*Discussion Draft*
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# Protection of Investors' Interest : Intention and Implementation
# A Case Study of the Concept of Companies Under the Same Management

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September 1993

An examination of the provisions of Companies Bill, 1993 relating to treatment of companies under the same management and those in the existing Companies Act, 1956 indicate that the changes suggested in the Bill leave a few important areas untouched, that deserved serious rethinking, more particularly in the wake of recent developments relating to structure of corporate sector and the capital market in India and abroad. Needless to say the concept of investor protection is more relevant in the case of those companies whose shares are traded on stock exchanges.

Section 370 (1-B) of the Companies Act and corresponding clause 387(3) of the Bill define the companies that are to be treated as 'companies under the same management'. These provisions deal with the loans etc. to and from companies under the same management. Clause 387, which seeks to replace Section 370, differs from the Section in a few respects. But Criterion for identifying 'companies under the same management', remained untouched. As the definition, in the present context, has a number of significant implications, this note attempts to illustrate the inadequacy of the definition and the consequential failure of other regulatory provisions which rely on the same and offers a few suggestions in this regard.

## The Background

About three decades ago, amendments to Section 372 of the Companies Act, 1956 through Companies (Amendment) Act, 1960 sought to regulate investments beyond certain prescribed limits by a company in other bodies corporate, whether in the same group or outside the *group* as the investing company. The scope of the provisions was extended in 1965 to inter-company loans by changes introduced through the Companies Amendment Act (XXXI of 1965). The rationale behind placing loans at par with investments was elaborated by the Vivian Bose Commission (1962), on whose recommendations the amendments were based, in the following words:

> We feel that inter-company loans should rank at par with inter-company investments for the simple reason that results flowing from both types of transactions are practically the same. Accordingly, we should suggest some limit on the amount of loans that can be advanced to companies in the same group, and if the loans were to exceed the specified limits, then it shall be necessary for the lending company to obtain the prior approval of the Central Government. The approval of the Central Government should follow the sanctioning of the loan by the company itself by means of a special resolution".

The Commission's recommendations were a result of their finding that :

> Our investigations disclose that the funds of public limited companies, banks and insurance companies were improperly used for buying shares of other companies with large accumulated resources and substantial liquid resources in order to obtain control over them.... We are aware that this is frequently done in the commercial world and we are not questioning the practice as such. But in companies that we are examining this was done with improper ends. The object was to use the accumulated funds of these companies for the benefit of the D.J. Group (Dalmia Jain Group) or R. Dalmia, or for the benefit of the companies some private, in which the group or R. Dalmia were interested. That again would not necessarily be improper. But in these cases it was always the public companies that suffered and the investing public along with them. *The wrong lay in the fact that those who were in control wrested improper advantage for themselves from the companies that they controlled and let the companies under their control suffer.* (emphasis added)

Therefore, provisions relating to investment in the bodies corporate under the same management also became applicable to loans given to bodies corporate under the same management. The definition of companies under the same management(CSMs) provided in sub-section (1B) of section 370 (dealing with inter-company loans etc.) subsequently became a standard definition for various purposes.

In October 1991, with a view to providing for greater disclosure of information about a company a few changes were introduced in the format of prospectus. Of various such changes one was to make it obligatory on the part of companies issuing capital to inform a few particulars about the listed companies under the same management within the meaning of section 370 (1B), which made any capital issue during the preceding three years. This information is also supplied in abridged prospectus that accompanies the application form for allotment of securities as also the letter of offer in the case of rights issues.

SEBI's insider trading regulation, 1992 also uses the definition of companies under the same management as defined in Sub-section 1B of Section 370 of the Companies Act as one of its criterion. The SEBI regulations for determination of insider companies define a company `to be deemed to be a connected person' for insider trading, as `a company under the same management or any subsidiary company thereof, within the meaning of subsection *(1B) of 370, or subsection (ii) of section 372 of the Companies Act, 1956 (emphasis added*) or sub-clause (g) of section 2 of the MRTP Act, 1969 as the case may be'. It may, however, be noted that the criteria for determining CSMs as defined in sub-section (1B) of 370 and subsection (ii) of section 372 of the Companies Act are the same. Therefore, there is no additionality due to the mention of both the sections of the Companies Act, 1956.

