Chapter 1 Introduction

1.1 History of Company Legislation in England

Company Legislation in India owes its origin to the English Company Law. The Companies Acts passed from time to time in India have been following the English Companies Acts, with certain modifications. Even the Companies Act, 1956, it is said, closely followed the U.K. Companies Act, 1948. In London, the earliest business associations during the 11th to 13th centuries were called the ‘merchant guilds’. These guilds obtained charters from the Crown mainly to secure for their members, a monopoly in respect of particular trade or commodity. These associations were either formed a ‘Commenda’ or ‘Societas’. ‘Commenda’ operated in the form of partnership, the financier being a sleeping partner with limited liability. The liability was basically borne by the working partners. In ‘Societas’, on the other hand, all the members took part in the management of the trade and had unlimited liability, more in line with the present day partnership.

In the 14th century, the word ‘Company’ was adopted by certain merchants for trading overseas. This was, more or less an extension of the merchant guilds in foreign trade. By the end of 16th century Royal Charters granted monopoly of trade to members of the Company over a certain territory. These companies were called regulated Companies. East India Company was one of such regulated companies established by a Charter in 1600. It had monopoly of trade in India; its members could carry on trade individually and had the option to subscribe to the joint fund or stock of the company. After such voyage, the profits made, together with the subscribed amount, were divided among the members. In 1653, however, a permanent subscribed fund was introduced, called joint fund or stock of the company. Accordingly, the term joint stock came into use. The profits were, however, shared at the end of each voyage. By the end of 17th century all these companies or merchant guilds any many regulated companies which the Crown had incorporated, meanwhile had established permanent fixed capitals represented by shares which were freely saleable and transferable. The property with which
The companies treated was recognised as being under the exclusive control of their governors or directors for the purpose of carrying on these undertakings and was not available for division between members at intervals of time.

At this time the only method of obtaining the incorporation of a company was by Royal Charter or by an Act of Parliament. These methods of incorporation were quite expensive and time consuming. Consequently, many companies were formed by agreement without incorporation. As a result, the first 20 years of 18th Century witnessed a flood of speculative and often fraudulent schemes of company floatation’s of which the notorious schemes of the South Sea Company is the best known example. The South Sea Company had a scheme to acquire virtually the whole of the national debt (approx. £ 31,000,000) by purchasing the holdings or exchanging the holdings for the stock of the company. The possession of interest-bearing loan owed by the State was a basis on which the company might raise vast sums to extend its trade. This theory was not necessarily unsound—it was indeed a logical extension of the principle upon which the Bank of England, and the South Sea Company itself, had been originally formed but unfortunately, the Company had very little trade to expand. It had paid a huge sum of money for obtaining the charter in competition with the Bank of England. Ultimately, the company failed. In 1720, the British Parliament came down heavily on such companies in order to check the orgy of speculation in shares and securities which had reached its heights. Consequently, the Bubble Act, 1720 was passed. The Act prohibited generally the use of the form of corporations unless a corporation was authorised to act as such by an Act of Parliament or Royal Charter. However, it exempted all undertakings operative especially before June 24, 1978. With the passing of the Act companies disappeared like the bursting of the bubble.

Although the Bubble Act held up the development of capital market for a century, it did not destroy the unincorporated company. To avoid the rigours of the Act, large partnerships were formed. The parties to the deed agreed to be associated with a joint fund or stock divided into number of transferable shares and agreed to alteration of the provisions of the deed by a specified majority. They
delegated the management to the directors. The property was vested in a body of trustees which was also given powers to sue or be sued on behalf of the company.

In 1825, the Bubble Act was repealed. In 1834, the Trading Companies Act, 1834 was passed empowering the Crown to confer by Letters Patent any of the privileges of incorporation except limited liability, without actually granting a Charter. The Chartered Companies Act, 1837 re-enacted the Act of 1834 providing for the first time that personal liability of members might be expressly limited by the Letters Patent to a specified amount per share.

In 1844, the Joint Stock Companies Act was passed for the first time. This Act provided for the registration of Companies with more than 25 members or with shares transferable without the consent of all the members. It also provided for incorporation by registration. The Act for the first time created the office of the “Registrar of Companies” and required particulars of the Company’s constitution, changes therein and annual returns to be filed with the Registrar so that there would be full record retained officially.

