these reasons, I fear that the present amendments are the beginning of the ultimate emasculation of the accounting profession.

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*The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise*

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

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