**12.16 hrs.**

## TRIPURA EXCISE LAW (REPEAL) BILL*

**The Minister of Revenue and Civil Expenditure (Dr. B. Gopala Reddi):** Sir, I beg to move for leave to introduce a Bill to provide for the repeal of the Tripura Excise Act.

**Mr. Speaker:** The question is:

"That leave be granted to introduce a Bill to provide for the repeal of the Tripura Excise Act."

*The motion was adopted.*

**Dr. B. Gopala Reddi:** Sir, I beg to introduce† the Bill.

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**12.16½ hrs.**

## COMPANIES (AMENDMENT) BILL—*contd.*

**Mr. Speaker:** The House will now take up further clause-by-clause consideration of the Bill further to amend the Companies Act, 1956, as reported by the Joint Committee. Shri G. D. Somani may continue his speech.

**Shri Somani** (Dausa): My amendments Nos. 94, 95, 96 and 97 to clause No. 70 read as follows:

Page 36,—

*after* line 24, *add*—

"Provided that before directing a special audit of the company's accounts, the Central Government shall give notice to the company of its intention to appoint a special auditor stating the reasons therefor and give the company an opportunity to show cause why such special audit should not be directed and if the Central Government is reasonably satisfied with the explanation, the said special audit shall not be directed.

(1A) Where the Central Government makes an order under sub-section (1), the company or any person aggrieved thereby may apply to the Court against such order and the Court may, if it thinks fit, vacate such order after giving the Central Government an opportunity of being heard." (94)

Page 37,—

*omit* lines 1 to 7. (95)

Page 37, line 9,—

*after* "Central Government" *insert*—

"shall furnish a copy of the report to the company and". (96)

Page 37,—

*for* lines 14 to 18, *substitute*—

"receipt, that Government shall send to the company a report with its comments thereon and require the company either to circulate a copy of the report or such extracts thereof as the Central Government may indicate to the members or to have the report or such extracts read before the company at its next general meeting." (97)

I may say that I am not opposed to the principle underlying this clause. I am opposing this clause as in my opinion this clause is neither necessary nor desirable and it will do more harm than good. I listened very carefully to the arguments put forward by Shri Morarka and Shri Nathwani yesterday supporting this clause but I respectfully submit that I still remain unconvinced. I had opportunities to function as chairman of certain investigation committees appointed by the Ministry to investigate the affairs of certain textile companies which had come to grief and the members associated with me in such committees and I felt that no

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*Published in the Gazette of India Extraordinary, Part II—Section 2, dated 25th November, 1960.

†Introduced with the recommendation of the President.

[Shri Somani]

useful purposes was served by these investigation committees carrying out a sort of *post mortem* about the affairs of companies which had already reached a stage where no remedy is possible or feasible. If action has to be taken, it had to be taken at an earlier stage. Under those circumstances, I am not opposed to any action which the Government may take to ensure that no company comes to grief due to mismanagement or other factors. But what I want to submit is that in my opinion this action is neither necessary nor will it serve the purpose for which the clause has been inserted here.

Hon. Members are aware that this clause did not form part of the original Bill, nor was it recommended by the Sastri Committee. This proposal was mooted by certain hon. friends in the Joint Committee and was, of course, accepted by the Committee. I do not raise any quarrel so far as this aspect of the procedure is concerned, but I would like to submit that I do not agree with the plea that was put forward yesterday that this is some sort of a compromise between two extremes—the circumstances under which no action need be taken and the circumstances under which the investigation into the affairs of a company may be ordered. Out of these two extremes it has been pointed out that this is really a very satisfactory compromise. But I would like to say that so far as the reputation or creditworthiness of any company is concerned it does not make the slightest difference whether the Government takes action to appoint a special auditor to go into the affairs of that company or the Government appoints an investigation committee to investigate the affairs of the working of that company. So far as the reputation or creditworthiness of the company is concerned the damage is equal in both the cases.

Therefore, purely from the negative point of view this compromise does not at all serve any purpose inasmuch as the damage to the reputation and creditworthiness of the company will be equal whether the Government orders a special audit by a special auditor or orders the appointment of an investigation committee. On the orther hand, looking from the positive point of view, this is nothing more than a sort of a fact finding enquiry to which the special auditor is entrusted to find out the various aspects of the company's working. So far as the actual action to be taken against the company is concerned, that action, again, has to be taken under the various other powers which the Government already enjoys under the Companies Act and also the Industries (Development and Regulation) Act.

My submission, therefore, is that this clause does not give to the Government any other extra power than those enjoyed by the Government already under the various other clauses of the Companies Act as well as the powers enjoyed by the Government under the Industries (Development and Regulation) Act. What I would like to ask the hon. Minister is, whether this sort of a fact finding enquiry could be conducted otherwise than by having this public appointment of a special auditor. It has to be announced by way of a Press note by the Government that they have appointed a special auditor to go into the affairs of a particular company. My suggestion is that the same fact finding enquiry can be conducted either by the Registrar or by any other officer of the Company Law Department to find out the nature of the data and details which the special auditor was supposed to find out during the course of his special audit of the accounts of the company.

Sir, the mischief or the injury to the reputation and creditworthiness of any company about whose affairs the special auditor later on may have nothing to complain will be avoided if this fact finding details could be found out by a method other than the one

contemplated in the clause under discussion. My submission is that there cannot possibly be any difficulty for the Registrar or for the Company Law Department to ask for such explanations or such details either from the auditor appointed by the shareholders or from the management of the company in the light of the printed balance-sheet of the company. The printed balance-sheet and accounts of the company does indicate in a broad outline the financial state of the company concerned, and if on the basis of that balance-sheet any further explanation or details are necessary, naturally, the Registrar has not only got the powers to ask for explanations but he can also ask for records and accounts books of the company to be produced before him. He can then make such enquiry as the special auditor is supposed to make.

Sir, one of the criteria laid down to appointed a special auditor is that, if the Government is of the opinion that the work of the company is not carried on on sound business principles or prudent commercial practices it can appoint a special auditor. I do not think it will be possible for any auditor or any special auditor to give his judgment whether the working of any company is going on on these lines. I beg to submit, it is rather very vague, it cannot be defined and it gives certain powers to the Government which certainly cannot be exercised in any precise manner.

Another criterion is that, if the working of any company is likely to cause any injury to the trade or industry the Government can appoint a special auditor. May I, Sir, in this connection, enquire one thing? Supposing there is a very efficient unit in any industry and that efficient unit chooses to undersell its goods compared to various other industrial units of that industry then that underselling by that efficient unit may also cause a lot of injury to the rest of the industry. Is it contemplated that because a unit which is very efficient, which has got a very modern machinery, chooses to undersell its manufactured goods, at prices much lower than what its other competitors can afford to sell and thereby the undersale by that efficient unit can cause a certain amount of injury to the other units of the industry, it will be the duty of the special auditor to go into the working of that efficient unit and take action under this clause? I think, Sir, it would be quite an absured proposition to do so.

**Shri Naushir Bharucha** (East Khandesh): If it is an uneconomic rate war, would it not be doing an injury to the nation?

**Shri Somani:** That is not contemplated under this clause. The purpose of this clause is not to go into the question of uneconomic competition or uneconomic rate war, whatever you may call it. That is something else which has to be dealt with by some other action of the Government. The present clause is only inserted to ensure that the mismanagement of any company is not allowed to continue and whenever the Government feels that there is cause for action then it can appoint a special auditor. What Shri Bharucha has in mind is certainly not relevant to this clause.

Then, the question about solvency of the company has also been referred to. That, again, is hardly to be helped by the appointment of any special auditor; if anything, the appointment of a special auditor will only cause further damage to the solvency of the company and the company will be put to unnecessary loss and inconvenience. It was argued yesterday that if the special auditor clears the affairs of the company, then the company at that stage will come out with flying colours. That does not serve the purpose. The damage is already done, and the management of that company which may not at all be guilty of any mismanagement will have to suffer simply because the order for a special audit has been issued.

My point in stressing all this is, that while you can serve the same purpose

[Shri Somani]

of making all possible enquiries about the working of a company through the office of the Registrar or any other officer of the Company Law Administration, it will be something too premature to appoint a special auditor only to find out that there is no cause for action. If genuinely there is a case for action, then I say that it is not the special audit which will help the Government to take action. Then it is the appointment of an investigation committee, the appointment of some directors on the Board on behalf of the Government or action under certain other powers which are available to the Government under the Indian Companies Act that will help the Government. This power which is being sought to be taken will not help the Government when they have to deal with real mismanagement cases of the corporate sector. The powers are already there under the Companies Act or under the Industries (Development and Regulation) Act. Those powers can certainly be utilised much more effectively than by the appointment of a special auditor. So why cause this unnecessary embarrassment and publicity for a company on a slight suspicion which might arise by one reason or the other. So long as you can get the same thing done in various other ways, by a departmental enquiry, by an investigation or by the Registrar going into the details of the working of the company, I see absolutely no justification for imposing a special audit into the affairs of any company.

