ROLE OF GOVERNMENT DIRECTORS IN COMPANIES

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Introduction

The term company in legal theory implies an association of a number of persons associated for some common object, mostly to carry on business for gain.[1] In a company, normally the running of the business is left to the directors, and the shareholders are mere lenders of capital on which they hope for a return but without any effective control over the borrower.[2] In the United States also the modern shareholder has ceased to be a quasi-partner and has become simply a supplier of capital. In the modern corporation, with the separation of ownership and control, these two functions are, in the main, performed by two different groups of people. Where such a separation is complete one group of individuals, the security holders and in particular the stockholders, perform the function of risk-takers and suppliers of capital, while a separate group exercises control and ultimate management.[3] This separation facilitates the group controlling the management to assume wide powers, at times, even to the detriment of shareholders, and over which the shareholders have little or no control. The rise of the modern corporations, the separation of ownership and control, the dominant position of the controlling group, all have resulted in the concentration of economic power in a few hands which, at times, competes on equal terms with the state's economic power, each being strong in its own field. This concentration of economic power presents much scope for the misuse of power to the detriment of the interests of shareholders, creditors, employees and the public. It, therefore, becomes necessary to regulate the functioning of the companies to some extent by the Government [3a]

The State seeks to regulate the corporation while the corporation,

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1. Gower, *The Principles of Modern Company Law*, 3-5 (2nd ed., 1957)
2. *Ibid.* at 9.
3. A.A. Borle & G.C. Means, *The Modern Corporation and Private Property*, 300-301 (1967).

3a. Hereinafter the Government means Central Government unless otherwise stated.

steadily becoming more powerful, finds it difficult to adhere to the stream of regulations emanating out from the Government. Though the company legislation primarily attempts to provide a legal framework for the corporate form of private business management in which entrepreneurial skill, capital and labour are brought together in a particular form of relationship, it also provides a charter of powers for the Government to interfere at different stages of the company's working. The present paper is restricted to a discussion of the power of the Government to appoint directors on the Board of Directors of a company to prevent the oppression of a minority of the shareholders and mismanagement by the majority of shareholders.

Legislative History

The legislative history of company law in India dates back to the Joint Stock Companies Act, 1850 followed by the amendment Acts of 1857 and 1860 respectively. These Acts were repealed by the Act of 1866 which in turn was repealed by the Indian Companies Act 1913. The Act of 1913 was passed with the object of consolidating and amending the law relating to trading companies and other associations in British India and was a verbatim copy of the English Companies Act of 1908. The Act of 1913 was periodically amended till 1951 when an important development took place in company law in that the Government promulgated an ordinance.[4] Under the ordinance the Government assumed extensive powers to intervene directly in the affairs of a company and greatly extended the powers of the Court to take suitable action when the affairs of the company were conducted in a manner prejudicial to its interests or in a manner oppressive to some part of its members. As a sequel to the extensive powers appropriated by the Government, the Indian Companies Act, 1913 was referred to a Committee,[5] called the Bhaba Committee, for consideration and report on the changes necessary for the healthy growth of joint stock enterprises and the desirability of adequately safeguarding the interests of investors and the public. The Committee reported in 1952 with the specific suggestions and amendments and a bill was introduced in Parliament in September, 1953. It was later referred to a Select Committee which reported in 1955[6] The Select Committee was of the opinion that the Central Government should be vested with powers to prevent mismanagement or oppression by nominating one or two members of the company to hold office as directors for a period not exceeding three years. The bill, which included the recommendations of the Select Committee, was introduced in Parliament in September, 1953 and was finally enacted in the year 1956. The Act is commonly known as the Companies Act 1956.

4. Government of India, Companies (Amendment) Ordinance, 21st July, 1951. The Ordinance was replaced with some changes by the Indian Companies (Amendment) Act, 1951
5. Government of India, Resolution No. 23 (7 D. Law (C.L.) 48 Bhaba Committee Report, Department of Economic Affairs, Ministry of Finance, 1952.
6. Part II, S. 2., May 2, 1955.

An industrial society like ours, where the management of corporate enterprise is based on the rule of the majority, faces the problem of relieving the minority of shareholders from oppression and mismanagement by the majority. To prevent oppression and mismanagement, the Companies Act 1956 has provided certain judicial remedies. These remedies available to a member or members are winding up of a company in case of oppression and a suitable order by the court in case of mismanagement. Apart from the judicial remedies, section 408 of the Companies Act, 1956 invests the Government with certain powers. It is provided that the Government may appoint not more than two persons to hold office as directors on the Board of Directors of a company if, after such inquiry as it deems fit to make, it considers necessary to make the appointments in order to prevent the affairs of the company from :

(*i*) being conducted in a manner which is oppressive to any member of the company, or
(*ii*) being conducted in a manner which is prejudicial to the interests of the company, or
(*iii*) being conducted in a manner which is prejudicial to the public interest.

Such appointments may be made by the Central Government either, *suo moto*, or on the application of the requisite number of members. The application for Government intervention must be made by not less than one hundred members of the company or by such members who are holding together not less than one-tenth of the total voting power of the company.

