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THE ROLE OF CORPORATE SECTOR IN A DEMOCRATIC  
SETUP WITH SPECIAL REFERENCE TO INDIA

By

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INTRODUCTION

'Economic development and the preservation of Democratic values has always posed a problem to the Major Democratic countries of the world and this challenge is still being faced by those countries which are fast emerging as developing nations with limited resources. Looking back to the history of development in European countries, development towards modern Industrialised Society was based on a strictly capitalistic system. Ideas of current political interest such as Economic equality came much later and acquired political importance only after the more important initial stages on the way to industrialisation were past. In the formative stages, industrially advanced countries such as U.K., U.S.S.R., France, U.S.A. and Japan to name only a few had to compromise with the two current philosophies of political ideology namely; capitalism and socialism. It was indeed a system when political power was in the hands of minority, not however, a numerically very small and closed minority but one of

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corporation aggregate and the new person begins to function as a entity.<sup>7</sup> This explains the correct position of a company under the law. But the bulk of the persons who constitute this legal entity are those persons who provide the necessary capital to enable it to carry on the object purposefully as laid down in the Memorandum of Association and are categorised as share-holders. Though, he loses his identity by becoming a member of the company, but he retains all interest in the proper functioning of the company and has a perpetual interest so long as he remains member. As said by Justice Shah in the case of Commissioner of Income Tax, Calcutta vs. Standard Vacuum Oil Company,<sup>8</sup> a share is not a sum of money, it represents an interest measured by a sum of money and made of diverse rights in the contract evidenced by the Articles of Association. The share-holder has a right to participate in all the important affairs of the company conducted in the Meetings convened from time to time as provided in the Act. The important provision which is a pivot around which the entire functioning of the company revolves is section 174<sup>9</sup> which lays down the Minimum quorum of 5 members in the case of public limited companies and 2 members in the case of other companies for passing a resolution brought forward before the share-holders., does not stand to reason in the present context of Indian conditions. The share-holders in India are spread far and wide and in some cases the distances between them and the company may even run into thousands of miles, which makes impossible for them to attend the meetings when important business are transacted relating to appointment of Directors, Managing Directors or other Managerial staff besides other business. The appointments can easily be manipulated to suit the interest of the persons in authority as the vast majority of share-holders invariably do not attend the Meetings due to sheer economic hardship. If the intention of the Act is to provide sufficient protection to the share-holders, as it appears to be, from the language of Sections 103<sup>7</sup>, 397, 399 providing for qualified<sup>11</sup> minority rights such intention can be circumvented within the existing legal frame work. Further the requirements of the above sections are disproportionate to the provisions of Sections 174. It is suggested that the minimum quorum required to pass a resolution should be linked with the total membership of the company and a certain reasonable percentage should be fixed as provided in Section 169<sup>12</sup> for requisition of extra-ordinary General Meeting.

## II. Provisions relating to Borrowing powers.

Capital is the main stay of the companies in the present set up. The largest among the principle source of finance today in the corporate sector is borrowing resorted to by the companies whether engaged in a trading activity or non-trading activity. The Indian company Act of 1956 does not contain an express provision granting the companies to borrow though it does not expressly prohibit companies from borrowing money.<sup>13</sup> As the present Act is based on the well established principles of English company law so the courts in India has also followed the trend of decisions as given by the English courts on the powers of the companies to borrow. As laid down in Ashbury Railway carriage and Iron Company vs. Richiel<sup>14</sup> and Baroness Wenlock vs. River Company<sup>15</sup> that the company is not authorised to do an Act which is not authorised by its memorandum as articles of Association, English courts have made an exception in the case of borrowing powers in the case of Trading companies, that there is an implied power to borrow in their case. So on the basis of English decisions in India<sup>16</sup>, Trading companies are considered to have the implied power to borrow and give security and this is so even where neither the Memorandum of Association or articles of association confer it upon them. It is, therefore, suggested that an express provision may be inserted in the Company Act to permit all types of Companies whether trading or non-trading to borrow money as the relevant provisions on this subject in the Act suggest that Indian legislature had contemplated that the companies registered under the Act may borrow.