Then, it is also indirectly, more or less, a reflection on the work of the existing auditor. If the existing auditor is at fault, by all means the Company Law Department can take action and ask for explanation from that auditor. Certainly all auditors function under certain code of conduct, ethics and, naturally, there is enough remedy so far as the defects or deficiencies of the functioning of the auditor are concerned. There is absolutely no reason why any other outside auditor should be imposed on a company simply because something comes to light. My complaint, and my submission in the past has always been that the Government are already armed with various powers under the various Acts. What is required is to take action in really serious cases and to take an effective action. It is no use going on arming with powers which are not utilised and which are not necessary and which naturally add to the apprehension of the various interests concerned. We are to present on the threshold of certain ambitious programmes of industrial development in the private sector where the foreign investors are also to play a very dominant and a very important role, and it is, therefore, in the context of the need to do everything possible to encourage the productive enterprises as far as possible and not to create any discouragement of any sort of measures which are likely to prove as a deterrent to the capital formation or to the investment capital from abroad, that I plead with all the earnestness that I can command that the purpose for which this clause is being sought to be inserted can be served very satisfactorily and to the same extent by taking recourse to the various other measures. Indeed, so far as any action that the Government want to take against any company is concerned, it is not the statutory obligation; today, an industrial unit cannot afford to ignore the advice of the Government. Many other actions are taken by the industry in a voluntary manner simply on the advice of the Government and there is no reason for going on adding to the statutory powers.

What is sought to be done can be done by various other ways. I therefore submit that this clause is unnecessary and that it will cause a lot of difficulty and unnecessary apprehension in the minds of those who are engaged in the corporate sector. I therefore plead that this clause is not necessary.

**Shri Jhunjhunwala** (Bhagalpur): Mr. Speaker, Sir, I do not want to take the time of the House by repeating the arguments which have already been advanced by various hon. Members. The previous speaker has dwelt at length on the necessity or otherwise of this new clause. There is only one point which I want to make regarding this clause. I fully agree with what the previous speaker said, and if this clause should at all be there, I would say that there is great force in what Shri Masani has said, namely, that the company should be given an opportunity to show cause as to why the special audit is necessary. As I said before, there is no necessity for this clause, but, if at all the Government thinks that this clause is necessary, then, the amendment given by Shri Masani should be taken into consideration.

While replying on the general consideration of the Bill, the hon. Minister said that if this opportunity is given to the company, in that case, the company might do away with the record and the information which is necessary to get from the company will not be available. If that is so, I would say that there is no necessity for this clause at all. Under section 234 the registrar has got full powers to ask for any information that he wants. If the Government thinks that the power which is given to the registrar under section 234 is not sufficient to ask for information which is required, then a small amendment to section 234 may be made. The existing provision says:

> "Where, on perusing any document which a company is required to submit to him under this Act, the Registrar is of opinion...".

I would like to suggest that the words "on any information received by him" may be added after the word required.

Then, section 234 (4) says:

> "If the company, or any such person as is referred to in sub-section (2) or (3), refuses or neglects to furnish any such information or explanation,—
>
> (a) the company, and each such person, shall be punishable with fine which may extend to fifty rupees in respect of each such offence;"

This may be deleted. Then, in the place of the word "Court" in sub-clause (4) (b), the word "Government" may be substituted, so that the clause may read like this:

> "(b) the Government may, on the application of the Registrar and after notice to the company, make an order on the company for production of such documents as, in the opinion of the Government, may reasonably be required by the Registrar for the purpose referred to in sub-section (1) and allow the Registrar inspection thereof on such terms and conditions as it thinks fit."

My point in referring to this section is this: the object for which the new section for special audit is being introduced is that if any information comes to the Government and on the basis of that information the appointment of an auditor in necessary, in that case, the Government may direct any special audit. Shri Masani says that unless the company is given opportunity to explain why the special audit is necessary, the special auditor should not be appointed. I fully agree with him and say that if the Government wants that a special audit is necessary, the registrar may be given the power to ask for information not only regarding the document which comes to the custody of the registrar but also such information which might be given to the registrar, and the registrar may have power to ask for any information regarding those materials which come to the notice of the registrar.

Under sub-section (4) (b), the Government may empower the registrar with such powers to call for any other

[Shri Jhunjhunwala]

information as may be necessary. So, my point is that instead of putting in this new clause—clause 234B, the Government can take power to direct the registrar to ask for any information to inspect or give him such instructions as to the way in which he should take the information. The purpose will be equally served by acceding to my suggestion. That would avoid multiplication of more and more clauses which would make the whole law complicated. When the purpose can be served by the existing law, it should not be the policy of the Government to make more and more stringent provisions of the law and unnecessarily create a scare in the minds of the public. Just as my hon. friend Shri Somani said, it should be the policy of the Governmnt to administer the law properly rather than make more and more new laws. If the existing laws are properly administered, I do not think there will be any necessity for bringing in this new clause.

With these remarks, I would say that this clause is not at all necessary. I think the purpose can be served by introducing one or two amendments of three or four words, by giving the necessary power to the Registrar whereby even the purpose of Shri Masani's amendments will be served by that and there will be no scare in minds of the public as the Registrar will ask for information as he does at present in his usual course under section 234.

**Shri Tangamani** (Madurai): I rise to support clause 70 which has been introduced after so much deliberation by the Joint Committee. It is true that the clause in the present form has not appeared in the original Bill, but there are several other clauses where the intention of clause 70 has been made abundantly clear. When the new clause was introduced the criteria for appointment of special auditor have been very clearly laid down after continuous discussion in the Joint Committee.

I submit that amendments Nos. 8 to 12 and Nos. 94 to 97, which are more or less same, are not conceived properly, because as Shri Morarka himself pointed out yesterday, the appointment of a special auditor gives really more protection to the companies which are functioning properly and where there is solvency. By this clause, we are introducing a new section 233A, which says:

> "Where the Central Government is of the opinion—
>
> (a) that the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices; or
>
> (b) that any company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or
>
> (c) that the financial position of any company is such as to endanger its solvency,
>
> the Central Government may . . ." etc.

During the first reading itself, several Members referred to the observations in the annual reports of the company law administration where they pointed out how even where the solvency of the company is not sound, dividends were also declared. Instances after instances were given. I am not going into it. Even after the special auditor is appointed, all that the Government says is, the special auditor will have the same powers as the auditor who is appointed under section 227, the only difference being that he makes his report to the Government instead of to the shareholders. Sub-clause (5) makes this clear. The powers of an auditor have been defined in section 227 and wherever there has been ambiguity, that has also been removed.

To show how much carefully the Joint Committee has gone into the

matter, I would refer to certain observations made in the Sastri Committee report. In para 97, they say:

> "Section 227(5) consists of one sentence running into 17 closely printed lines, which it is difficult to interpret. The intention of the draftsmen evidently is, where a company by virtue of other statutory provisions applicable to it is not required to disclose certain matters which under this Act the company is required to disclose, the balance sheet would nevertheless be regarded as presenting a true and fair view of the company's affairs, provided that the relevant statutory provisions are specified therein. This simple matter may be expressed in a few simple words."

This directive in the report has been embodied in a very able manner in clause 68. I must compliment the draftsmen for this. Clause 68(c) says:

> "(c) for sub-section (5), the following sub-section shall be substituted, namely:—
>
> "(5) The accounts of a company shall not be deemed as not having been, and the auditor's report shall not state that those accounts have not been, properly drawn up on the ground merely that the company has not disclosed certain matters if—
>
> (a) those matters are such as the company is not required to disclose by virtue of any provisions contained in this or any other Act, and
>
> (b) those provisions are specified in the balance sheet and profit and loss account of the company." "

My point is, even though we have appointed a special auditor, we are not clothing him with extraordinary powers. Shri Morarka has rightly said that this really enhances the prestige of the auditors. In the first instance, the auditor will be much more careful, because he knows there will be a checking auditor under clause 70 under certain circumstances. This also creates confidence in the minds of the general public and fear in the minds of those people who may not run the affairs of a company in accordance with sound business principles. Apart from that, this is a very salutary provision and a reference to section 227 will make it clear that those who have drafted this amending Bill have applied their minds carefully.

The objection raised by Shri Masani is this. His amendment says: the following proviso should be added:

> "Provided that before directing a special audit of the company's accounts, the Central Government shall serve a notice on the company indicating the reasons why it proposes to appoint a special auditor and shall give the company an opportunity to show cause why such special audit should not be directed if the company shows such case to the reasonable satisfaction of the Central Government, the said special audit shall not be directed."