**Inadequte Criteria for CSMs**:

The inadequacy of the criteria under Section 370 (1B) to satisfactorily represent corporate reality comes out sharply from a perusal of large company annual reports and prospectuses. A select list of companies which claimed that there were no companies under the same management as defined under section 370 (1B) is given in Tables I & II illustrate this point clearly. Some of the prominent ones belonging to large industrial houses falling in this category are: Tata Sons Ltd., Bajaj Auto Ltd., Century Textiles & Inds Ltd., Shaw Wallace & Co Ltd., Kirloskar Brothers Ltd., Mafatlal Industries Ltd., Mahindra & Mahindra Ltd., J.K. Synthetics Ltd., TISCO, TELCO, Greaves Cotton & Co Ltd., Ballarpur Industries Ltd., Onida Savak Ltd., Ceat Financial Services Ltd., Bombay Dyeing & Mfg. Ltd., Premier Automobiles Ltd., Mcdowell & Co Ltd., etc. The list is based on either the auditor's report of the respective companies or the company's own declaration in the prospectus. Interestingly McDowell & Co. Ltd. provided the issue details of UB Ltd., Herbertsons Ltd., UB Petroproducts Ltd., Mangalore Chemicals & Fertilizers Ltd., Best & Crompton Engineering Co Ltd., and Western India Enterprises Ltd which according to the company were "group companies, not within the meaning of Sec. 370(1B), which made capital issues in the last three years". The case of Ballarpur is also a typical one. The company while claiming in its prospectus (issue dated April 6, 1993) that "There are no listed companies under the same management within the meaning of section 370(1B) of the Act" went on describing issues by "Associate/Group" companies such as Crompton Greaves Ltd., English Indian clays Ltd., Greaves Cotton & Co Ltd., JCT Ltd and The Waterbase Ltd. The company's auditors merely stated in its Annual Report that:

> The Company has not granted any loans, secured or unsecured, to companies, firms or other parties listed in the register maintained under Section 301 of the Companies Act, 1956 or to the companies under the same management as defined under Sub-section (1B) of Section 370 of the Companies Act, 1956.

The Auditors reported similarly in the case of loans taken from such parties. The Company had 10 subsidiaries in 1991-92. Except English Indian Clays Ltd each one of the subsidiaries was given unsecured loans by their immediate holding company or the ultimate holding company *i.e.*, Ballarpur Industries Ltd. From this example two things become apparent. *One*, merely because the auditors have not reported that there were no CSMs one should not take it for granted that the company has admitted that there were such companies. Secondly, even if a company admitted that there were CSMs it does not necessarily mean that the criteria for the same management covered all companies of the group. This throws up the possibility of many more large companies effectively avoiding the criteria for same management.

**Table I**

**Select List of Companies Whose Auditors Reported that There Were No Companies Under the Same Management**

**Bajaj**

Bajaj Auto Ltd (1991-92)
Bajaj Hindustan Ltd (1991-92)
Mukand Ltd (1991-92)

**Birla**

Birla Cotton Spg & Wvg Mills Ltd (1988-89)
Century Textiles & Inds Ltd (1988)
ECE Industries Ltd (1989-90)
Grasim Industries Ltd (1988-89)
Hindustan Motors Ltd (1991-92)
Hyderabad Industries Ltd (1991-92)
Indian Rayon & Inds Ltd (19921-93)
Indo-Gulf Fertilisers & Chemicals Co Ltd (1988-90)
Kusum Products Ltd (1991-92)
Mangalam Cement Ltd (1988-89)
Mangalam Timber Products Ltd (1988-89)
Mysore Cements Ltd (1991-92)
National Engineering Industries Ltd (1991-92)
Oudh Sugar Mills Ltd (1988-89)
Texmaco Ltd (1990-91)
VXL India Ltd (1991-92)