Limited liability, however, was still excluded. Although the company became incorporated, the personally liability of the members was preserved, but their liability was to cease three years after they had transferred their shares by registered transfer and creditors had to proceed first against the assets of the company. Members could only escape personal liability by providing in its contracts, as unincorporated companies had formerly done, that only the Company’s property and the amount unpaid on its member’s shares should be answerable in default. Such a provision was effective if inserted in the contract on which the plaintiff sued, but not, if it was merely contained in the Company’s deed of settlement, even if the plaintiff knew of it when he contracted with the Company.

In 1855, however, an Act of Parliament was passed called Limited Liability Act, 1855 by which any company registered under the Act of 1844 might limit the liability of its members for its debts and obligations generally to the amount unpaid of their shares. The Act was repealed within a few months. In fact, the
English Companies Act, 1856 known as the Joint Stock Companies Act, 1856 replaced both the Acts of 1844 and 1855. Under this Act, the company legislation assumed for the first time a form which has been broadly handed down almost to the present day, subject to various amendments which were made from time to time to suit various exigencies. Under this Act seven or more persons could form themselves into an incorporated company with or without limited liability by signing a memorandum of association and complying with the requirements of the Act. The Act of 1856, in its turn, was repealed by the Companies Act, 1862 which followed the same pattern but contained a number of improvements. The Companies Act, 1862 was amended by 17 later Acts, the most important of which enabled Companies to reduce their share capital to alter the objects which they were formed to carry out, imposed liability on promoters and directors for false statements inviting public subscription to shares and debentures, and introduced the concept of private company, which could be incorporated with only two members. In 1908, the whole of the existing statute law was consolidated and after further amending statutes, in 1929 and 1948, the Companies Act of those years repealed the existing law and enacted new consolidated legislation. The Companies Act, 1948 was itself amended and supplemented by the Companies Acts of 1967, 1976, 1980, 1981 and 1983. In 1985, the whole of the existing statute law relating exclusively to companies was consolidated in the Companies Act, 1985 which is the present statute governing companies in England.
1.2 History of Company Legislation in India

As noted in the initial paragraphs, the Company Legislation in India has closely followed the Company Legislation in England. The first legislative enactment for registration of Joint Stock Companies was passed in the year 1850 which was based on the English Companies Act, 1844. This Act recognised companies as distinct legal entities but did not introduce the concept of limited liability. The concept of limited liability, in India, was recognised for the first time by the Companies Act, 1857 closely following the English Companies Act, 1856 in this regard. The Act of 1857, however, kept the liability of the members of banking companies unlimited. It was only in 1858 that the limited liability concept was extended to banking companies also. Thereafter in 1866, the Companies Act, 1866 was passed for consolidating and amending the law relating to incorporation, regulation and winding-up of trading companies and other associations. This Act was based on the English Companies Act, 1862. The Act of 1866 was recast in 1882 to bring the Indian Company Law in conformity with the various amendments made to the English Companies Act of 1862. This Act continued till 1913 when it was replaced by the Companies Act, 1913. The Act of 1913 had been passed following the English Companies Consolidation Act, 1908. It may be noted that since the Indian Companies Acts closely followed the English Acts, the decisions of the English Courts under the English Company Law were also closely followed by the Indian Courts. Till 1956, the business companies in India were regulated by this Act of 1913. Certain amendments were, however, made in the years 1914, 1915, 1920, 1926, 1930 and 1932. The Act was extensively amended in 1936 on the lines of the English Companies Act, 1929. Minor amendments were made a number of times thereafter.
At the end of 1950, the Government of independent India appointed a Committee under the Chairmanship of H.C. Bhaba to go into the entire question of the revision of the Indian Companies Act, with particular reference to its bearing on the development of Indian trade and industry. This Committee examined a large number of witnesses in different part of the country and submitted its report in March 1952. Based largely on the recommendations of the Company Law Committee, a Bill to enact the present legislation, namely, the Companies Act, 1956 was introduced in Parliament. This Act, once again largely followed the English Companies Act, 1948. The major changes that the Indian Companies Act, 1956 introduced over and above the Act of 1913 related to: (a) the promotion and formation of companies; (b) capital structure of companies; (c) company meetings and procedures; (d) the presentation of company accounts, their audit, and the powers and duties of auditors; (e) the inspection and investigation of the affairs of the company; (f) the constitution of Board of Directors and the powers and duties of Directors, Managing Directors and Managers, and (h) the administration of Company Law.


In the wake of economic reforms processes initiated from July, 1991 onwards, the Government recognized the many provisions of the Companies Act had become anachronistic and were not conducive to the growth of the Indian corporate sector in the changing environment. Consequently, an attempt was made to recast the Act, which was reflected in the Companies Bill, 1993. The said Bill, however, was subsequently withdrawn. As part of continuing reforms process and in the wake of enactment of the Depositories Act, 1996, certain amendments were, however, incorporated by the Companies (Amendment ) Act, 1996.