My submission is this kind of opportunity is given in other instances. Here it is an extraordinary case. As soon as we interfere under clause 70, the reasons are implied. If for any other matter we are going to interfere, there are other provisions. This is a special provision which will instil confidence not only in the minds of the general public, but also in the minds of those who are running the administration of the company on sound business principles. Under the circumstances, I submit that amendments 8 to 12 and similar amendments 94 to 97 should be rejected and the clause should be adopted as it is.

**Shri N. R. Muniswamy** (Vellore): Sir, we can advance arguments both for the retention and also for the elimination of this clause. The accepted practice usually varies from person to person and from place to place. How far sound business principles or pru-

[Shri N. R. Muniswamy]

dent commercial practices are to be borne in mind and how they are to be implemented is more of a subjective nature. We know that banks have been periodically checked by the Reserve Bank of India. We also know that the Registrar of Co-operative Societies or the Deputy Registrar occasionally lays his hands on the accounts of the co-operative societies in various parts of India. Still, so far as the internal affairs of the company is concerned, it is purely an autonomous body and any interference from the Government or from anybody else will create some sort of scare in the minds of the people. The object for which this clause is introduced is only to safeguard the interests of the shareholders, and we all appreciate the principle. But if there is some announcement that there is mismanagement of accounts in a company, or the commercial practice conducted by a company is not on a sound business principle, certainly that would create a scare. In the end, it is quite possible that the auditor may be satisfied that the accounts are quite correct. But we may not be able to restore confidence or allay the misgivings of the people or the shareholders once a special audit is ordered and it creates a scare. Therefore, though I do not agree with the wording of the amendment suggested by Shri Masani, still I would say that some *via media* course should be thought of by the Government.

Now, take the case of co-operative societies or banks. The accounts of the banks are periodically examined by the Reserve Bank. In the same way, the Registrar of Co-operative Societies examines the accounts of co-operative societies. In the same way, there can be a periodical check of the accounts of the companies by the Government. It can be a special audit or sudden audit, whatever it may be. Suppose some information is received by the Government or the Company Law Administration as regards certain aspects of the working of a company which are not very conducive to that particular company, they can order an audit without announcing it in the paper or in public. If an announcement appears in the paper, the reputation of the company might be jeopardized and ultimately the company may fail. So, in the larger interests of the firm and in the larger interests of the shareholders also, no publicity should be given to such an audit. We have seen several cases where officers have been arrested for doing something which is in the interest of the administration. Then an enquiry is held and the officer contends that what he has done is in pursuance of his official duties. Ultimately, what happens is that the officer is put on some trial and later on he is declared innocent. In the same way, there are firms and firms, belonging to various categories. Suppose a firm does some mischief, which is detrimental to the interests of the shareholders, there is necessity for appointing an auditor. But an announcement about special audit creates thunder and lighting in the minds of the people and, ultimately, there may be no downpour of rain. Government have got every right to have a special audit or concurrent audit, whatever it may be, but they should not give publicity to it. Because, every firm is supposed to have its own autonomy to conduct its administration in its own away. If the conventional method is being departed from by the company, that would be rectified by the company in its own way. Of course, the jugglery in the maintenance of accounts should be stopped. I am quite ignorant of account, because I do not know why a debit is actually shown as a credit, a credit as a debit and ultimately by some other entry that is wiped out. It is not discernible to an ordinary man. We have to see that there are no vagaries or juggleries in the maintenance of accounts. For that we have got the Company Law Administration, which is an expert body. If a report comes either from the shareholders or responsible quarters that the accounts of a company are mismanaged, Government should analyse and scrutinise such reports and then

order an enquiry. That enquiry can very well be made without creating a scare among the people, particularly the shareholders.

**Shri Achar** (Mangalore): In the general discussion I have supported the clause on special audit. But here I would like to make a submission, with all humility, as to the actual wording and the effect that the section will have on the company. Firstly, this clause on special audit says "Where the Central Government is of the opinion". How exactly the Central Government comes to an opinion is not clear from this section. It cannot be intuition or omniscience; it must be based on some reports, returns or information. If it is based on them, well and good; nobody will have any objection. It is not likely that always this audit may be ordered only on the basis of those returns or reports; it is likely, sometimes, to be on some information given by some interested persons, probably a minority section of the shareholders. It may happen that, in some cases, a person wants to create some scare in the minds of the people and so he may send a report. Not that Government will always act on this report immediately; but a possibility is there. So, my submission is that nobody should be allowed to set the law in motion without a corresponding responsibility or obligation. A person should not be allowed to make a statement and then get out with it. Suppose an audit is ordered on the basis of a report. Then the company suffers in reputation, shares go down and many things happen. So, such a contingency should not be allowed to happen. If a person makes a report, he must be made fully responsible for that. For example, in the ordinary course of law, if a search warrant is to be issued, it must be supported by evidence. So, if a person makes a report on a company, it should be on affidavit for which he would be criminally liable. This is necessary so that Government need not act on some information which, later on, may be found to be absolutely without any basis.

Secondly, I feel that before a special audit is ordered proper notice should be given to the company. It is one of the basic principles of jurisprudence that no person should be condemned without being heard. Of course, the special audit assumes there was an earlier audit. Even then, the ordering of a special audit means certain serious steps being taken by the Government. It is a very delicate matter. When that rumour is afloat, the shares may go down and people may suffer. So, on such matters, before ordering an audit, a *prima facie* case must be made out; I do not say a conclusive case. The notice can be given even three days before the date of audit. So, I support the amendments of Shri Somani and Shri Masani to that extent; not to the full extent. I am not in full agreement with those amendments, because I feel the audit is necessary but I say that it should not be done without notice. I was surprised to hear even an experienced lawyer like Shri Bharucha saying that if a notice is given then the documents may not be forthcoming and evidence may not be forthcoming. I can understand that sort of argument from a person who is not an experienced lawyer. So far as a compapny is concerned, we know what is the nature of the document that is going to be examined.

There is already an audit report. The account books have already been produced. The documents are there. If they are changed, that itself is a condemnation. That is the end of the matter. I presume that there is a previous audit and there is a previous auditor's report. If that is so, I submit that this short notice being given will not increase the scope. I would go a step further and say: Does the Government think that it will ever be possible that the companies would not come to know that the Government is contemplating special audit, knowing as we do the present administration?

**13 hrs.**

I would give an instance of my own personal experience during the salt

[Shri Achar]

*satyagraha* days. Those days the administration was much stricter. They had better control. I was in charge of the *satyagraha*. I remember that before something was contemplated or even thought of in the Collector's office, the information would come to our camp. So I feel that this will be one more source of revenue to the concerned people. Nothing more. From that point of view also it is not practical.

Not only that, I would go a step further. What is the power that this special auditor has got? He has the power only of an ordinary auditor. If really the Government wants to be very strict about this matter, the special auditor must be given all the necessary powers to go with a search warrant. He can take the police, break open the doors and locks, if necessary. That is if you really want to make this section effective. As it is, it is practically of no use. As a lawyer I feel that it is absolutely ineffective if it is with the intention of seeing to it that the other side is not allowed to concoct things. If we really want it to be effective, it has to be changed. The power of an ordinary auditor will be absolutely insufficient. You must arm him with police powers, if necessary, to go to the premises, break open the doors and the boxes and arrest people if they obstruct. That sort of power must be given.

Is it necessary to have such a provision, that is, to have special audit? As I said, I am in favour of special audit. I do not want to take more time. I have taken sufficient time of the House. The only point that I want to impress is that there must be a *prima facie* case to show that there is justification for this.

An argument was put forward that special audit may mean a reflection on the first audit. I do not agree with this. Take the case of the judiciary. The first judge comes to a decision and against that there is an appeal to the High Court. That is no reflection on the first court. Similarly, if there is an audit and if we ask for a second audit by another gentleman, it does not mean that there is any reflection on the first audit. If really there are circumstances and if a *prima facie* case is made out, I can understand a special audit being done. But I feel that the clause as it stands is against the ordinary principles of jurisprudence. You cannot condemn a person without giving him an opportunity to show whether there is a *prima facie* case or not. I have no doubt in my mind that apart from anything else, it would harm even innocent people who may suffer due to this.

**Shri H. N. Mukerjee** (Calcutta—Central): Sir, this provision in regard to special audit is in our view one of the most welcome innovations which have been made by the Joint Committee. I participate in the discussion only in order to reiterate our support to new clause 70 where this provision has been put in.

I did not have personally the advantage of participating in the work of the Joint Committee and I do not know the factors which were brought to their notice, but I have tried to look up the annual report on the working of the administration of the Companies Act for the year ended the 31st March, 1959 and from the chapter in relation to company accounts and audit I have discovered material enough to justify the provision of special audit as has been made by the Joint Committee.