**Chhabria**

Dunlop India Ltd (1991-92)
Shaw Wallace & Co Ltd (1991-92)

**Chowgule**

Chowgule Steamships Ltd (1991-92)

**DLF**

DLF Universal Ltd (1991-92)

**Dalmia**

Dalmia Industries Ltd (1991-92)
GTC Industries Ltd (1991-92)

**Escorts**

Goetze (India) Ltd (1988-89)

**Foreign***

BASF India Ltd (1992-93)
Bayer (India) Ltd (1991-92)
Birla Yamaha Ltd (1991-92)#
Boots Pharmaceuticals Ltd (1991-92)
Coates of India Ltd (1991-92)
Corn Products Co (India) Ltd (1990-91)
Cynamid India Ltd (1990-91)#
Dewrance Macneill & Co Ltd (1991-92)#

Duphar-Interfran Ltd (1990-91)
E Merck (India) Ltd 1991
Eternit Everest Ltd (1991-92)
Fag Precision Bearings Ltd (1991-92)
Glaxo India Ltd (1991-92)
Goodyear India Ltd (1991)
Grindwell Norton Ltd (1991-92)
Hero Honda Motors Ltd (1988-89)#
ITC Ltd(1991)
India Photographic Co Ltd (1988-89)
Indian Dyestuff Industries Ltd (1991-92)
Indian Sewing Machine Co Ltd (1990-91)
KSB Pumps Ltd (1992-93)
Nestle India Ltd (1988-89)
Peico Electronics & Electricals Ltd (1990-91)
Porrits & Spencer (Asia) Ltd (1991-92)
Rhone-Poulenc (India) Ltd (1989-90)
Shriram Honda Power Equipment Ltd (1988-89)#
Taylor Instrument Co (India) Ltd (1991-92)#
Union Carbide India Ltd (1991-92)
VST Industries Ltd (1985-86)
Vespa Car Co Ltd (1990-91)
Vickers Systems International Ltd (1991-92)
Wartsila Diesel (India) Ltd (1991-92)#
Zuari Agrochemicals Ltd (1992-93)#
(* In each of these 25 per cent or more equity is held abroad. # Indian industrial houses are partners in these companies)

**J.K. Singhania**

Ganges Fertilisers & Chemicals Ltd (1988-89)
JK Industries Ltd (1991-92)
JK Synthetics Ltd (1988-89)
Key Leasing & Finance Ltd (1988-89)
Raymond Woollen Mills Ltd (1988-89)

**Tata**

Associated Cement Cos. Ltd (1991-92)
Associated Tyre Machinery Co. Ltd (1991-92) subsidiary of Associated Cement Cos. Ltd
Forbes Gokak Ltd (1991-92)
GNP (Madras) Ltd (1991-92)
Goodlass Nerolac Paints Ltd (1991-92)
Hitech Drilling Services India Ltd (1991-92)
Indian Hotels Co Ltd (1991-92)
Lakme Ltd (1991-92)
Rallis India Ltd (1990-91)
Special Steels Ltd (1991-92)
Stewarts & Lloyds of India Ltd (1991-92)
Tata Engineering & Locomotive Co Ltd (1990-91)
Tata Iron & Steel Co Ltd. (1991-92)
Tata Sons Ltd
Tata Telecom Ltd (1989-90)
Tata-Robins-Fraser Ltd (1991-92)
Voltas Ltd (1988-89)