In the year 1996, a Working Group was constituted to rewrite the Companies Act, following an announcement made by then Union Minister for Finance in his Budget Speech to this effect. The main objective of the Group was to re-write the Act of facilitate healthy growth of Indian corporate sector under a
liberalized, fast changing and highly competitive business environment. Based on
the report prepared by the Working Group and taking into account the
developments that had taken place in structure, administration and the regulatory
framework the world over, the Companies Bill, 1997 was introduced in Rajya
Sabha on August 14, 1997 to replace by repealing the Companies Act, 1956. In the
meantime, as part of the reforms process and in view of the urgency felt by the
Government, the President of India promulgated the Companies (Amendment)
Ordinance, 1998 on October 31, 1998 which was later replaced by the Companies
(Amendment) Act, 1999 to surge the capital market by boosting morale of national
business houses besides encouraging FIIs as well as FDI in the country. The
amendments brought about number of important changes in the Companies Act.
These were in consonance with the then prevailing economic environment and to
further Government policy of deregulation and globalisation of the economy. The
corporate sector was given the facility to buy-back company’s own shares,
provisions relating to the investments and loans were rationalized and liberalized
besides the requirements of prior approval of the Central Government on
investment decisions was dispensed with, and companies were allowed to issue “
sweat equity” in lieu of intellectual property. In order to make accounts of Indian
Companies compatible with international practices, the compliance of Indian
Accounting Standards was made mandatory and provisions for setting up of
National Committee on Accounting Standards was incorporated in the Act. For the
benefit of investors, provisions were made for setting up of “Investor Education
and Protection Fund” besides introduction of facility of nomination to
shareholders debenture holders etc.¹

¹ Company Law and Practice by A. K. Majmudar and Dr. G.K. Kapoor Taxmann’s Publication 15th
Edition see pg. 1 to 5
The First Amendment of 2002 provides for producer companies. The Second Amendment of 2002 replaces the Company Law Board with National Company Law Tribunal and also creates an Appellate Tribunal. Apart from taking over the jurisdiction of the Company Law Board, the National Company Law Tribunal has been vested with the jurisdiction of the High Courts under the Companies Act. The result is that the jurisdiction of the High Courts has also become reduced to a very few points. Since this amendments has not been enforced, the original Act holds good.²

1.2.1 Company

The word ‘Company’ has no strictly technical or legal meaning Stanley, Re.³ It may be described to imply an association of persons for some common object or objects. The purposes for which people may associate themselves are multifarious and include economic as well as non-economic objectives. But, in common parlance, the word ‘company’ is normally reserved for those associated for economic purposes i.e. to carry on a business for gain.

Used in the aforesaid sense, the word ‘company’, in simple terms, may be described to mean a voluntary associations of persons who have come together for carrying on some business and sharing the profits there from.

Indian Law provides two main types of organisations for such associations: ‘partnership’ and ‘company’. Although the word ‘company’ is colloquially applied to both, the Statute regards companies and company law as distinct from partnerships and partnership law. Partnership law in India is codified in the Partnership Act, 1932 and is based on the law of agency, each partner becoming an agent of the others and it, therefore, affords a suitable framework for an association of a small body of persons having trust and confidence in each other. A more complicated form of association, with a large and fluctuating membership, requires a more elaborate organisation which ideally should confer corporate personality on the association, that is, should recognise that it constitutes a distinct

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² Company Law by Avtar Singh Publication Eastern Book Company, 15th Edition see pg.3
³ [1906] 1Ch. 131
legal person, subject to legal duties and entitled to legal rights separate from those of its members. This can be obtained easily and cheaply by registering an association as a company under the Companies Act, 1956.\textsuperscript{4}

\subsection*{1.2.2 Definition of a Company}

The Companies Act, 1956, does not define a company in terms of its features. Section 3 (1)(i) of the Act merely states that “a company means a company formed and registered under this Act or an existing company as defined in Section 3(1)(ii).” Section 3(1) (ii) lays down that “an existing company means a company formed and registered under any of the previous Company Law.” This definition does not clearly point out the meaning of a company. In order to understand the meaning of a company, let us see the definition as given by different authorities. Some of the definitions are:-

Lord Justice Lindley- “A company is an association of many persons who contribute money or monies worth to a common stock and employed in some trade or business and who share the profit and loss arising there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it or to whom it pertains are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted.”