There is no question of damning all auditors or all companies. My hon. friend, who just now spoke, was referring to the desirability on the part of the Government to break open all the doors if things are bad enough. It may be that occasionally the Government may have to break open all the doors, but for the time being it appears that Government does not want to go the whole hog and therefore all the provisions that reasonably can be adopted without too much detriment to the companies which are now in operation are being sought to be adopted by Government. That is why

Government wants to make sure that in the conditions of our country, at the rate at which we can progress according to the Government's own computation, there should be certain provisions not only in regard to ordinary audit, which is already there under the law, but also special audit because circumstances warrant that kind of special provisions.

There are auditors in our country who surely look upon their jobs and profession as one of great value and propriety and therefore they behave very well. There is no question of condemning all auditors of all companies, but the fact remains from the working of this, as the report for 1959 says, that the new obligations for auditors which were implicit in the change in the law in 1956 were not appreciated by a large number of them. That is why on page 99 of this Report, it was said:

> "An examination of the company accounts duly audited by the auditors and filed by the companies discloses that there is as yet no adequate realisation of this obligation by a majority of the auditors."

It is because in the conditions of our country it is not possible to secure a condition of things where the companies would behave properly and the auditors also would behave correspondingly—it is because of that—that some kind of special steps are necessary.

We have discovered that in relation to very big companies the auditors are faced with a tremendous temptation because, professionally speaking, of their desire to be associated with the work which they have been doing in relation to these very big companies and they know also that these very big companies occasionally take recourse to practices which have to be cloaked over by some kind of professional justification. In order to keep their jobs, so to speak, only to ensure that their occupation is not gone occasionally they have to kotow to the interests of those who manipulate scenes from behind. I am very sorry, but that is the condition of things in our country, which is why so many egregious cases in regard to company direction have come to our notice.

Then again, an idea of a correct and fair assessment of the position of the companies finances has not been appreciated by a very large number of auditors. A correct and fair assessment of the position of the company implies not only that the interests of the company and the interests of the shareholders alone have to be taken into consideration but the interests of the country's economy at large have also to be taken into consideration. Even in British practice I find from a quotation from a statement by one, Mr. W. G. Campbell, that even in Britain they recognise that in exceptional cases the economic interests of the country have to be taken into consideration by the auditors when they certify that a correct and fair state of the financial position has been given out by a particular organisation. In our country, today, the economic interest, of the country as a whole, is of paramount importance. But, to the rather narrow and inhibited view of the auditors and similar people, in general, in our country, that idea has no position in the picture. Therefore, there have been many deviations from the best traditions of Audit practice and the department of Company law Administration has pointed out how failure of duty of auditors has taken place in a rather calamitous manner. The auditors have sometimes made statements which were demonstrably untrue. So many other instances of default have been listed on pages 102 and 103 of this report. We are also told that the department investigated failures on the part of auditors and in 11 cases, after hearing the explanation of the auditors concerned, and after considering all the circumstances of the case, the Government decided not to file any complaint against them. They were, however, duly warned. Eight cases were referred to the Disciplinary committee of the Institute of Chartered Accountants for suitable

[Shri H. N. Mukerjee]

action. Two cases were under examination in the department at the end of the year. We know very well that sometimes, the department also is not quick enough in finding the guilty. But, even the department has discovered so many cases of failure by auditors in the pursuit of their ordinary jobs. Therefore, in spite of the Act of 1956 having laid some special responsibility on the Auditors, it is very necessary that we have to take other extraordinary measures. This idea of special audit has commended itself to the Joint Committee, and that is provided for in the report which has come to us. I do not think that any company is going to be jeopardised on account of this provision. I am sorry I did not hear Shri M. R. Masani this morning. I remember him saying earlier that if a special audit is ordered in relation to a particular company, that company's name would be mud and that, therefore, we should not order special audit without giving that company prior opportunity, so to speak, of defending itself. I do not happen to agree with Shri M. R. Masani's proposition. After all, the interests of the country as a whole are very much more important than the reputation which a particular company might have, and perhaps, it is better that the reputation of many companies which operate today had turned to be mud, not only in common parlance, but also in the eyes of the Government of the day, so that they can take special steps in regard to the operations conducted by these companies. Besides, I do not see why the interests of the shareholders should be jeopardised if there is a special audit. Because, even though there may be certain manipulations and manoeuvres going or in the stock exchange, that should not affect the interests of the shareholders when a special audit is ordered and the Government comes into the picture to see to it that the company is put on the proper road, and the total interests of the economy are subserved by the operation of special audit. I feel that in view of the inadequacies of ordinary audit, even though the Act of 1956 tried to make certain improvements in that regard, the provision for special Audit at the discretion of the Government is extremely important. This is, therefore, a provision which we support with every enthusiasm.

**The Minister of Commerce (Shri Kanungo):** This clause introduces a new section with a new provision and therefore, it is natural that it will create a certain amount of apprehension. At the outset, I might say that the Government is not anxious to be armed with powers more than is absolutely necessary. Because, when there are powers, whatever they are, the Government is always answerable in the exercise of these powers. Therefore, I do not believe any Government would like to expose itself to opportunities of being accused and offering explanations for their actions.

When we see the evolution of the legislation regarding corporations not only in our countnry, but in other countries also, we find that various measures of regulations become necessary from time to time as complexities of operation develop and also opportunities are taken by the more unscrupulous elements in society to act in a manner which is not conducive to the well-being of the corporations themselves. The Government is certainly armed with adequate powers of investigation as envisaged in the various sections, 237 onwards. But, the Government is also hamstrung. What I mean to say is this. According to Shri Somani, the Government has large powers. The powers that Parliament has conferred on the Government are severely limited and in actual practice it has been found that the powers are not so adequate. I shall give one example. Section 237 of the Companies Act of 1956, which gives powers to the Government along with the courts and to the company reads as follows:

> "..... the Central Government
> (a) shall appoint one or more competent persons as inspectors to

investigate the affairs of a company and to report thereon in such manner as the Central Government may direct, if—

(i) the company, by special resolution, or"—

Here, the initiative is with the company.

(ii) the Court, by order, declares that the affairs of the company ought to be investigated by an inspector appointed by the Central Government;

These are the unlimited powers of investigation of the corporation itself and the court. Later on, in sub-clause (b), when it comes to the powers of the Central Government, says that the Central Government may do so on its own motion if in the opinion of the Central Government there are circumstances suggesting—what are those circumstances.

"(i) that the business of the company is being conducted with intent to defraud its creditors, members or any other persons, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive of any of its members, or that the company was formed for any fraudulent or unlawful purpose; or

(ii) that persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members;

(iii) that the members of the company have not been given all the information with respect of its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director, the managing agent . . ."

Only if these conditions are satisfied, can Government on its own motion order an investigation, which is certainly an elaborate process of investigation, for which there are adequate powers. There can be circumstances where these serious acts of fraud, misfeasance etc., have not happened; but there are less objectionable operations.

**Shri M. R. Masani** (Ranchi-East): Such as what?

**Shri Kanungo:** Such as defined in the clause itself.

**Shri M. R. Masani:** That is no use; too vague.

**Shri Kanungo:** It is not so vague. I am coming to it. Mind you, the present clause does not give powers to Government for all the elaborate enquiries; it only gives powers to Government to appoint an auditor, a chartered accountant, and his audit has to be like any other auditor, with a little power added to it at the discretion of the Central Government regarding production of documents and that sort of thing. The clause says:

"(a) that the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices; or

(b) that any company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or

(c) that the financial position of any company is such as to endanger its solvency."

Shri Masani was apprehensive that these conditions under which the audit can be ordered were rather vague and might be used arbitrarily. I would mention that it is not so vague because these conditions are fairly understood by the profession and by the auditors.

I would merely mention that in the Select Committee of the UK Parliament, where the question was being discussed about the nature of audit, or special audit, by Government, of what

[Shri Kanungo]

we call public undertakings, the Institute of Chartered Accountants themselves suggested that these matters might be looked into. The following matters could be looked into on the instructions of Government:

"Lack of proper administrative and financial control on revenue and expenditure, including purchasing procedures, assets and liabilities;

Substantial capital expenditure incurred which was intended to be productive, but which had not proved productive or upon which an adequate return has not been received;

Expenditure incurred which is of an extravagant or wasteful nature judged by normal commercial practice and prudence;

Any other matters concerned with the financial administration of the undertaking which appear worthy of special note."

**Shri M. R. Masani:** Surely there can be no comparison between a Government investigating its own companies as in that case and investigating other people's businesses as in our case.