While making this change in the law, care should be taken to safeguard the interest of the creditors as the recent happenings in India have shown that companies have indulged in anti-social activities by interlocking their funds in speculative and non-liquid ventures thereby risking the money of the Investor and in the event of inability to pay off the debts, taking advantage of the provisions of winding up.

## III- The Provisions relating to Directors, Managing Directors, and Managing Agents.

The Directors of the company are the brain behind the corporate personality attributed to a company by the fiction of law. Nevill J. said in Bates vs. Standard Land Company<sup>17</sup> that the Board of Directors are brains and only brains of the company which is the body and the company can and does act through them. They occupy a highly important position in the management of the companies and lay down the principle policies to be followed by the company and at the same time the custodians of the fate of the share holders, creditors, and employees. As regards

their correct position visa-vis a company the courts are unanimous both in England<sup>18</sup> as well as in India<sup>19</sup> that they are trustees in a very limited sense. In<sup>20</sup> R.K. Dalmia v. Delhi Administration, Raghubar Dayal J., said that a Director or a Managing Director is in no way a servant of the company. He is an agent of the company for carrying out its business. As an agent of the company the Directors are expected to act for the benefit of the company. In the modern complex commercial world, Management of the companies requires special skill, and knowledge of the basic principles of business management, it is no more a layman paradise. The company Act of 1956 in Section 274(1)<sup>21</sup> provides the various disqualifications for a person being appointed as a director. The Section does not speak of any Managerial or professional qualification to be possessed by a person to be appointed as a director. Section 254 speaks of the appointment of first Directors and Section 291 of the Board of Directors. These sections should be suitably amended as follows:-

Firstly, to give due consideration to the professional skill and long experience to be possessed by a person before he can be considered for appointment as a Director in the Public Limited Companies.

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Secondly, in the case of first appointment of Directors under Section 254, a fair proportion is to be fixed for those persons possessing specialised knowledge of Accounts, Business Management and Marketing and

Thirdly, a nominee of the employees of the company be given representation on the Board of Directors, as the Statute at present governing the creation and administration of limited liability companies does not provide for the Directors and Managers to heed, still less to be accountable to the workers employed in them. They unlike their counterparts have no right of say in the mismanagement which may be detrimental to their interests as well.

Further it is, now a days, increasingly observed in India that Public servants who come in contact with companies during the course of employment find a place on the Board of Directors or appointed as Managing Directors immediately after retirement on most lucrative terms which is against all principles of moral ethics. Such practice should be curbed. Section 254 should be amended to include

further "where he held a public office in a Central or State Govt. and two years have not elapsed from the date he ceased to hold such office. A similar change is also advocated in Section 267<sup>25</sup> which lays down the disqualification for appointment as Managing Director. Similarly, a section should be inserted in the company act prohibiting the employment of retired Government servants in Public limited companies immediately after retirement on terms more favourable than available to them during employment under the Central/State Government or Statutory corporation under the control and direction of the Central and State Governments.<sup>24</sup>

#### IV-Managing Agents.

Managing Agency system played a significant role in supplying the necessary capital, skill and techniques in the early period of the corporate development in India. But in the recent years the system had been subjected to severe criticism both in the legislature and public due to various malpractices practised by them in the companies under their management and control. Consequently Section 324-A25 was inserted in the company Act abolishing the Managing Agents completely from April 3, 1969.<sup>26</sup> of late a growing tendency has been observed on the part of managing directors or whole time directors to appoint such organisation as sole selling agents in which they are interested either directly or through their family members or both, thus circumventing the provisions of the Act.<sup>27</sup> Section 360 of the Act requires the approval of the Central Government for appointment of Managing Agents as the sole selling Agents of the Managed companies. So in order to circumvent this provision of the act, some companies have resorted to the practice of appointing the consultancy organisations of Managing Agents, which got themselves converted in the above form in order to defeat the provision of the Section.<sup>28</sup> It is a serious matter which directly concerns the share-holders, creditors and the general public. It is, in the general interest of all concerned with the constitution and functioning of the companies, that the Act may be suitably amended to put a check to such practices adopted by directors and Managing Directors of the companies.