Chief Justice Marshall- “a corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the Charter of its creation confers upon it, either expressly or as incidental to its very existence.”

Prof. Haney-“a company is an artificial person created by law, having separate entity, with a perpetual succession and common seal.”

The above definitions clearly bring out the meaning of a company in terms of its features. A company to which the Companies Act applies comes into existence only when it is registered under the Act. On registration, a company

\textsuperscript{4} Supra note 1 pg. 10
becomes a body corporate i.e. it acquires a legal personality of its own, separate and distinct from its members. A registered company is there created by law and law alone can regulate, modify or dissolve it.

### 1.2.3 Characteristic Features of a Company

The most important characteristic features of a company are ‘separate legal entity’ of the company and in most cases ‘limited liability’ of its members. These and other characteristic feature of a company is discussed below:

#### 1.2.3.1 Incorporated association

The company must be incorporated or registered under the Companies Act. Minimum number required for this purpose is seven in the case of a ‘public company’ and two in case of a ‘private company i.e., Section 12. It may also be mentioned that an association of more than 10 persons in case of banking business and 20 persons in other commercial activities, if not registered as a company or under any other law, becomes an illegal association i.e., Section 11.

#### 1.2.3.2 Legal entity distinct from its members

Unlike partnership, the company is distinct from the persons who constitute it. Hence, it is capable of enjoying rights and of being subjected to duties which are not the same as those enjoyed or borne by its members. As Lord Macnaughten puts it, “the company is at law a different person altogether from the subscribers......; and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers and the same hands receive the proceeds, the company is not in law, the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.” i.e., Solomon’s case.

The first case on the subject even before the famous Solomon’s case was that of Kondoli Tea Co. Ltd.,\(^5\) In this case certain persons transferred a tea estate

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\(^5\) Re ILR [1886].
to a company and claimed exemption from ad valorem duty on the ground that they themselves were the shareholders in the company and, therefore, it was nothing but a transfer from them in one to themselves under another name.

Rejecting this, the Calcutta High Court observed- “The Company was a separate person, a separate body altogether from the shareholders and the transfer was as much conveyance, a transfer of the property, as if the shareholders had been totally different persons.”

Even where a single shareholder virtually holds the entire share capital, a company is to be differentiated from such a shareholder. In the well known case of Solomon v. Solomon & Co. Ltd Solomon was a prosperous leather merchant. He converted his business into a limited Company- Solomon & Co. Ltd. The Company so formed consisted of Solomon, his wife and five of his children as members. The company purchased the business of Solomon for £ 39,000 for purchase consideration was paid in terms of £10,000 debentures conferring a charge over the company’s assets, £20,000 in fully paid £1 share each and the balance in cash. The company in less than one year ran into difficulties and liquidation proceedings commenced. The assets of the company were not even sufficient to discharge the debentures held entirely by Solomon himself. And nothing was left for the unsecured creditors. The House of Lords unanimously held that the company had been validly constituted, since the Act only required seven members holding at least one share each. It said nothing about their independent or that there should be anything like a balance of power in the Constitution of the company. Hence, the business belonged to the company and not to Solomon. Solomon was its agent. The company was not the agent of the Solomon.

Likewise, in the case of Lee V. Lee’s Air Farming Ltd ‘L’ formed a company with a share capital of three thousand pounds, of which 2999 pounds were held by ‘L’. He was also the sole governing director. In his capacity as the controlling shareholder, ‘L’ exercised full and unrestricted control over the affairs.

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6 Supra note 1 pg 10-11
7 [1859-99] All.ER 33 (HL)
8 [1960] 3 All. ER 420 (PC)
of the company. ‘L’ was a qualified pilot also and was appointed as the chief pilot of the company under the articles and drew a salary for the same. While piloting the company’s plane he was killed in an accident. As the workers of the company were insured, workers were entitled for compensation on death or injury. The question was while holding the position of sole governing director could ‘L’ also being an employee/ worker of the company. Held that the mere fact that someone was the director of the company was no impediment to his entering into a contract to serve the company. If the company has a legal entity, there was no reason to change the validity of any contractual obligations which were created between the company and the deceased. The contract could not be avoided merely because ‘L’ was the agent of the company in its negotiations. Accordingly ‘L’ was an employee of the company and, therefore, entitled to compensation claim.

So much so that even if a shareholder acquires all shares of a company, business of the company does not become his business unless the company is treated as his agent. – Gramophone & Typewriters Ltd. V. Stanley 9.