**Table II**

**Select List of Companies which claimed in their Prospectuses that there were no Companies/No Listed Companies Under the Same Management or which Accepted only a Limited Relationship**

| Name of the Company/Issue Date | Remarks |
|---|---|
| The Waterbase Ltd<br>June 29, 1992 | The company claimed itself through its prospectus to be a Thapar Group company. The promoters of the company include Karamchand Thapar & Bros (Coal Sales) Ltd, Chohal Investments Ltd (a subsidiary of JCT Ltd). The prospectus mentions that "There is no company under the same management within the meaning of Section 370 (1B) of the Act". (p. 14) |
| Usha Services & Consultants Ltd<br>January 14, 1993 | Promoted by Shri Vinay Rai, Chairman of Usha Rectifier Corp (I) Ltd and Usha Ispat Ltd. The company also claimed that these two companies belonged to the group but declared that: ". |
| Citicorp Securities & Investments Ltd<br>June 29, 1992 | The company claimed itself to be an affiliate of Citibank Overseas Investment Corp (COIC), a wholly owned subsidiary of Citibank N.A. According the prospectus "COIC operates through various subsidiaries in different countries across the globe, its activities spanning financial services like capital structuring and underwriting, debt and equity positioning, local and cross-border leasing as well as information and software business".<br>It mentions that "There is one another company under the same management within the meaning of Section 370 (1B) of the Act. The name of this company is Citicorp Overseas Software Ltd." |
| Reliance Polyethylene Ltd<br>November 12, 1992 | The prospectus mentions neither this company nor any other company under the same management (within the meaning of Section 370 (1B) of the Act) have made any public or rights issue of capital during the last three years, nor is there any listed company under the same management. (emphasis added)<br><br>Both these companies have Reliance Industries Ltd and Itochu Corp of Japan as co-promoters. |
| Reliance Polypropylene Ltd<br>November 12, 1992 | |
| MIRC Electronics Ltd<br>November 11, 1992 | The prospectus terms on the cover that the company was the **Pride of Onida**. Further, it mentions that the other listed companies promoted by the promoters are: Onida Saka Ltd, Onida Savak Ltd and Monica Electronics Ltd. However, it claimed that "There are no listed companies under the same management as defined under Section 370 (1B) of the Act". |
| McDowell & Co. Ltd.<br>November 5, 1992 | At the top of highlights on the cover page the company claimed itself to be "Flagship Company of the UB Group". The prospectus claimed that there were no companies within the meaning of 370 (1B). However, McDowell provided a list of other group companies specifically mentioning that they do not come under the meaning of Section 370 (1B). These are: UB Ltd., Herbertsons Ltd., UB Petroproducts Ltd., Mangalore Chemicals & Fertilisers Ltd., Best & Crompton Engineering Co Ltd., Western India Enterprises Ltd.(??) |

| Name of the Company/Issue Date | Remarks |
|---|---|
| Jindal Iron & Steel Co. Ltd May 10, 1993 | While declaring Jindal Strips Ltd and Jindal Ferro Alloys Ltd as the group companies, the company stated that Jindal Strips Ltd was the only company under the same management within the meaning of Section 370 (1B) of the Companies Act, 1956. |
| Monet Ispat Ltd June 21, 1993 | The prospectus of the company claimed that it was jointly promoted by Jindal Strips Ltd. However, it declared that there was no listed company under the same management within the meaning of Section 370 (1B) of the Companies Act, 1956. |
| Tata Metaliks Ltd May 18, 1993 | "There are no listed companies under the same management within the meaning of Section 370 (1B) of the Act, which have made any public issue of capital in the last three years preceding the date of this Prospectus." (p.17) |
| Ballarpur Industries Ltd April 6, 1993 | While declaring that there were no listed companies under the same management within the meaning of Section 370 (1B) of the Companies Act, 1956 the company termed Crompton Greaves Ltd., English Indian Clays Ltd., Greaves Cotton & Co Ltd, JCT Ltd and The Waterbase Ltd as associate/group companies. |
| Chambal Fertilisers & Chemicals Ltd April 15, 1993 | The company was promoted by Zuari Agro Chemicals Ltd which was registered under the MRTP Act as part of the Birla Group. |