#### V- Political contributions by the companies.

The companies Act was amended in 1969 and a new Section<sup>29</sup> was inserted with the intention that companies may not participate with the share-holder's money in the political life of the country. The legislation has been

enacted with the best of intention but looking to the realities of modern times, how far it would serve the purpose of protecting the interest of the investing community is open to discussion. In a democratic set up, elections are fought with party labels having different economic programmes to which they are committed in their election manifestoes. To fight an election has become a costly game and unless and until substantial financial assistance is rendered, it is not within the reach of an individual to finance his election with his own means. At the same time, it is essential that different interests should be effectively represented in the legislature responsible for initiating important legislation in the sphere of social welfare, and economic activities for such an effective representation, in the legislature, persons with tested ability and committed ideology, lacking finance should not be deprived at the opportunity to participate in the body politics of the country. The corporate sector had played a significant role in bringing about "freedom" a reality in the pre-independence era and the same role can be played by it, if an opportunity is extended, with suitable safeguards. The share-holders should have the right to divert a certain portion of their profits towards political funds needed by a party or individual to protect their interests. Therefore,<sup>30</sup> companies may be allowed to donate (subject<sup>31</sup> to certain limitations and conditions) but the fact of such donations should be widely known not only to share holders but also to the general public.

#### VI- Winding up of the companies.

Justice Barman in the case of Mohan Lal Saraf vs. The Cuttack Electric Supply Company Ltd.<sup>32</sup> said that only persons interested as creditors and contributories are entitled to appear in petition for winding up. Employees Union as such has no locus standi to enter appearance. The statement of objects and reasons of the companies Act only states 'The object of this bill is to amend and consolidate the law relating to companies<sup>33</sup>.... The Act is silent about the employees of the company except stray Sections<sup>34</sup> which relates to employees securities and Provident Funds. Employees constitute a vital link of the companies but still no importance seems to have been given to them under the scheme of the Act. In the modern set up when we are striving to achieve a welfare state through legislation, to ignore the employees altogether is undesirable from social point of view. As the companies have to act within the frame work of the companies act,

a due place should be accorded to them to protect their own interests as well as the interest of all sections of the society who are equally interested in the efficient management of the companies. In this context, it is suggested that the provision relating to winding up should be suitably amended so as to bring within its orbit, the right of the employees of the company to present a petition for winding up.<sup>35</sup>

### Conclusion.

To regulate and discipline the corporate sector, it has become a major responsibility of a State in the Major Democracies of the world, to protect the interest of the vast majority of persons who come in contact with the companies either in the capacity of its members or consumers is of utmost importance to usher the era of prosperity and economic development. The state is bound to assume sweeping powers within the frame work of the constitution to protect the interest of that category of persons for whom the corporate sector ultimately exists. We are witnessing a constant tussel of wits and strength between the corporate sector and the State. Within the existing set up of the legislation governing the corporate sector, there are no provisions which directly give any protection to the consumer's interests, though the state has powers to protect their interest under the Industrial Law. The State is committed to Mixed economy as is clear from the major<sup>36</sup> Industrial policies declared from time to time and the State is striving hard to achieve the goal of establishment of welfare state within shortest possible time. Strategic and Industries considered "essential" from the national view point have been reserved for central and State Governments for their creation and development. The State has also moved in the direction to curb the anti-social policies practised by the companies which ultimately prove detrimental to the interest of consumers in the form of anti-monopoly legislation. In spite of all these measures and efforts on the part of the State, the poor consumer is still living in a world of illusion of abundances and prosperity. Unless

the State is in a position to create a sufficiently competitive market, the lot of the consumer can hardly be improved. For that purpose, strict regulation and enforcement of licencing laws, price controls is of utmost importance. At the same time there is need to streamline the administrative machinery as advocated by the members of Parliament, from time to time and Administrative Reform Commission. It is a sad story and sorry reflection on our capabilities and capacities that in the major industrial sector taken charge of by the State they have been constantly running at a huge loss imposing additional burden on the tax payer. It would be desirable to create a seperate Ministry of company affairs dealing mainly with company law and separate Ministry of Industry dealing with industrial matters. The aim of all legislation should be to create consumer's market with fair return on capital to the producer and owner.