Even where a decree has been issued by the Court in respect of sums due against a company, the same cannot be enforced against its managing director. In H. S. Sidhana V. Rajesh Enterprises,10 it was held that the liability to discharge the decretal amount was that of the company and not of its managing director. The executing court could proceed against the managing director only if it came to the conclusion that the managing director was personally liable to discharge the decretal amount.

Again, in Chamundeeswari V. CTO, Vellore Rural11 it was held that a company being a legal entity by itself, any dues from company have to be recovered only from company and not from its directors.

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9 [1908-10] All. ER 833 (CA)
10 [1993] 77 Comp. Cas. 251 (P&H)
11 [2007] 78 SCL 151 (Mad).
1.2.3.3 Artificial person

The company, though a juristic person, does not possess the body of natural being. It exists only in contemplation of law. Being an artificial person, it has to depend upon natural persons, namely, the directors, officers, shareholders, etc., for getting its various works done. However, these individuals only represent the company and accordingly whatever they do within the scope of the authority conferred upon them and in the name and on behalf of the company, they bind the company and not themselves.

1.2.3.4 Limited Liability

One of the principal advantages of trading through the medium of a limited company is that the members of the company are only liable to contribute towards payment of its debt to a limited extent. If the company is limited by shares, the shareholder’s liability to contribute is measured by the nominal value of the shares he holds, so that once he or someone who held the shares previously has paid the nominal value plus any premium agreed on when the shares were issued, he is no longer liable to contribute anything further. However, companies may be formed and unlimited liability of members or members may guarantee a particular amount. In such cases, liability of the members shall not be limited to the nominal or face value of their shares and the premium, if any, unpaid thereon. In the case of unlimited liability companies, member shall continue to be liable till each paisa has been paid off. In case of companies limited by guarantee, the liability of each member shall be determined by the guarantee amount, i.e., he shall be liable to contribute up to the amount guaranteed by him. If the guarantee company also has share capital, the liability of each member shall be determined in terms of not only the amount guaranteed but also the amount remaining unpaid on the shares held by a member.

If a company is unable to pay its debts, its creditors may petition the Court to wind it up. If a winding-up order is made, a liquidator is appointed to administer its affairs, and if he realises insufficient amount to pay its debt by selling its assets,
he calls upon its shareholders to make good the deficiency, but, of course, their liability to do so is limited to the balance of capital unpaid on their shares plus unpaid premiums. It may be that some of the shareholders as at the date the winding-up commences are themselves insolvent and unable to contribute the balance of unpaid capital in respect of their shares. In that case, the liquidator can recover the unpaid capital from any person who held the shares in question within a year before the winding-up began.

1.2.3.5 Separate Property

Shareholders are not, in the eyes of the law, part owners of the undertaking. In India, this principle of separate property was best laid down by the Supreme Court in Bacha F. Guzdar V. CIT\(^\text{12}\) The Supreme Court held that a shareholder is not the part owner of the company or its property, he is only given certain rights by law, for example, to vote or attend meetings, or to receive dividends.

1.2.3.6 Transferability of Shares

One particular reason for the popularity of joint stock companies has been that their shares are capable of being easily transferred. The Companies Act, 1956 in Section 82 echoes this feature by declaring "the shares, debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company". However, in case of private companies certain restrictions are placed on right of the member to transfer his shares.

\(^\text{12}\) [1955]25 Comp. Cas.1 (SC)
1.2.3.7 Perpetual Succession

Company being an artificial person cannot be incapable by illness and it does not have an allotted span of life. Being distinct from the members, the death, insolvency or retirement of its members leaves the company unaffected. Members may come and go but the company can go for ever. It continues even if all its human members are dead. Even where during the war all the members of a private company, while in general meeting were killed by a bomb, the company survived.

1.2.3.8 Common Seal

A Company being an artificial person is not bestowed with a body of a natural being. Therefore, it does not have a mind or limbs of human being. It has to work through the agency of human beings, namely, the directors and other officers and employees of a company. But, it can be held bound by only those documents which bear its signature. Common seal is the official signature of a company.¹³

1.2.4 Lifting the Corporate Veil

The chief advantage of incorporation from which all others follow is, of course, the separate legal entity of the company. In reality, however, the business of the artificial person is always carried on by, and for the benefit of, some individuals. In the ultimate analysis, some human beings are the real beneficiaries of the corporate advantages, “for while, by fiction of law, a corporation is a distinct entity yet in reality, it is an association of persons who are in fact the beneficiaries of the corporate property” – Gallaghar V. Germania Brewing Company.¹⁴ It may, therefore, happen that all the corporate personality of the company is used to commit frauds or improper or illegal acts. Since an artificial person is not capable of doing anything illegal or fraudulent, the facade of

