Historical background

3. Company legislation in India started with the Joint Stock Companies Act, 1850 (Act XLIII of 1850). An historical account of the course of subsequent legislation will be found in the report of the Company Law Committee submitted in 1952. Indian Company Law has been largely based on the prevailing English Law. The predecessor of the Companies Act, 1956, was Act VII of 1913, which underwent several amendments, including the amajor amendments of 1936 and 1951 when Acts XXII of 1936 and LII of 1951 were passed. The period of the Second World War and the post-war years witnessed an upsurge of industrial and commercial activity on an unprecedented scale in India and large profits were made by businessmen through incorporated companies. During these years, several developments took place in the organisation and management of joint stock companies which attracted public attention. At the end of the War, the Company Law Amendment Committee in the United Kingdom familiarly known as the Cohen Committee, after an enquiry spread over two years, submitted its report recommending far-reaching changes in the English Companies Act, 1929. In India, too, there was a general feeling that in view of the experience gained during the war years, the time was ripe for fresh legislation so as to ensure efficient and honest management of the business of companies and check unfair business methods and anti-social practices resorted to by some persons engaged in the management of companies. The Government of India took up the revision of Company Law immediately after the termination of the last war. Two company lawyers—one from Bombay and the other from Madras—were successively appointed to advise Government on the broad lines on which the Indian Companies Act, 1913, should be revised and recast in the light of the experience gained during the war years. Their reports were considered by Government and a memorandum embodying its tentative views was circulated towards the end of 1949 for eliciting opinion. On 28th October, 1950, the Government of India appointed a Committee of twelve members representing various interests under the chairmanship of Shri C. H. Bhabha, to go into the entire question of the revision of the Companies Act, with particular reference to its bearing on the development of trade and industry in the

country. This Committee, popularly known as the Bhabha Committee, submitted its report in March, 1952, recommending comprehensive changes in the Companies Act of 1913. The report of the Bhabha Committee was again the subject of discussion and comment by Chambers of Commerce, Trade associations, professional bodies, leading industrialists, shareholders and representatives of labour. The Bill, which eventually emerged as the Companies Act, 1956, was introduced in Parliament on 2nd September, 1953. It was a comprehensive and consolidating as well as amending piece of legislation. The Bill was referred to a Joint Committee of both Houses of Parliament in May, 1954. The Joint Committee submitted its report in May, 1955, making some material amendments to the Bill. The Bill, as amended by the Joint Committee, underwent some further amendments in Parliament and was passed in November, 1955. The new Companies Act (I of 1956) came into force from 1st April, 1956.

Objectives of the new legislation

4. To some extent, the new Act reflected the prevalent trends of public opinion. It was considered desirable in the public interest, and in order to prevent the diversion of companies' funds for purposes that thwarted national economic policies or approved economic objectives, that the Government should have greater control over the formation and management of joint stock companies. A minimum standard of good behaviour and business honesty in company promotion and management, a due recognition of the legitimate interests of the shareholders and creditors and of the duty of the management not to prejudice or jeopardise those interests, provision for greater and effective control over and voice in the management for shareholders, a fair and true disclosure of the affairs of companies in their annual balance sheets and profit and loss accounts, a higher standard of accounting and auditing, a recognition of the rights of shareholders to receive reasonable information and facilities for exercising an intelligent judgement with reference to the management, a ceiling on the share of profits payable to the management as remuneration for services rendered, a check on their transactions where there was a possiblility of conflict of interest and duty, a provision for investigation into the affairs of any company managed in a manner

prejudicial to the interests of the company as a whole or oppressive to a minority of the shareholders, enforcement of the performance of their duties by those engaged in the management of public companies or of private companies which were subsidiaries of public companies by providing sanctions in case of breach and a speedy and effective machinery for liquidation of companies—these were among the objectives of the new legislation. At the same time, it was recognised that private enterprise had played and had still a large part to play in the industrial and economic progress of the country and that joint stock companies covered such a wide area of the industrial and commercial field in the private sector that their continued existence and effective functioning should not be imperilled by the imposition of unduly irksome restrictions and fetters on their activities. It was not the object or purpose of the Act to put private enterprise in a strait jacket leaving no room for free play at the joints. Its object was rather to encourage honest private enterprise and safeguard private investments in fields not earmarked for the public sector. It was considered necessary that the influence of the general body of shareholders in any company should not be eliminated by a small controlling group. In view of the representations made to the Committee as regards the objectives of the Act, we have set out above what we conceive to be "the purposes underlying the Act" within the meaning of our terms of reference. We take the view that any reassessment of the considerations of general economic or social policy on which the Act is based is outside the ambit of our enquiry. Individual cases of mismanagement of the affairs of companies which were brought to our notice are also outside our purview except in so far as they disclose defects and omissions in the existing law requiring to be rectified.