**Shri Kanungo:** I have mentioned this because, as I said, it refers to only public undertakings.

**Shri M. R. Masani:** It is has no relevance.

**Shri Kanungo:** It is assumed that the shareholders can take care of their own affairs. In fact, that is the basis of the Companies Act. Unfortunately, the 1956 Act had to be passed because the shareholders were not able to exercise the rights inherent in them. That relates not only to this particular provision. As Shri H. N. Mukerjee has pointed out, the conditions in our country are such that the bulk of the shareholders are not in a position to effectively ensure their rights. Let us not argue about it, because that was the reason for the Companies Act becoming so elaborate. Possibly some time in the future entrepreneurs and managing personnel, by whatever name they are called, will be more social-minded, and there will be no occasion for invoking any of the provisions of the Act as it stands today. But conditions being as they are, we have to face the situation as it arises.

Therefore, the reason for incorporating this new section in the Act is this, that we do not want to go in for an elaborate investigation as contemplated in the existing sections. As Shri Somani has rightly pointed out, the investigations with which he has been associated as also others almost become post-mortem investigations when no remedy can be applied. If timely remedies can be applied, not by Government necessarily but by the shareholders even or by other agencies; conditions will not come to that stage, and it is exactly to meet such situations that these powers are being taken. One of the functions under this section will be taking a sort of preventive or prophylactic action. No action is going to be taken on that. All the action arising out of this special or any other audit or other circumstances can only be taken in court. The whole struture of the Act is this, that no penalty, barring what you call procedural penalties, can be imposed by Government as such. All penalties are to be imposed by courts. This is, as Shri Somani as rightly said, a fact-finding work. Today this fact-finding work can be done only under the powers of ordering investigations and appointment of inspectors. Without going to that drastic stage, this is a provision by which facts can be elucidated, and those facts may enable the shareholders to correct their own affairs, or, if necessary, Government can launch a prosecution. Government cannot take any action otherwise.

It has been argued that the Registrar, under section 234, has ample powers, and that can serve this purpose. Section 234 says:

"(1) Where, on perusing any document which a company is required to submit to him under this Act...."

That means the Registrar's power is confined to those obscurities and doubts which he finds in the documents which are required to be filed by the company with the Registrar, and nothing more. Therefore, between the Registrar and the Inspector, this is really a very mild form of investigation and fact-finding for a prophylactic purpose, so that more drastic action may not become necessary by the Government, and this is largely in the interests of the corporations themselves so that they may not come to grief.

The argument has been advanced, and rightly so, that the party should have an opportunity of showing cause before any action is taken. I would merely submit that under section 237 the hands of Government are completely unfettered. It only says that the Government may take action if in its opinion there are certain circumstances. In such cases, I can assure the House that this power has not been exercised without asking the company for an explanation. I can also assure the House even today normally, the powers under this clause 70 will not be exercised, that means, special audit will not be ordered without giving an opportunity to the parties or without the parties being informed of it. But I may also make it clear that in special cases, in extreme cases, to which I need not make a reference here, because cases are there, and people who are in the business and the legal world know about them, where quick and immediate action is necessary, it has got to be taken.

I can also assure the House that these powers would not be exercised, as has been suggested, by any subordinate officer as such. So far, all the powers of investigation normally under section 237 have been used only under the final orders of Government, not by any particular officer at whatever level. Apart from the broad principle that the Minister is responsible for the actions of any officer at whatever level, these powers of investigation can be used only by the Central Government, and Central Government means, on the responsibility of the Minister; the normal practice so far has been that that Minister is consulted.

Further, it is our intention that in normal cases, where we think fit, we might consult the commission also, which is an independent body, because section 411 gives powers to Government to refer any matter to the commission, and it contains the words 'on all other matters which may be referred to the commission by the Central Government'.

Therefore, though the provisions of the section as it has been proposed may look rather severe, they are tempered by the procedures that I have indicated, and some of these procedures can also be laid down in the rules.....

**Shri Morarka** (Jhunjhunu): Tempered by your assurances.

**Shri Kanungo:** .....so that these things will not be lightly dealt with.

I am very grateful to Shri Somani who has clearly indicated the scope of this section, namely that it is merely fact-finding in character.

It has been said that the reports of such investigations should be made available to the company or the corporation as the case may be, as quickly as possible.

Sub-section (6) of the proposed section 233A reads thus:

> "Provided that if the Central Government does not take any action on the report within four months from the date of its receipt, that Government shall send to the company either a copy of, or relevant extract from, the report..."

So, the period of four months is a statutory limit. That means that Government cannot delay for more than four months, but I believe that it will be possible to do so much earlier,

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where no action is taken. Where court action is necessary, I can only assure the House that extracts of the report may be made available. But, in certain cases, it may not be made available, because it might prejudice action in courts.

I believe, in the broad context of the happenings of the last several years, and in the background of the rather wild conditions which prevailed before 1956, and in view of the explanations that I have offered, namely, that this section is much milder than what it is imagined to be, this Bill will allay the suspicions and apprehensions of people, and I believe that after a year, the House will have an opportunity to judge whether these powers have been used arbitrarily or not.

Therefore, I commend the clause as it has emerged from the Joint Committee, for the acceptance of the House.

**Mr. Speaker:** Need I put the amendments to the vote of the House?

**Shri M. R. Masani:** Yes.

**Mr. Speaker:** I shall now put amendments Nos. 8, 9, 10, 11 and 12 to the vote of the House.

*Amendments Nos. 8 to 12, moved on 24th November, 1960, were put and negatived.*

**Mr. Speaker:** I shall now put the clause to vote.

**Shri Kanungo:** I think there are some other amendments by Shri Somani also.

**Shri Somani:** I am not moving them

**Mr. Speaker:** The question is:

"That clause 70 stand part of the Bill."

*The motion was adopted.*

*Clause 70 was added to the Bill.*

**Mr. Speaker:** We shall now take up the next group of clauses, namely clauses 72, 74, 75, 77 and 79.

There are no amendments to clause 72. Clause 71 has been adopted already. So, I shall put clause 72 to vote now.

The question is:

"That clause 72 stand part of the Bill".

*The motion was adopted.*

*Clause 72 was added to the Bill.*

**Mr. Speaker:** Clause 73 has already been adopted. Now, we come to clause 74.

**Clause 74— (*Amendment of section 240*)**

**Shri Naushir Bharucha:** I beg to move:

Page, 42, *after* line 20, *insert*—

'(cc) in sub-section (5), the brackets, figure and word "(2) or" shall be omitted;'. (63).

Clause 74 seeks to amend section 240 dealing with production of documents and evidence. It is being provided now that:

"If any such person fails without reasonable cause or refuses—

(a) to produce to an inspector any book or paper which it is his duty under sub-section (1) to produce; or

(b) to appear before the inspector personally when required to do so under sub-section (2) or to answer any question which is put to him by the inspector in pursuance of that sub-section;

the inspector may certify the failure or refusal under his hand to the court....",

and the court would take action against such persons.

My object in moving this amendment is to see that the party who appears before any such inspector should not be made to answer questions which are likely to incriminate him. I do not know whether indirectly by the amendment of section 240 we could bring this in view of the fact that under article 20(3) of the Constitution, a person is exempted from answering questions which are likely to incriminate him. So my submission is that where a person says that an answer would incriminate him, he should not be compelled to give answer to such a question. Whether he is a company inspector or for the matter of that anybody else, he is a person in authority. So I request the hon. Minister to look into this more closely.

**Shri Kanungo:** We have thought over it, but in view of the possibility of such a provision offending against article 20 of the Constitution and in view of the judgment of the Supreme Court in what is known as the Harinagar Sugar Mills case, we find that it may not be appropriate to put in this provision.

**Mr. Speaker:** Is the hon. Member pressing his amendment?

**Shri Naushir Bharucha:** No.

**Mr. Speaker:** Amendment No. 63 is not pressed.

*The amendment was by leave withdrawn.*

**Mr. Speaker:** The question is:

"That clause 74 stand part of the Bill".

*The motion was adopted.*

*Clause 74 was added to the Bill.*

**Clause 75—** (*Insertion of new section 240A*).

**Shri Naushir Bharucha:** I beg to move:

Page 43,—*after* line 14, *add*—

"Provided that no books or papers seized by an Inspector under sub-section (2) shall be detained in his custody for a longer period than sixty days without obtaining the permission of the Magistrate". (64).

Clause 75 inserts a new section, 240A, and that deals with seizure of documents. So far as the wording of this new section is concerned, there is no doubt that a provision of this character is necessary. I suppose it is part and parcel of any legislation which deals with investigation of a criminal character. But there is absolutely nothing in this section to say that the inspector seizing the books of account should return them to the company within a particular period of time.

I quite appreciate that Government are faced with two difficulties. If they provide for a time-limit, it is conceivable that the investigation may not be over within that period and the time-limit may have to be exceeded. Secondly, there is the other difficulty, that if they do not provide for a time-limit, probably a lethargic inspector may keep the books of account indefinitely and unnecessarily cause inconvenience to the company.

