

A Visit to India's Companies Act

History and Scope

When the present Indian Companies Act went into effect on April 1, 1956,¹ it was generally believed to represent a significant improvement over the previous Act it was replacing.² In particular, it was thought to have been imposing much stricter standards of conduct on management and therefore was a step in the right direction toward improving corporate morality.³

To any American practitioner, unfamiliar with the general tenor of the British Companies Act, which is followed by many of her former dependencies, the Indian Companies Act (hereinafter called "the Act") represents a curious mosaic of corporate legislation. In an effort to cover the broadest possible spectrum of corporate jurisprudence, this omnibus statute reaches out into such divergent fields as regulation of securities,⁴ registration of corporate mortgages,⁵ commingling of employee funds,⁶ and even prohibition of political contributions,⁷ or fields generally considered outside the purview of corporation codes in the United States.

There are, to be sure, separate Indian laws governing certain specific corporate activities,⁸ as well as statutes which codify the common law and apply it *mutatis mutandis* to companies, in addition to individuals, partnerships and other entities.⁹ In general, however, the Act covers a very broad field of law

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¹It has subsequently been amended, directly or indirectly, at least sixteen times, most recently in February 1975.

²Enacted in 1914.

³M. J. SETHNA, *INDIAN COMPANY LAW*, 1967, p. 35.

⁴The Act, §§ 55-68.

⁵*Id.*, §§ 124-145.

⁶*Id.*, §§ 417-420.

⁷*Id.*, § 293A.

⁸Examples are the Capital Issues Control Act, 1947, Monopolies and Restrictive Trade Practices Act, 1969, Foreign Exchange Regulation Act, 1973, Temporary Restrictions on Dividends Act, 1974 and others.

⁹Such as contracts, sales, negotiable instruments and others.

relating to companies. It is important to note that, unlike in this country, the Act speaks of a "company" rather than a "corporation," using again the British precedent, although it recognizes the term "body corporate"¹⁰ to accommodate corporations from outside of India as well as Indian companies formed under that designation by special acts of Indian legislature.¹¹

With some minor exceptions, the Act extends uniformly to the entire Republic of India¹² and applies to all trading companies as well as those non-trading companies whose activities cover more than one state. Companies in this latter category, such as banks, insurance companies and electric utilities,¹³ are, however, governed by the Act only to the extent that it does not contravene the provisions of their own organic acts. In varying degrees, depending on the extent of Indian control, foreign companies incorporated outside India which maintain a place of business in India, are also covered by the Act.¹⁴

The Act is topically arranged into thirteen parts and contains a total of 658 sections, although some of them have been repealed or rendered obsolete by subsequent amendments. Its text, without annotations, covers 344 pages.

Types of Companies

All companies registered under the Act are either private or public. To qualify as a private company, a company must by its articles have no more than fifty shareholders (excluding employees or former employees), restrict the rights to transfer its shares and prohibit subscription by the public for any of its shares or debentures.¹⁵

The Act further recognizes three different types of companies with respect to liability, any one of which can be either private or public. Where the liability of the stockholders (or members as they are known in India) is limited by the amount, if any, remaining unpaid on their shares, the company is known as a company limited by shares. Where their liability is limited to such amount as they may agree to contribute to the assets of the company, the company is known as a company limited by guarantee. Finally, where there is no limit on the personal liability of the stockholder, the company is known as an unlimited company.¹⁶

There are many advantages in being a private company. Only two

¹⁰The Act, § 2(7).

¹¹A. RAMAIA, *GUIDE TO THE COMPANIES ACT, 1975*, p. 11.

¹²The Act, § 1(3).

¹³*Id.*, § 616.

¹⁴*Id.*, §§ 591-601.

¹⁵*Id.*, § 3(1)(iii).

¹⁶*Id.*, § 12(2).

incorporators are required instead of seven;¹⁷ it does not have to hold the initial statutory meeting and file the detailed report to the stockholders;¹⁸ it needs only two instead of three directors;¹⁹ it can start doing business or issue further capital without certain formalities;²⁰ its directors qualify more easily for election or appointment;²¹ it does not have to file a registration statement when allotting its shares;²² and it requires only two rather than five shareholders to demand a poll at a shareholders' meeting.²³ Of an even more practical nature is the absence of restrictions on managers or managing directors of private companies.²⁴

The status of a private company can be lost, subject to some exceptions, when the annual volume of sales exceeds Rs. 10,000,000 (about \$1,000,000), or when control of twenty-five percent or more passes into the hands of a public company.²⁵ When this happens, a company is required to file a statement with the registrar of companies.²⁶

Incorporation: Capital Shares

The legal existence of an Indian company begins with the adoption of a memorandum of association, which must include the name of the company and the suffix "Limited" in case of a public company, and "Private Limited" in case of a private company. It must also give the name of the state in which the company's registered office is located, the company's main objects and the limits of its liability.²⁷ The memorandum and any subsequent amendments must be registered with the registrar of companies. There is no provision regarding duration and it is therefore presumed to be perpetual. What we refer to as "bylaws" are known as "articles of association" under the Indian law.