The directors appointed by the Government will not, however, hold office for a period exceeding three years on any one occasion. Such directors are not required to hold qualification shares nor are they liable to retire by rotation. However, the Government may remove them at any time and appoint others at its will. For the purposes of reckoning two-thirds or any other proporation of the total number of directors of the company, any director or directors appointed by the Government would not be taken into account. Once such directors are appointed no change in the Board of Directors made thereafter is to be valid so long as such directors continue in office, unless the change is approved by the Government.

The Role of Government Appointed Directors

It has been mentioned frequently that the appointment of Government directors is one of the important devices that would protect the interests of the public in general and that of the minority of shareholders in particular. The very existence of this power has been claimed as a deterrent to the possible abuse of majority rights in companies.

"Some shareholders instead of going to Court of law to settle their disputes were inclined to use these provisions as a swift, cheap and summary alternative remedy and seem to think that it is the duty of the Central Government to exercise these powers to appoint directors on the Board of a company as a matter of course whenever they are dissatisfied with its working under the existing management."[7]

These powers conferred on the Government are extraordinary, thoug h exercised sparingly, and require it virtually to step into the day to day management of the company through its nominated directors. In some undefined manner, these directors are to be special guardians of the broad public and company interest. Yet it is not clear what the public interest suggests. No indication is given eithe by any provisions of the Act, or by these specific provisions, of the specific manner in which the Government nominees are to achieve this purpose. Secondly, the Act itself says nothing in particular about the powers of these directors except to specify the manner of their selection and the term of office.

In fact, the little legislative history at our disposal reflects two rather different conceptions of the role of the Government nominees. The first, presumably, is that they are to use their presence and voting power within the Board of Directors to influence the decisions affecting the public interest or the management of the company. This may amount to Government sitting on the management through the nominee directors. In apparent accord with this aim, it is worth questioning whether these Government-appointed directors are sufficient to achieve the desired ends.

The other conception of the Government-appointed directors' role is that they are to serve primarily as a two way window for the Government, keeping the Government informed about the internal affairs of the company, and serving to communicate the Government's view to the Board of Directors. Under this view, of course, little direct influence on the decisions of the Board of Directors would be expected from the Government-appointed directors.

The Government appointed directors are not given adequate powers to exercise a significant-influence on the decisions of the company. The number of directors (maximum two) may easily be outvoted and there is no basis for inferring any special powers for these directors. Actually, the two Government-appointed directors will not be able to provide adequate protection to the public interest and for that matter even for mismanagement and oppression because mainly they are responsible to the Government

7. 2nd Annual Report on the Working and Administration of the Companies Act 1956, 31-32 (1958).

and their shares are not at stake. The directors appointed by the Government have mostly been recruited from the civil service. There may be few men with business knowledge and technical knowhow of the companies at the disposal of the Government. The three years term of office is hardly long enough to permit the acquiring of expertise in so complex an area. In reality, the effectiveness of this section would depend on the personality, business reputation and independence of the directors appointed by the Government, the manner in which they conduct themselves *vis-a-vis* the other members on the Board of Directors and the attitude of the company's management. The Government, on its part, feels difficulty in finding suitable persons for this purpose and even those persons who are considered suitable by the Government are often unwilling to be nominated as directors.[8] The reason is that the Government appointed directors' interference encounters hostility from the other directors on the Board of Directors. Further, they may be considered as Government spies.

It is presumed under the relevant provisions of the Act, that they have a duty to safeguard the interests of the company and of the public at large, at the same time it should not be forgotten that primarily he is a corporate director and has a primary obligation towards the shareholders. In fact, the Act as such is silent on the function, role or obligation of the Government-appointed directors. It is manifest from the Companies Act 1956, that normally all the directors on the Board of Directors will have similar rights and duties. It rejects the notion that Government-appointed directors have any other special obligation towards the public and the minority shareholders superseding the normal duty which by itself is not sufficient to fulfil the purpose for which they may be appointed. Thus, for the reasons mentioned above, it is not true to conclude that they can purge the corporation of mismanagement and oppression to the minority.

Conclusion

Both the working of the Companies Act 1956 with the subsequent amendments, and the complexities of corporate management lead to the conclusion that the appointment of Government directors under section 408 in the circumstances set out, cannot effectively protect the public interest against private abuse or for that matter even oppression and mismanagement too. Such directors may be instruments of harm to other aspects of public interests when there is every possibility of abuse of such power by disgruntled shareholders avoiding the efficacious remedies available throughout the Companies Act. Rather, their presence may reinforce the belief that the Government assures protection to the minority at the cost of the majority. There is also the possibility that the presence of Government directors on the Board of Directors will dampen the zeal of other regulatory

8. *Ibid.*

agencies such as investigation officers and to a lesser extent of the Courts too. Even if the appointees were given greater power, they would still offer little protection for the public interest because of their lack of experience and the hostility of their fellow directors. This hostility may turn acute if the nominated director takes a vigorous and independent position. In sum, section 408, in view of the above arguments, provides hardly any remedy for mismanagement and oppression nor does it serve any public purpose.