**The Criteria for CSMs**:

The Companies Bill, 1993 introduced in the Parliament in May this year did not make any changes in the criteria for CSMs. The clause dealing with their definition is 387(3). The criteria for identifying companies under the same management common to Clause 387 (3) of the Bill and Section 370(1B) are as follows:

Two bodies corporate shall be deemed to be under the same management:

(i) Common Managing Director: if the managing director or manager of the one body is managing director or manger of the other body; or

(ii) Majority Common Directors: if a majority of the directors of the one body constitute, or at any time within the six months immediately preceding constituted, a majority of the directors of the other body; or

(iii) One-third Voting Power: if not less than one-third of the total voting power with respect to any matter relating to each of the two bodies corporate is exercised or controlled by the same individual or body corporate; or

(iv) Holding Company is a CSM: if the holding company of the one body corporate is under the same management as the other body corporate within the meaning of clause (i), or clause (ii) or clause (iii); or

(v) Majority of Shares held by Directors & Relatives: if one or more directors of the one body corporate while holding whether by themselves or together with their relatives, the majority of shares in that body corporate also hold,

whether by themselves or together with their relatives, the majority of shares in the other body corporate.

We shall examine these criteria in detail in the given order.

(i) Common Managing Director: It is highly unlikely that Managing Directors of large companies would simultaneously hold Managing Directorship of other companies. Indeed, some of these have more than one Managing Director or Wholetime Directors, Presidents, Vice-Presidents or Joint Managing Directors.

(ii) Majority Common Directors: Coming to the requirement of common majority directors, in practice it could easily be circumvented. As shown by Ramaiya's guide to Company Law, if in a Company A, the total number of directors is three and in Company B, seven, even if all the three directors of Company A are the directors of Company B, the majority of the Company A do not constitute a majority of the directors of Company B. It is relevant here to understand the role of non-executive Directors or for that matter any individual director. It is not also difficult to imagine that in case of necessity companies would adjust the composition of the Board suitably. Given the reality of the Indian corporate sector if any group of shareholders can fill a director they are more or less sure to elect all the vacant positions with their own men since the same set of votes can be cast for each of the vacancies. In spite of the provision in the Companies Act for proportional representation not many are known to avail of it. Except for the nominee directors, it would not be wrong to say that the remaining Directors are there on the Board at the pleasure of the controlling interests. In any case, the nominee directors are known to support the incumbent management. It is not be easy for the directors who do not have any controlling interest to influence a company's policy or take or give loans of substantial amount. In any case Board's approval would be necessary in cases involving such transactions.

(iii) One-third Voting Power: In this case it should be noted that in not many cases of large companies with huge market capitalisation any single party/individual would be able to hold one-third share. At best, one could cover the subsidiary and associate companies and not the major companies in the group. If the groups so wish they can easily split up the equity and hold the same in the name of more than one company to avoid 370 (1B).

In any case, it is very unlikely that in case of a dominant company in a group, one-third of the equity will be held by any other company of the group. Yet, in practice, this fact does not mean that the dominant company is not a part of the group. Take for example the ITC group. ITC Hotels Ltd (a subsidiary of ITC Ltd.) reported that there was only one CSM as defined under Section 370 (1B) namely, ITC Bhadrachalam Paper Boards Ltd. ITC has a 38.6% of

holding in ITC Bhadrachalam Paperboards Ltd. (Prospectus p. 16). On its part ITC Ltd claimed that there is no CSM as defined under subsection (1B) of section 370 of the companies Act 1956 (Annual Report 1991, p. 23). It means that a dominant company of a group with a large amount of equity, despite having substantial stake (minimum 1/3) in other group companies can easily avoid Section 370(1B). The reason is there is no same individual or body corporate which has minimum one-third of share capital of both the companies i.e. the dominant company of the group as also other companies in the group; in this case, the ITC Ltd and ITC Bhadrachalam Paperboards Ltd. So the companies, in which ITC has at least one-third share would report that they are under the same management. But ITC Ltd itself would not. While ITC would be technically correct to report that there are no CSMs as defined under 370 (1B), the fact remains that there is a group of much larger number of companies which are run under a broad common authority, direction, control and which work towards a common objective.