The Act provides for two kinds of share capital, preference shares and equity shares. The former is entitled to have preference on dividends and capital distribution in the event of dissolution,²⁸ while the latter is prohibited from allowing disproportionate rights to holders of the same class of shares.²⁹

¹⁷*Id.*, § 12(1).

¹⁸*Id.*, § 165(1).

¹⁹*Id.*, § 252.

²⁰*Id.*, §§ 81 & 149.

²¹*Id.*, § 266.

²²*Id.*, § 70.

²³*Id.*, § 179.

²⁴*Id.*, § 388A.

²⁵*Id.*, § 43A.

²⁶*Id.*, § 44.

²⁷*Id.*, § 13.

²⁸*Id.*, § 85.

²⁹*Id.*, § 88.

Management and Administration

The board of directors, elected by the shareholders, is the governing body of an Indian company. Directors must be individuals,³⁰ cannot be directors in more than twenty companies at the same time,³¹ are subject to disqualification in certain cases,³² and one-third of the total board members are subject to retirement by annual rotation, with a right to be re-elected.³³ Interim appointments may be made by the board but such directors serve only until the next annual meeting.³⁴ There is no requirement that directors also be shareholders or even Indian nationals, although since consent of the central government is required for any board appointments exceeding twelve,³⁵ the government exercises some control over who the individuals will be. Directors are required, under criminal penalties, to disclose contracts or arrangements of the company in which they have interest, are precluded from voting on any matter involving such interest and the company is required to maintain a separate register of such contracts or arrangements.³⁶

The board is required to meet at least once every three months³⁷ but there is no requirement that such meetings be held in India. Cumulative voting is permitted where the articles of association provide for it.³⁸

Except for the office of secretary, discussed herein later, the provisions of the Act relating to officers bear no resemblance to similar provisions found in our state corporation codes. The very term "officer" is broader than ours and includes not only the directors but also any person in accordance with whose directions the board of directors or any one or more of the directors is or are accustomed to act.³⁹ This definition would seem to suggest that the term includes even consultants and experts retained by the company and has even been construed to include a director's wife.⁴⁰ It certainly does include the two types of chief operating officers recognized by the Act; i.e., the managing director and the manager. The distinction between the two is somewhat unclear, except for the obvious implication that in order to be a managing director, a person must also be a director. Both of these positions require as a condition to appointment a unanimous consent of the board of directors and of the central

³⁰*Id.*, § 253.

³¹*Id.*, § 275.

³²*Id.*, § 274.

³³*Id.*, § 256.

³⁴*Id.*, § 260.

³⁵*Id.*, § 259.

³⁶*Id.*, §§ 299-301.

³⁷*Id.*, § 285.

³⁸*Id.*, § 265.

³⁹*Id.*, § 2(30).

⁴⁰A. RAMAIIYA, *GUIDE TO THE COMPANIES ACT, 1975*, p. 17.

government. In neither of the two positions can a person serve in the same capacity in more than two companies at the same time, nor can his term of office exceed five years, though he can be reappointed. As a general rule, the remuneration of neither one, if based on an incentive plan, can exceed five percent of the net profits of the company.

There is one statutory distinction between the two offices which would seem to suggest that the managing director outranks the manager in power and importance. While both are ineligible for their positions if delinquent in paying their bills, adjudged insolvent or convicted of an offense involving moral turpitude by an Indian court, such ineligibility carries back only five years prior to appointment in case of a manager,⁴¹ while it is permanent in case of a managing director.⁴² Moreover, although the central government may remove such disqualification in case of a manager,⁴³ it has no power to do so in case of a managing director.

Aside from the interesting dichotomy of the status of managers and managing directors, the only other office the Act presently recognizes is that of a secretary.⁴⁴ The position is mandatory in all companies which have a paid up capital of Rs. 2,500,000 or more.⁴⁵ Under the implementing provisions of Section 642(1)(a), the central government provided certain minimum professional requirements necessary to hold the office of a secretary. The Act then imposes certain specific duties on the office of a secretary, but most of his duties emanate from the board of directors. Like his American counterpart, he acts as the corporate housekeeper, maintains liaison with the various regulatory organs of the central government and functions as the depository of official corporate records.

The sole section dealing with indemnification of officers, employees and auditors⁴⁶ is couched in prohibitive rather than permissive language. There can be no indemnification for any liability attaching as a result of any malfeasance, negligence, default, breach of duty or breach of trust under any law.⁴⁷ Such indemnification extends to all reasonable expenses, which include damages, legal fees, and so on, but the central government has issued instructions that any such indemnification must await the determination of innocence from a competent court and no funds can be advanced.

⁴¹The Act, § 385.

⁴²*Id.*, § 267.

⁴³*Id.*, § 385.

⁴⁴The office of Treasurer, formerly covered by §§ 378-382, was abolished in 1970.

⁴⁵The Act, § 383A.

⁴⁶*Id.*, § 201.

⁴⁷*Compare with* the broader provisions of the Delaware Corporation Code, Title 8-145 or even the so-called "threshold test" of the N.Y. Business Corporation Law, § 723.