As I have said all along, so far as this Companies' Act amendment legislation is concerned, I am of the view that sufficient and adequate powers must be vested in the Government or the Company Law Administration; but at the same time, avoidable inconvenience must not be caused. In this particular case, I feel that there should be imposed on the inspector an obligation to be diligent; at the same time, the contingency should be guarded against that in case of an incomplete investigation, they should have sufficient time to complete it.

Therefore, I have put down this safeguard, that in the first instance, automatically the inspector should have 60 days time to carry on his investigation. But later on, if it be-

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comes necessary, to have more time, it should be incumbent on him to apply to the Magistrate for extension, in which case the Magistrate will take into consideration relevant facts and see, probably after issue of a notice to the company, whether there is any justification for detention of the books of account.

May I point out that while this new clause relating to seizure of documents is very important for investigation, it is equally important that the day to day business of the company must also proceed? Detention of the books of account must virtually bring the business to a standstill. No company can carry on business if its books of account are seized and indefinitely detained.

Therefore, I have moved this amendment as a precautionary measure. It will make the inspector more diligent in pursuing the investigation; at the same time, it will give him reasonable time to complete the investigation. If there is an exceptional case, the burden should be put on the inspector to ask for extension of time and not for the company to make an application. After all, the inspector knows how far the inspection has proceeded. I would then ask Government to look into the matter.

**Shri Kanungo:** I appreciate the point made by Shri Naushir Bharucha. It was also discussed at the earlier stages and it was decided that certain safeguards had to be there to ensure the quick return of documents which were not necessary and to see that the inspection or investigation was not unduly prolonged. But we are faced with a situation that an investigation may take years. I do not want to mention cases, but there are investigations which are taking more than two years and are likely to take some time more. Of course, I must admit that this situation has arisen because the present powers and present procedures are not adequate. All I can say is that we can provide by issue of departmental instructions for the quick disposal of cases. Beyond that I cannot go.

**Shri Naushir Bharucha:** Will departmental instructions be issued to this effect that any inspector requiring more than a stipulated time must approach the head of the Company Law Administration for extension of time?

**Shri Kanungo:** We will issue instructions to the effect that an inspector who requires more time should get orders from an officer at the higher level.

**Shri Naushir Bharucha:** I am not pressing my amendment, No. 64.

*The amendment was, by leave, withdrawn.*

**Mr. Speaker:** The question is:

"That clause 75 stand part of the Bill".

*The motion was adopted.*

*Clause 75 was added to the Bill.*

*Clause 77 was added to the Bill.*

**Clause 79**—*(Substitution of new section for section 250)*

**Shri M. R. Masani:** I beg to move:

Pages 44 to 46,—

*for* clause 79, *substitute*—

'79. *Amendment of section 250.*—In section 250 of the principal Act,—

(a) after sub-section (2), the following sub-sections shall be inserted, namely:—

(2A) (1) Where as a result of transfer of shares of a company, a change

(a) in the composition of the Board of Directors, or

(b) where the managing agent is an individual of the managing agent, or

(c) where the managing agent is a firm or a body corporate, in the constitution of the managing agent,

of the company may take place any members of the company who claim that such change would be prejudicial to the interest of the Company may apply to the Court for an order under this section provided such members have a right so to apply in virtue of section 399.

(2) If on any such application the Court is of opinion that any such chance would be prejudicial to the interests of the company, the Court may by order direct that the voting rights in respect of those shares shall not be exercisable by the transferees of those shares or any persons claiming through or under them for such period not exceeding three years as may be specified in the order.

(2B) (1) where any members of a company have reasons to believe that a transfer of shares in a company is likely to take place whereby a change

(a) in the composition of the Board of Directors, or

(b) where the managing agent is an individual of the managing agent, or

(c) where the managing agent is a firm or a body corporate, in the constitution of the managing agent,

of the company may take place, such members may apply to the Court for an order under this section provided they have a right to so apply in virtue of section 399.

(2) If on any such application the Court is of opinion that any such change would be prejudicial to the interests of the company, the Court may by order prohibit the transfer of shares in the company for such period not exceeding three years as may be specified in the order".' (13).

My amendment is in the form of a substitute motion for the present clause.

**Mr. Speaker:** Let me find out which are the other amendments to be moved.

**Shri Nathwani** (Sorath): I beg to move:

Page 44, line 8,—*omit* "or otherwise". (89)

Page 44, line 15,—*for* "three to 39 and 1 to 10 respectively. (90).

Page 45,—*omit* lines 6 to 10. (91).

**Shri Naushir Bharucha:** I beg to move:

Page 44, line 15,—*for* "three years" *substitute* "one year". (65)

Page 44,—*after* line 15, *add*—"Provided that the said period of one year may, with the sanction of the Court, be extended to not more than three years". (66).

Page 45, line 23,—*for* "three years" *substitute* "one year". (67).

Page 45, *after* line 24, *add*—"Provided that the said period of one year may, with the sanction of the Court, be extended to not more than three years". (68)

**Shri Somani:** I beg to move:

Page 44,—*after* line 15, *add*—"Provided that the Central Government shall not take any action in pursuance of this sub-section

[Shri Somani]

if the company in general meeting so decides by a resolution passed by a tow-thirds majority.". (98).

**Mr. Speaker:** These amendments and the clause are before the House.

**Shri M. R. Masani:** Sir, I was saying that my amendment No. 13 substitutes a new clause in place of the present clause. It covers the same ground but arrives at a different solution. Where the composition of the Board of Directors or the individual personality of the managing agent or the composition of the managing agency firm is substantially changed as a result of a transfer of shares, this clause drafted by Government gives the Government a chance to intervene, again arbitrarily, without any set criteria except their own opinion to say that a transfer of shares may not take place for as long a period as 3 years. My amendment meets the same situation by suggesting that a minority of shareholder, who would be 100 or 1/10th of the number of shareholders as under section 399, should have the right, in such a situation, to go to a court of law and ask for an order restraining the transfer of shares for the same period of time.

Behind, this difference lies a very profound philosophical and profound practical difference. The difference is this. How do you deal with what you call a take-over bid? Let me say at this stage that there is nothing wrong whatsoever in shares changing hands and in the management of companies passing from one set of hands to another. It would be a very sad say for this country if all businesses were frozen in the hands of those who control them today. The essence of joint-stock enterprise is competition which is the law of efficiency. Where a particular management does not prove itself to be efficient by the yardstick of profit, it gives way to somebody else who can do a better job of that particular enterprise. And if that safeguard was not there and if all owners were guaranteed the rights of management for eternity, we would soon have a country of bankrupt companies and without any production. Therefore a change in the composition of management is a good thing. We must keep that in our mind when we deal with certain aberrations that take place in that situation.

I concede that there may be occasions where unscrupulous groups may try to corner the shares of a particular company, not with a view to taking over the management for the proper development of the enterprise but in order to milk that company, to shut it down or to prevent some process and so on. When such a thing takes place, which is called a take-over bid, not of a good kind but of a bad kind, then the poor shareholders or a minority of them should have the right to go to a court of law and ask for protection. In other parts of the Act that right is given to 100 shareholders or one-tenth of the number of sharehouders—a minority of one out of ten.

They should have a right to go to a court of law, a body which can be expected to exercise a judicial attitude which, certainly, the government of the day cannot be trusted to do at all times. Therefore, we have to deal with the situation, which is contemplated in emergency cases, where the protection of the shareholders of the company becomes necessary. It is the court, at the instance of the minority, a group of shareholders or a majority group, that should be able to intervene and not the administration of his right in what is caled a right's between my amendment and the government clause.

The clause is clearly expropriatory in its nature. It divests people of their rights. Not only is the shareholder divested of the right in his present shares but he is also divested of lies right in what is called a right's issue and for as long a period as three years the government department is

arbitrarily given the right to expropriate the people of their vested rights.

**Shri Nathwani:** That right is already there in the existing Act.

**Shri M. R. Masani:** But here it is in a new context; and that expropriatory principle is further extended. I am not going to justify every part of the Act of 1956. Some of its provisions may be deficient and such defects may be liable to the same, criticism.

**Shri Nathwani:** The power of Government expropriate does not seem to be extended as you appear to make it out because it is there under sub-section (1). But in subsequent sub-sections such power is not given.

**Shri M. R. Masani:** I am not at the moment comparing the old section. Maybe there is something in what the hon. Member says. I respect his study of this matter which is much more profound than mine. What I am establishing is this: That for three years the Government is entitled to prevent the exercise of certain property rights. I am told that this particular veto or expropriatory action might even be in violation of article 31 of the Constitution of the Republic. That, however, is a matter for the courts of law, ultimately, to decide.

The test given in the clause is also objectionable. The test given is that the take-over bid may be against "the public interest". I think that again is objectionable. The public interest has nothing to do with the ownership of a particular property or the control of a particular management. It is the shareholders' interest and the interests of the majority or minority of the shareholders and of the enterprise that we are concerned with in Company Law. This bringing in of "public interest" which varies with every man's intelligence and every man's point of view or ideology is unknown to company law. That is not sound. Therefore, this reference to public interest, in my view, is irrelevant. The interest of the company, of the shareholders and also of the minority of shareholders is the real test.