(iv) Holding Company is a CSM: In view of the weaknesses of criteria (i), (ii) and (iii) explained above, criterion (iv) would also fail to get the larger companies of a group within the ambit of 370 (1B) as it is solely dependent on them.

(v) Majority of Shares held by Directors & Relatives: The last criterion also does not take corporate realities into account. In most of the cases of large companies with huge paid-up capital, what an individual director or all directors together with their relatives own does not happen to be a significant part of total paid-up capital, not to speak of majority of paid-up capital. In such a situation it would be naive to expect that this criterion would be able to ensure desired results.

**Specific cases of two Reliance Group Companies:**

We have shown in the foregoing that many large companies are able to avoid the CSM criteria and also explained the deficiencies of the criteria which seem to be responsible for the present state of affairs. The case of the two Reliance group companies *viz.*, Reliance Polyethylene Ltd (RPEL) and Reliance Polypropylene Ltd (RPPL) may further help in understanding the mechanisms available to large houses to avoid 370(1B). How these companies could avoid inter-linkages at the Board level makes an interesting and useful study. There were six directors on the Board of RPEL. Besides the two sons of Shri Dhirubhai Ambani, namely, Shri Anil D. Ambani and Shri Mukesh D. Ambani who are also on the Board of RPPL no other director is common to the two companies. The particulars of other directors of RPEL as reported by the company are as follows:

| Name of the Director | Position In the Company | |
|---|---|---|
| Shri H.S. Kohli | President Petrochemicals division | Reliance Industries Ltd |
| Shri Kanakray Trivedi | Senior Vice-President (Non-Technical) & President Petrochemicals division | Reliance Industries Ltd |
| Shri K.P. Nanavaty | Senior Vice-President (Marketing) | Reliance Industries Ltd |
| Shri Sandeep Junnarkar | Solicitor, Senior Partner | M/s. Kanga & Co., Solicitors |

RPPL also has six directors. The following are the four directors who are not common to RPEL.

| Name of the Director | Position | In the Company |
|---|---|---|
| Shri P.N. Devarajan | Group President, (Corporate Development & Planning) | Reliance Industries Ltd |
| Shri J.S. Bakshi | President (Commercial) | Reliance Industries Ltd |
| Shri P.S. Balasubramanian | President (New Projects) | Reliance Industries Ltd |
| Shri Atul S. Dayal | Solicitor, Senior Partner | M/s. Kanga & Co., Solicitors |

From the above it becomes clear that the companies could avoid the criteria for same management by carefully placing the senior management personnel of Reliance Industries Ltd (RIL) on their respective Board of Directors. They could also successfully avoid being termed so with RIL. At the first glance it looks as if there is at least one outside Director on each of the Boards. On a closer examination it, however, turns out that M/s. Kanga & Co. are retained as Solicitors & Legal Advisors by not only RPPL and RPEL but also by RIL.

Thus, while all the Directors of RPPL and RPEL are closely related to RIL management, both the companies could manage to declare that "within the meaning of Section 370 (1B) of the Act there is no other listed company under the same management" thereby effectively defeating the provisions. On the shareholding side too one finds an interesting practice. Each of the companies had the equity participation of different sets of four investment and trading companies (termed as Indian promoters) besides RIL as the co-promoter and Itochu of Japan as the foreign collaborator. As per the issue details none of the Indian companies would be having more than 32 % share in either RPEL or RPPL. Needless to say, the general perception and the public participation in these companies would be influenced by their association with Reliance and Itochu and not because the companies were promoted by Riaz Trading or Sanatan Textrade, two of the promoter companies. It is also relevant to note that neither RPEL nor RPPL deemed it necessary to declare that any of the Directors were interested in the engagement of Reliance Capital & Finance Trust Ltd (Advisers to both the issues) and Reliance Consultancy Services Ltd (Registrars to both the issues -- also Registrars and Share Transfer Agents to RIL) as none of the Directors of RPEL and RPPL were on the Boards of these two companies.