Critics of the Act

5. The Companies Act of 1956 was the outcome of a prolonged and detailed consideration (both inside and outside the legislature) of the various aspects of company law and administration. It has nevertheless been the subject of criticism by businessmen, company managements, shareholders, accountants and auditors, lawyers and judges. Critics of the enactment—and they are

numerous—have focussed attention on its inordinate length, the complexity of its structure, its involved language, the vagueness and obscurity of many of its material provisions, the interposition of Government control even in apparently minor matters, the plethora of returns and forms required to be furnished by the management without any corresponding utility, the loopholes it has left, and many other features which make the enactment cumbersome or defective and difficult of application. Under our terms of reference, we have been asked to consider what changes in the form or structure of the Act are necessary or desirable to simplify it. It is possible to have a different lay out of the Act on the basis of a subject-wise arrangement and a regrouping and recasting of its different provisions. For instance, sections 198, 199, 200, 201, 309, 310, 311, 314, 348, 349, 350, 351, 352, 353, 354, 381, and 387 relating to managerial remuneration might be grouped together and compressed into a smaller number. The same could have been done about the sections dealing with different modes of liquidation. Similarly, exemptions for private companies could have been grouped together. This would, however, have necessitated a rewriting of large portions of the Act and a complete rearrangement of the sections. Well-informed opinion was almost unanimous against our attempting such a drastic or wholesale change. It was represented to us that it was too soon to introduce major changes or radical amendments and that during the twenty months that have elapsed since the Act was passed, those responsible for the management of companies as well as shareholders had, with considerable efforts, familiarised themselves with its scheme and its different provisions and that it would be a hardship to the business community and accountants and auditors, if they were now obliged to switch over to a set of new provisions. The balance of convenience and advantage was found to lie in retaining the scheme and arrangement of the present Act, which, it might be mentioned, mainly follows the order in which the different topics were dealt with in the Indian Companies Act of 1913. We, therefore, focussed our attention on the difficulties attendant on the working of the Act in actual practice, and the interpretation of its provisions. We have tried to plug loopholes, supply omissions, clarify ambiguities, correct mistakes, remove inconsistencies, omit unnecessary or otiose provisions and add others conducive to the smooth and effective working.

of the Act. We have also indicated the changes recommended by us as far as possible in the form of drafts of new sections or amendments of the existing ones in the hope that they might be of some assistance to Parliamentary draftsman.

Scheme of the Act

6. The Act with its 658 sections and 12 Schedules, no doubt appears, on the face of it, to be far too elaborate and detailed. The increase in the number of sections in the (Indian) Companies Act of 1956, compared with the 462 sections of the English Act of 1948, is due mainly to the following reasons:—

(1) The inclusion of several provisions which do not find a parallel in the English Act, but which are peculiarly appropriate to Indian conditions (*e.g.* sections 324 to 377 relating to managing agents) ;

(2) the inclusion of matters which formed part of the model regulations for company management contained in Table 'A' of the First Schedule of the English Act in the body of the new Act as substantive provisions (*e.g.* sections 285 —289);

(3) splitting of matter comprised in one section of the previous Act and of the English Act into a number of sections; and

(4) repetition of certain common statutory provisions with reference to each of the different classes of officers of a company or different modes of winding up of a company.

Though the number of sections in the Indian Act exceeds those of its English counterpart, still it will be found that the volume of printed matter of both the Acts is approximately the same, the English Act having relegated to the schedules several provisions found in the body of the Indian Act. It was presumably the intention of the legal draftsman who drafted the Bill, as well as the then Finance Minister, who piloted it in Parliament, that the enactment should be a self-contained, complete and exhaustive exposition of the law governing joint stock companies in India. Whatever might be our view if we had to write on a clean slate we have, in deference to the almost unanimous views

of those whom this legislation primarily concerns, not attempted to rewrite the Act or upset its arrangement of the topics dealt with by it. Moreover, the time allowed to the Committee was too short for such an overhaul.