Prospectus and Allotment

Part III of the Act deals with allotments of shares and also requirements for prospectuses. Broadly speaking, the term "allotment" includes any issuance of capital shares or debentures, but such meaning must be derived from the context, as the Act nowhere defines the term.

The information required to be furnished to the prospective investor is not as exhaustive as in the United States, but it does include considerably detailed financial data, biographical information on management, material contracts and interests of directors and history of the company. Experts to an offering cannot be engaged or interested in the formation, promotion or management of the company⁴⁸ and must consent in writing to the issue of the prospectus.⁴⁹ The prospectus itself must be signed by all directors, either in person or under a power of attorney and filed with the registrar of companies along with the consent of the experts.⁵⁰

Civil liability for misstatements in the prospectus extends to the directors, promoters and experts.⁵¹ It is a valid defense to claim that the party charged had reasonable ground to believe up to the date of the issue of the prospectus that the statement was true.⁵²

There is also criminal liability in connection with the issuance of false prospectuses and once again the "reasonable ground to believe" can be used as defense in addition proving that the untrue statement was immaterial. Violators are subject to a fine up to Rs. 5,000 and imprisonment up to two years or both.⁵³

Amalgamation and Reconstruction

As used in the Act, the term "amalgamation" includes both merger and consolidation in that it contemplates blending of two or more companies of which one may survive or a new one be formed as a result. Reconstruction, on the other hand, contemplates restructuring of a company by means of transfer of assets, in which the shareholders of the transferor company receive in exchange an allotment of shares of the transferee company. While the United States practitioner will immediately recognize here a favorite vehicle in the field of acquisitions, in India the process of reconstruction more often serves as a tool of protecting creditors' rights. Both of these procedures require consent of the

⁴⁸The Act, § 57.

⁴⁹*Id.*, § 58.

⁵⁰*Id.*, § 60.

⁵¹*Id.*, § 62.

⁵²Compare with the "reasonable investigation" requirement of § 11(b)(3) of the Securities Act, 1933.

⁵³The Act, § 63.

court. Amalgamation, in addition, is thought to require an enabling provision in the memorandum of association.⁵⁴

Suits Against the Company

While the supervisory powers of the various branches of the central government over Indian companies are generally not much more onerous than in this country, nowhere is the controlled nature of the Indian economy as regards companies more self-evident than in those sections of the Act dealing with prevention of oppression and mismanagement.⁵⁵ An aggrieved shareholder can petition the court for relief whenever he feels his interests are not adequately promoted by the management. By adding the words "prejudicial to the public interest" to "prejudicial to the interest of the shareholders"⁵⁶ the central government injected itself into the scope of this chapter by having the right to intervene on a basis much broader than merely the interests of one or more shareholders. The powers of the court to grant relief under this chapter are broad and include divestiture orders, modification or termination of certain employment contracts, setting aside contractual obligations entered into within thirty days of the petition and even regulation of the conduct of the company's affairs in the future.⁵⁷ The last of these can conceivably open the door to eventual takeover by the government.

Government Supervision

The administration of the Act is left to the office of the registrar of companies,⁵⁸ somewhat compatible to our departments of corporations within the office of the secretary of state in many of our states. Appointed by the central government, the registrar is responsible for serving as a depository of papers filed by the companies under the Act, accepting fees and preparing authentication of documents. Additionally, he performs all such duties that the central government may prescribe to implement the Act. All documents filed in his office are a matter of public record and are available for inspection upon payment of one rupee.⁵⁹

Aside from the office of the registrar, the Act also created the so-called Board of Company Law Administration,⁶⁰ with membership not exceeding nine,

⁵⁴A. RAMAIA, *GUIDE TO THE COMPANIES ACT*, 1975, p. 618.

⁵⁵The Act, §§ 397-409.

⁵⁶Section 399 of the Act requires that not less than 100 shareholders, or one-tenth of the total number, whichever is less, join in such petition.

⁵⁷The Act, § 401.

⁵⁸*Id.*, § 609.

⁵⁹*Id.*, § 610.

⁶⁰*Id.*, § 10E.

appointed likewise by the central government. This organ, more in the nature of a policeman than the registrar, is given wide powers to assure strict compliance by the companies with the Act. To this end, the board can issue subpoenas to compel attendance of witnesses or production of documents, examine witnesses under oath and receive evidence on affidavits. In practice, the powers of this organ over Indian companies are practically limitless and its orders are not subject to appeal except by a collateral civil suit.

Summary

There is an obvious advantage in having a national corporation law in a country as large and diversified as India is. Allowing for the often random topical arrangements of the sections as well as an overall ambitious attempt to codify all law as it may relate to companies, the Act nonetheless represents a remarkable legal tool for practitioners dealing with the *modus vivendi* of Indian companies. Whenever it coincides in wording with the British Companies' Act, British case law may be used as precedent in addition to Indian, although it is only guiding rather than binding. In what is generally considered a state-controlled socialist economy, the Indian Companies Act is all the more interesting in that it offers a relatively unrestrained environment within which private enterprise can still function with little more interference than one is used to in this country. This is indeed unusual in a country where major businesses, such as banks, insurance companies and others, have long been state-owned and where the government now rules virtually by decree.