**Status of Subsidiaries**:

Further, it is surprising that as per the criteria above, subsidiaries would not be deemed to be under the same management as that of the parent company. Are subsidiaries left out because in any way their interests coincide with those of parent/holding companies

as they are very often wholly owned. But, can one rule out the possibility of outside shareholding in subsidiaries? Foreign subsidiaries ofcourse, are a case in point. There are Indian companies too. For instance, Shivaji Works Ltd., itself a subsidiary of Kirloskar Oil Engines Ltd (also a listed company), claimed in its prospectus that there were no listed companies under the same management. This is irrespective of the fact that there are a number of other Kirloskar house companies whose shares are listed on stock exchanges. Similar is the case with McDowell Ltd. - a subsidiary of UB Ltd. This gives raise to a further point that whether one can completely equate the interests of a subsidiary company with those of the parent company? If so, why should these not be treated under the same management. If not, why should the parent company extend facilities at terms which often go against market principles. The involvement can take different forms. The subsidiaries can be given interest free loans, parent company's personnel can look after all the requirements of the subsidiary or the subsidiary can be given rent free accommodation for its office and so on. Probably such a dilemma is reflected in the auditors' reports of some prominent companies. For example, the auditors of Reliance Industries Ltd reported in the following manner:

> The Company has not granted any loans, secured or unsecured, to companies, firms or other parties listed in the register maintained under Section 301 and/or to the Companies under the same management as defined under sub-section (1B) of Section 370 of the Companies Act, 1956, except interest free loans to its subsidiary companies. In our opinion, having regard to the long term involvement with the subsidiary companies and considering the explanations given to us in this regard, the terms and conditions of the above are not, prima facie, prejudicial to the interests of the Company. (Annual Report (abridged) of Reliance Industries Ltd 1989-90, p. 14)

If subsidiary company's interest actually coincides with that of the parent why should the auditors of the subsidiary certify that certain transactions with the parent company are not prejudicial to the interests of the company. It gives raise to a strange situation that while the auditors of the parent company certify that giving interest free unsecured loans to subsidiary companies was not prejudicial to the interest of the parent company the same auditors of also certify in case of that the subsidiary taking such loans was not prejudicial to the interests of the subsidiary.

**Misplaced Emphasis to this Convincing**:

One unstated assumption behind all these provisions seem to be that the Boards of Directors are prone to misuse company funds of the company and that the shareholders, the real owners of these companies should be protected from any losses that might arise from such misuse. This again ignores one reality of the corporate sector. Are in India ownership and management so much divorced as they are in some developed countries that the management should be seen in isolation of the controlling interests? How many of the large

publicly traded companies are professionally managed without the controlling families having varying degrees of direct control over the day-to-day affairs of such companies? There is considerable evidence which indicates that certain sections of Indian large corporate sector have perfected the art of manipulating corporate funds to individual families' advantage. They operate through large networks of companies (often private limited), trusts, partnership firms which need not necessarily be covered by either Section 301 or 370 of the Companies Act, 1956.

**Applicability to Foreign Companies**:

What is the scope of Section 370 (1B) in case of foreign companies? The Act/Bill seem to be silent in this respect. But with some of the foreign subsidiaries and other minority held companies claiming that there were no companies under the same management it is possible that this provision is not being extended to affiliates of transnational corporations. One, however, finds exceptions to this: e.g. Ingersoll Rand India Ltd., Bata India Ltd., etc. which give details of loans/dues, etc. against companies incorporated in other countries which the companies term as 'companies under the same management'. Do these cases suggest that the decision is left to the individual companies and their auditors or are they reporting these out of abundant caution?