Scope of the enquiry

7. From 1936 when major amendments to the Indian Companies Act, 1913 came to be made, the managements of companies and even shareholders began to evince interest in the shaping of company law as well as in its application. The machinery set up under that Act was, however, wholly inadequate for the task with the result that several provisions were honoured more in the breach than in their observance and irregularities on the part of the management often went unchecked. The Act of 1956 has remedied this defect and provided for some measure of Government control over company management in the interests of the shareholders and the investing public. Since the passing of the Act, public interest in company law and its proper enforcement has increased and the volume and variety of representations that we have received show that small investors as well as managerial interests are becoming more and more company-law minded. This is all to the advantage of healthy joint stock enterprise. We have taken into consideration the representations, written and oral, made to us by representatives of trade and industry, managements of companies, representatives of shareholders and by accountants and lawyers. We have paid attention to the difficulties experienced by the Department of Company Law Administration in the working of the Act. The Committee was asked to furnish solutions for several problems which confronted companies and shareholders individually, apparently under the impression that the Committee was an advisory body constituted for giving advice to the public. Wherever questions affecting companies and shareholders at large or a considerable section of them or relating to the interpretation of abscure or ambiguous provisions of the Act were raised, we have attempted to deal with the difficulties pointed out and given our reasons for recommending a change in the law or a clarification of the meaning and effect of the sections of the Act. We have refrained from assuming the role of a legal adviser or a judicial tribunal and recording opinions on concrete cases brought to our notice. It is

obvious that a great deal has to be left to judicial interpretation in due course. We have also refrained from recommending changes on matters of major policy. The decisions embodied in the Act on such matters were taken after great deliberation and very recently and it would be premature to alter such decisions at this stage. We have received numerous representations, *e.g.*, on managerial remuneration, proportionate representation, appointment of auditors by Government, investment of companies' funds, appointment of Government directors on companies' boards, etc. We have not recommended any radical changes in such matters, though divergent views have been expressed and changes advocated in the representations received by us.

Machinery for the Administration of the Act

8. The previous Act failed in its objectives to a considerable extent due to lack of adequate and efficient machinery for its enforcement. Its administration was left to the States, who had little interest in the Act and did not provide adequate staff. The Central Government have now taken over the enforcement and administration of the Act and set up an organisation for its proper working. The Department of Company Law Administration in its present shape consists of a Secretariat Organisation in New Delhi. In the field, there are four Regional offices and Registrars of Companies one for each State. The regional offices are under Regional Directors of the status of Deputy Secretary and are located at Bombay, Calcutta, Madras and Kanpur. Each regional organisation has a qualified Accounts Officer and a Solicitor to help and advise the Regional Director and the Registrars in the region. The status and strength of these Registrars' offices vary according to the work-load. In accordance with the provisions of the Act, an Advisory Commission with a full time Chairman has also been set up at headquarters to advise the Department in the discharge of the various functions assigned to Government by the new Act.

Sittings of the Committee

9. The Committee held separate sittings between May, 1957 and November, 1957, of which seven were held at Delhi and the rest at Bombay, Calcutta and Madras. At the first meeting held at Delhi on 27th May, 1957, the programme and procedure to be followed by the Committee were settled. At the second meeting held at Delhi on 26th and 27th June, 1957, the Committee examined

the views and suggestions of the Department with regard to remedying defects and removing difficulties found from experience of the working of the Act. The third, fourth and fifth meetings were held at Bombay, Calcutta and Madras respectively on different dates between 3rd July and 20th July, and at these meetings the Committee had the advantage of a personal discussion with representatives of management as well as of shareholders, Chambers of Commerce, Banks, Millowners, Chartered Accountants, lawyers and representatives of Advocates' Associations. At the sixth meeting held at Delhi for a week from the 19th August, the Committee heard further evidence and considered some of the controversial points. At the seventh meeting held at Delhi for a week from the 5th September, 1957, the Committee considered the draft report prepared by the Chairman after consideraing the representations received by the Committee. Further consideration of the draft report was taken up at the eighth and ninth meetings of the Committee at Delhi from 21st to 24th September, 1957 and from 15th to 19th October, 1957, respectively. The Committee held its last meeting at Delhi on 9th November to sign the report. The evidence and suggestions submitted to the Committee by various organisations and individuals were of great assistance to it in its enquiry and the Committee desires to express its gratitude to all of them.

A list of the Chambers of Commerce and Trade Associations and individuals who presented their views before the Committee is appended to this Report as Appendix I.

II

Amendments suggested

10. It will be convenient to follow the order of the sections of the Act and to indicate the changes which we recommend together with a brief statement of our reasons therefor. A section-wise list of amendments proposed by us is appended to this Report as Appendix II.

Section 2(3) : Associate

11. "Associates" of managing agents are subject to restrictions and disabilities in their dealings with the managed companies (see, for instance, sections 239, 249, 261, 356 to 360 and 369), the object being to prevent managing agents from securing unfair