From this point of view I oppose the present clause and move that the clause embodied in my amendment No. 13 be substituted for the present clause.

**Shri Nathwani:** I rise to support my amendments Nos. 89, 90 and 91. The first amendment seeks to delete the two words 'or otherwise', in sub-section (1). It seems to give powers to the Central Government to issue directions which are of a very drastic nature.

At the outset, I want to emphasise this aspect that the powers which are conferred under this section are of a very drastic nature, even of an expropriatory nature. Of course, under sub-clause (2)(d) the holders of shares are prohibited from receiving even rights issue shares. It is in this context and against this background that we have to see the provisions which are mentioned in this sub-clause which would enable the Government to exercise these powers.

In the original section power has been given to Government to issue these directions in connection with any investigation under sections 247, 248 and 249 so that before Government can exercise any of these powers investigation had to precede. In the light of that investigation or explanation or information collected by Government, Government was to form its opinion. Its opinion had to be formed regarding two matters; one is, that there is good reason to find out the relevant facts about shares. The facts about shares are these. Who are the owners of the shares in the company or who are the real persons in charge of any managing agency company or who are the real Secretaries or the Theasurers? These are the relevant facts. In substance, who controls the company or the managing agency firm or company, whatever it might be.

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Even after investigation or information was called for, if Government was not able to decide about the ownership of these shares, then, Government was authorised to take the action indicated in one of the several ways. This was a salutary check.

Now, we find that two more words are added. It says:

> "wherever it appears to the Central Government whether in connection with an investigation under the three sections mentioned or otherwise.".

**14 hrs.**

So, without going through the preliminaries of sections 247, 248 or 249, Government can exercise these powers. I emphasise that this is not an ordinary power. This is a very drastic power. Are we going to confer these powers on the Government even without resorting to these preliminaries? Even discretion is never made absolute. If it is absolute discretion, it is dubbed as absolute tyranny. Therefore, discretion is to be exercised according to law, according to justice and according to well-defined principles. Law has reached its finest moment of achievement when it sought to regulate discretion of even kings, of officers and even Judges. There is always danger in giving an unfettered discretion. As the provisions stand at present, these powers can be exercised even before the Government has conducted an investigation in the manner indicated. In the absence of such an investigation, it is open to the Government to say: we have come to a particular opinion; we have formed this opinion. The danger of arbitrariness and absolutism lurks there and our amendment seeks to do away with it. I hope the hon. Minister will give due consideration to this aspect of the matter.

Then, I come to my second amendment—No. 9 which seeks to do away with sub-section (3) altogether. The reason is not that I am very much against the provisions. I feel that there is considerable overlapping and these powers are not necessary. If as a result of transfer of shares change in the composition of the board of directors or change in the managing agency is likely to take place, then the Government can pass one of the two orders specified in this sub-section. But are there not ample powers under the other provisions of the Act? I shall briefly advert to them. Section 346 clearly states that no change in managing agency will remain in force for more than six months unless it is approved by the Central Government. Therefore, every change in the managing agency has to be approved by the Central Government. This further power, therefore, seems to be unnecessary. Likewise, section 409 says that if, as a result of transfer of shares, there is likely to be change in the management which would prejudicially affect the interests of the company, Government can pass an order asking such a change not to take effect. Are these powers not sufficient or enough? If they are not, what are the reasons? We would like to be satisfied before such drastic powers are taken. Again the expression "public interest" used here is wide. Public interest may be that the quality of the goods to be produced may suffer; maybe, the price may fall or the labour interests may suffer. Then, under the Industrial Regulation and Development Act, you have got ample powers. Are these powers not sufficient to meet the kinds of contingencies that would be visualised? Therefore, unless the Government gives cogent reason for equipping itself with these additional powers, we are not inclined to give these powers.

Now, I come in our amendment No. 91 which seeks to do away with sub-clause (2) of clause (3). We are objecting to the second kind of power. It says here:

"No resolution passed or action taken to effect a change in the composition of the Board of directors .....shall have effect unless confirmed by the Central Government."

This power visualises that a resolution has been passed and therefore a change has taken place in the composition of the board of directors. If so, it conflicts with what is stated in the main part because it says: "whereas as a result of transfer of shares a change in the composition of the managing agency is likely to take place....." It says that this state of affairs is likely to arise. But here we find that a resolution has been passed; a change has taken place; director has been appointed or removed. If this is the state of affairs, we fall to understand the reasonableness of this kind of power being conferred upon the Government. If we go to the clause as it stood in the Bill as it was introduced, we do not find this kind of power. There it does not visualise the second kind of power at all. It is uncalled for, unnecessary and does not fit in with the state of affairs. Therefore, I submit that all these amendments which are moved by us should be duly considered by the hon. Minister. With these words, I commend our amendments.

**Shri Morarka:** Mr. Speaker, I think, that clause 79 is one of the most important clauses and deserves very serious consideration of the House. Under this clause you are not only interfering with the managerial rights of shareholders but you are also abrogating their proprietory rights and therefore this clause 79 commends itself for the special attention of the House.

**14.09 hrs.**

[MR. DEPUTY SPEAKER *in the Chair*]

Before I come to the amendments which my hon. friend Shri Nathwani has just moved—they stand in our joint names—I would like to make a few general remarks about this clause. When I spoke at the time of general debate on this Bill, I said something about the proxy-pirates and also about protecting good management from the harassment of what I call blackmailers and professional shareholders.

I think, Sir, one can boldly ask of this Government to give such protection to the company management against such undesirable elements particularly when the entire Company Act is designed to impose so many restrictions and so many shackles on the management. You have given rights to the shareholders, you have given special rights to the minority shareholders and you have protected them—rightly, if I may say so—against the oppression of the majority. Having done that, I think there is an equal duty on the part of the Government to give protection to the management, that is the board of directors and others from these undesirable elements which are now coming up.

If I mistake not, there are only two sections in the Companies Act which give some such protection to the company management. One of them is section 250 which, Sir, we are now proposing to re-write by clause 79. The other is section 409 to which my hon. friend Shri Nathwani made a brief reference just now. But even the provisions of these two sections do not go for enough because they do not give any protection against blackmailers or proxy pirates. The only protection they gave is against the people whom I may call "corporate raiders".

Sir, this clause of corporate raiders is not so unknown in this country now as it used to be before, and it is now fast coming up. The country's economy has suffered under the attacks of these corporate raiders. I would like, therefore, to say in some detail about these corporate raiders, because I would very much wish that the Government take note of their activities and make enough provisions

[Shri Morarka]

against the activities of such corporate raiders, proxy pirates and also professional blackmailers.

It is not so easy, in the first place, to distinguish a corporate raider because he does not bear any special identifying marks. As a matter of fact, there are only two chief characteristics of a corporate raider. One is, he has money or an access to money and, secondly, he has a nose for the special situation. Then with the help of professional finders he just finds out his target *i.e.* the company which he is going to attack. He finds a company after he applies certain tests. Those tests have been very well enumerated by an American writer, and I think this House would benefit by making a note of how these corporate raiders are functioning there and how the same thing is being applied in a lesser degree in this country.

What are those tests which a corporate raider applies before he launches his attack? He selects a company which has got accumulated cash reserve, *i.e.* cash reserve which is not immediately needed by the company or the cash reserve more than what is needed for its actual business purposes. Secondly, he selects a company the shares of which are quoted, at a price lesser than their actual worth, in the market. Thirdly, he selects a company which has got hidden assets. Fourthly, he selects a company where the management shares have got some option, *i.e.* where the shareholders are entitled to have further shares because of their holding certain shares. Fifthly, he generally attacks a company which has got a very weak board of directors, where there is conflict of opinion among the directors.

**Dr. M. S. Aney** (Nagpur): 'Weak' means 'corrupt'?

**Shri Morarka:** Not necessarily corrupt, but where the directors themselves do not hold many shares and they are always at the mercy of the general body etc. Sixthly, another test is, negligence on the part of the shareholders and a company of which the shareholders are widely spread. If the shareholders of a company are widely dispersed over a wide area and they are not likely to come together, that is one type of company which this corporate raider attacks. Seventhly, the final test applied is on the working results of a company. In order to create some sort of dissatisfaction among the shareholders he selects a company which though otherwise sound does not show fairly good working results.

Mr. Deputy-Speaker, Sir, these are the characteristics for which, as I said, this corporate raider has a special nose. Once he selects his target, the company which he is going to attack, with the help of his professional finders, his next step begins. His next task is to accumulate the shares of that company. He goes on purchasing the shares of that company. He does not, generally, purchase the shares in his own name. He purchases shares in the name of *benamis* or, what is called in America, in the "street name". After having purchased the shares he takes his third step. That is, he comes out in the open. It is made known that he is the person behind all these purchases, he has got the controlling interest or, in any case, the dominating voice. He makes that announcement and the veil of secracy is pierced.