**Evolving Effective Criteria and their Implementation**:

It may be mentioned in this regard that even the much talked about criteria for inter-connection under the MRTP Act failed to take note of corporate realities in full. Apprehensions were expressed when the criteria under Section 2(g) were strengthened that it would lead to illogical grouping of companies. It was feared by corporate circles that due to enhanced scope of the criteria even those entities would be termed as inter-connected which in effect were not so. But, this did not happen. Except those of a few trusts of the M.K. Mohta group none of the hundreds of trusts and other entities belonging to large industrial houses could be covered by the Act. Indeed, persons belonging to some of these houses have floated new companies without recourse tothe MRTP Act and have even offered shares to the public.

It may be interesting to note that Escorts Farms (Ramgarh), the top most private shareholder in Escorts Ltd was not registered under the MRTP Act. In other words, even under the criteria of inter-connected undertakings mentioned in the Act which is considered quite comprehensive by corporate circles, the top most private shareholder company of Escorts Ltd namely, Escorts Farms (Ramgarh) could avoid being termed as inter-connected undertaking of Escorts Ltd.

Even some of the undertakings registered under the MRTP Act continued to claim non-inter-connection. The lengths to which the Company Law Board had to go to establish certain companies' inter-connection with large houses reflect the ground reality as also the extent to which one needs to go to establish relationship.

The case of Reliance Group described earlier, along with the evidence gathered by us regarding registration of multiple number of companies not only by certain networks but also possibly by many large industrial houses amply demonstrate the magnitude of the problem the regulatory authorities need to face. While the criteria under 2(g) of the MRTP Act is still alive, there is no corresponding mechanism and infrastructure to oversee the phenomenon. In the present situation it is doubtful if the SEBI would be able to go into antecedents of hundreds of companies everytime the need arises.

**Implications of the Failure:**

It, therefore, becomes evident that in numerous cases, the corporate structures are too complex and complicated to be covered by the definition provided by Section 370(1B) which also means the corresponding clause 387(3) of the Bill. On the other hand, due to lack of any such mechanism which may collect and monitor information relating to developments in the corporate sector, the intention of better corporate information disclosure has been reduced to a formality not serving any useful purpose. Given the limitations of the criteria under section 370(1B), the companies issuing securities are free not to report about all the group companies. They may report only about the ones, which may be advantageous for the purposes of displaying better performance of the management and keep silent regarding poorly performing companies, which otherwise are part of group. This has serious implications for corporate information disclosure practices. In effect, the well intended move to ensure better disclosure by getting a few particulars relating to companies under the same management does not seem to produce the desired results. This needs to be corrected. For that a comprehensive group approach needs to be adopted which includes all public and private limited companies and other entities of a group. The need is for regular monitoring on the part of some official organisations to collect and have information about the firms of a particular network so that investors may know about the real state of affairs and not the one which the management of a company may give at its own discretion of course satisfying the provisions. A comprehensive and up-to-date information base may be a tool to ensure better information disclosure as also to deter the unscrupulous promoters from pursuing undesirable practices. Indulging in insider trading and circumventing take over code are a few examples in this regard. Experts, investors and authorities would do better to evolve measures to tackle this issue, which is assuming increasing significance in wake of growing dependence of corporate sector on capital market.

When the criteria for CSMs were initially developed the issues relating to better information disclosure for investors did not figure as that of significance. The criteria could not obviously take into account the various other uses the concept may be put to. But now with changed conditions of the capital market, the issues relating to better information disclosure are at the centre-stage of debate on capital market and corporate sector. What, therefore, is needed is a fresh thinking on the criteria of identifying CSMs in the context of present conditions. In other words, the provisions should respond to the wider uses which

they might be put to and not specifically to giving and taking of loans. It is understandable that those affected by regulatory provisions would continuously strive to defeat the hurting provisions. In the normal course, one expects that the policy makers would keep in touch with reality and reframe the regulations accordingly. This unfortunately did not happen with the CSM criteria. Just as the criteria for inter-connection under the MRTP Act was modified to reflect corporate reality better similar steps should have been taken in this case too.