Then comes the final stage. In the final stage he goes to the board of directors, uninvited mostly, and makes a demand for representation in order to safeguard the interests of shareholders, whom he has never met and for whom he is never concerned. When that demand is refused—which is naturally likely to be refused—he enters into what is known as the 'proxy contest'. When he enters into the 'proxy contest' and the proxy battle starts, 99 out of 100 times he is successful in pushing out the old directors who knew something about

the company management and installing himself there.

**Shri Naushir Bharucha:** Does he justify clause 79?

**Shri Morarka:** I fully justify clause 79 subject to our amendments moved and I shall try to justify our amendments also.

**Shri Tangamani:** You are speaking against your amendment.

**Shri Naushir Bharucha:** So far.

**Mr. Deputy-Speaker:** He will qualify his observation when he comes to his amendment.

**Shri C. R. Pattabhi Raman** (Kumbakonam): He spoke about proxy pirates even during the general discussion.

**Mr. Deputy-Speaker:** That was very interesting.

**Shri Morarka:** What I am saying is, the powers given under clause 79 are powers which are necessary, in a way, to safeguard the rights of a good management. Those powers need certain qualifications, they need certain curbs. You cannot leave them entirely to the whim of the bureaucracy.

I was speaking about the corporate raiders. A corporate raider functions in three ways: (1) He risks his own money. Though his activities are undesirable, still one may not find fault with him because, after all, he is prepared to risk his own money and undertakes such an adventure. (2) His second way of functioning is, he resorts to what is known as "corporate pyramiding"; he invests the funds of one corporation in another, of a second one in the third, of the third in the fourth, of the fourth in the fifth and like that he goes on building up a pyramid.

**Shri Tangamani:** Like Mundhra.

**Shri Morarka:** That is how he makes the entire structure weak. If one link breaks the entire edifice collapses. (3) The third way he functions is, he does not either invest his own money to a large extent, nor does he resort to building up a corporate pyramidal, he only collects a group of share brokers or, what you may call, financiers. They form a group and they start either purchasing shares or canvassing proxies. Here, the major interests does not belong to anybody. It is a group, and then, their purpose is only very temporary, and that is, to upset the regular management of the company, so that their own directors—representatives may get in without any substantial stake in the company nor are they likely to have any substantial stake in future. These are the various activities of the undesirable corporate raiders which are being resorted to, to a great extent in other countries and to a smaller extent even here. I think that the intention behind sections 409 and 250 was mainly this: that before the management of a company is upset, you must satisfy yourself that the persons who are coming in are the genuine investors and that they represent really aggrieved shareholders who want a change in the management of the company and that they are not coming in the form of corporate raiders.

Now, as I said in the beginning, this corporate raider does not wear any special dress or has any special identification mark. How is the company to identify them? The American authorities have laid down one test and that is a very sure test. It was to ascertain the period for which he had been holding the shares. That test, according to them, is a very sure yardstick. If the person has been holding the shares for a long time and has been tying his fortunes with the fortunes of the company, he cannot be called a corporate raider. But, if a person just entered only three or six months ago and wants to dictate the terms to the company and disrupts the management and takes over the company, then certainly he would have the characteristics of a corporate raider. I think, apart from the Gov-

[Shri Morarka]

ernment preventing such corporate raiders, there should be a provision in the company law itself where a duty must be cast upon the management also to the effect that whenever they come to know of any such activity the management must take all the shareholders into confidence.

**Shri Naushir Bharucha:** How are you to define 'corporate raiders'?

**Shri Morarka:** I am afraid the hon. Member is not listening to what I have been saying.

**Shri Naushir Bharucha:** You are casting an obligation on the management.

**Shri Tangamani:** The hon. Member has been developing the point about the kind of evaders. Is it not proper then, that the two words which have been added in this amending clause, namely, 'or otherwise", are absolutely necessary?

**Shri Morarka:** I hope to satisfy the hon. Member, before I sit down, about this amendment. I would request him to wait and if he waits for a few more minutes, I am sure to attempt to give him such satisfaction as I am capable of. I was saying that a duty should also be cast upon the company to inform the shareholders about the activities of the corporate raider. But how are the companies to know about it? I think there are certain means by which the companies can suspect...

**Shri Naushir Bharucha:** How will the hon. Member legally define a corporate raider?

**Shri Morarka:** I said that one has to distinguish between a genuine investor and a corporate raider. I went further and said that there is only one test laid down by the American authorities and that test is the length of time for which the person has been holding the shares. Anyway, let us leave that point there for the time being. I go further and say that a company has certain means of knowing or of smelling a situation where such a raid is likely on the company. What are those means? First, some abnormal activities in the shares of the company. Any company can know whether on the stock exchange the shares are being sold or bought in a normal way or in an abnormal manner. Secondly, whether the share transfers are being received as usual in the ordinary course or whether there is concentration of transfer in particular names. Thirdly, there is what is known as the financial community. If the company is alert, it can also listen to the rumours in the financial community. These rumours are often very helpful in knowing whether there is going to be any attack on a particular company. Finally, whenever there is a demand from a company for a list of shareholders or of any other document of that nature, the company may suspect that there is going to be either a proxy battle or a raid on the company. Therefore, under such circumstances, I think, the company must feel warned and take the shareholders into confidence and give them the information and alert them against such activities of the corporate raider.

I was saying something about professional blackmailers. These are the people who have no real interest in any company; they purchase one or two shares which in some of the companies, the share value being only Rs. 10 or even less, they acquire for nominal investment.

**Shri Naushir Bharucha:** We understand all these aspects. What is he trying for through his amendments? When is he coming to his amendments?

**Mr. Deputy-Speaker:** He is coming to his amendments.

**Shri Morarka:** Sir, I think it is your province, and Shri Naushir Bharucha is not the Speaker of the House. He should not make inroads into your domain. However, I was referring to the professional blackmailers and

when I was about to say something more, I cannot understand why my hon. friend wanted me to stop. I personally consider that it is a very important aspect, especially when we are legislating for these companies and when we are giving so much protection to the minority shareholders, whose cause Shri Naushir Bharucha champions so very validly and so approximately, I think I have a right to say something also on behalf of managements and also seek the protection of this House for their proper and good management.

These professional blackmailers are becoming increasingly a menace. These people have no interest but they procure one or two shares to attend a general body meeting or to receive balancesheets and then create trouble and bad blood among all the other shareholders. Sometimes these people are outsiders! sometimes they are ex-employees and disgruntled directors or some such other interested persons. The ultimate aim of these persons is this: to resell their shares at a high premium. I have known these things, and if anybody is interested I can give a number of instances where a person makes himself a nuisance—he has just a nuisance value—and then the company directors who do not want to fight, generailly call these people and say, "You sell your shares" and they pay even a higher price and purchase them.

My point is, while in section 250, we have made certain provisions regarding the corporate raiders, we have made no provision at all against the professional blackmailers, or, what I called the other day, the proxy pirates. Since my hon. friend Shri Naushir Bharucha is anxious to speak and he wants me to come to my amendments, I will bow down to his wishes and come to my amendments Nos. 89, 90 and 91. There three amendments have been moved by my hon. friend Shri Nathwani and he explained the purpose behind them. The only point that I wish to make is, section 250 is the operative section for sections 247, 248 and 249. Sections 247, 248 and 249 relate to the investigation about the ownership of shares. If the ownership of certain shares is not known, then, under section 250, the Government can impose certain restrictions. Unless one carries on some investigations under sections 247 to 249, how is one to know whether the ownership of a particular share is known or not? You must make some enquiries. Suppose you want to find out the facts about certain shares, unless you make some enquiries and call upon somebody to give the information, how are you to know whether it is *benami* transaction or he is the real owner or whether he is not the owner at all of those shares? I think that as soon as you find the real owner of the shares—when the ownership of the shares is known—whatever other consequences may follow, you cannot take action under section 250(1). In other words, you cannot deprive a shareholder of his propritory rights if the proprietor of the shares is not known. But once the proprietor is known you may deprive him of his rights of control and rights of management. You cannot, however, interfere with his proprietory rights, namely the right to receive dividends, the right to receive right shares and the right to receive a share in the assets of the company in case of liquidation, etc. Without there being a *prima facie* investigation, *i.e.* investigation under one of the three sections, how are you to know whether there is any real owner of the shares or not.

**Mr. Deputy-Speaker:** Will the hon. Member like to continue next day, or will he like to conclude now?

**Shri Morarka:** I shall continue on the next day.

**Mr. Deputy-Speaker:** He will continue on Monday. The House will now take up non-official business.