¹³ Supra note 1 pg.13-16
¹⁴ [1893] 53 MINN. 214
corporate personality might have to be removed to identify the persons who are really guilty. This is known as ‘lifting the corporate veil’. Although, in general, the courts do not interfere and essentially go by the principle of separate entity as laid down in the Solomon’s case and endorsed in many others, it may be in the interest of the members in general or in public interest to identify and punish the persons who misuse the medium of corporate personality.

In Cotton Corporation of India Ltd. V. G. C. Odusumath\textsuperscript{15} the Karnataka High Court has held that the lifting of the corporate veil of a company as a rule is not permissible in law unless otherwise provided by clear words of the Statute or by very compelling reasons such as where fraud is needed to be prevented or trading with enemy company is sought to be defeated.

As to when the corporate veil shall be lifted, the observations of the Supreme Court in Life Insurance Corporation of India V. Escorts Ltd.\textsuperscript{16} is worth noting. “While it is firmly established ever since in Solomon V. Solomon &Co. Ltd.\textsuperscript{17} that a company is an independent and legal personality distinct from the individuals who are its members, it has since been held that the corporate veil may be lifted, the corporate personality may be ignored and the individual members recognised for who they are in certain exceptional circumstances. Generally, and broadly speaking the corporate veil may be lifted where the statute itself contemplates lifting the veil or fraud or improper conduct is intended to be prevented, or a taxing statute or a beneficent statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern.”\textsuperscript{18}

\textsuperscript{15} [1999] 22 SCL 228 (Kar.)
\textsuperscript{16} [1986] 59 Comp. Cas. 548
\textsuperscript{17} [1897] AC 22
\textsuperscript{18} Supra note 1 pg. 19-20
1.2.5 Company vis-a-vis Body Corporate

Body Corporate means an association of persons which has been incorporated under some statute having perpetual succession, a common seal and having a legal entity different from the members constituting it. Sub-section (7) of section 2 of the Companies Act defines the expression ‘body corporate’ as follows:

“Body corporate’ or ‘corporation’ includes a company incorporated outside India but does not include-

(a) A corporation sole; (b) a co-operative society registered under any law relating to co-operative societies; (c) any other body corporate not being a company which the Central Government may, by notification in the Official Gazette, specify in this behalf.”

It will further include all public financial institutions mentioned in section 4A as well as the nationalised banks incorporated under section 3, sub section (4) of the Banking Companies (Acquisition & Transfer of Undertakings) Act.

It may be noted that under clause (c) of sub-section (7) of section 2, the Central Government has reserved the right to declare any association of persons as a body corporate. Accordingly, Oil & Natural Gas Commission (ONGC) was declared as a body corporate.

Thus, the word ‘body corporate’ is not equivalent to the words ‘incorporated company’. An incorporated company is a body corporate but many bodies corporate are not incorporated companies- Madras Central Urban Bank Ltd. V. Corporation of Madras19 The expression ‘corporation’ or ‘body corporate’ is, thus, wider than the word company.

Is a Society registered under the Societies Registration Act, a body corporate?- A society registered under the Societies Registration Act has been held by the Supreme Court in Board of Trustees Ayurvedic & Unani Tibia College,

19 [1932] 2 Comp. Cas. 328 (Mad.)
Delhi V. State of Delhi\(^{20}\) not to come within the term ‘body corporate’ under this Act, though such a society is a legal person capable of holding property and becoming a member of a company.

Similar view had been held by the Department of Company Law administration in its communication No. 8/26/2(7)/63/PR dated 13\(^{th}\) June, 1962 addressed to Federation of Indian Chambers of Commerce. The Department observed as follows:

Generally speaking, this Department would consider that a body which has been or is incorporated under some statute and which has a perpetual succession and a common seal and is a legal entity apart from the members constituting it, will come within the definition of the term ‘body corporate’. The term will not, however, include a society registered under the Societies Registration Act, 1860, or any of the bodies which have been specifically excluded by clauses (a), (b) or (c) of Section 2, sub-section (7).

A close scrutiny from the above characteristics of the company viz, Legal entity distinct from its members, separate property, artificial person, limited liability, separate property, transferability of shares, perpetual succession and common seal clearly indicates that company has a separate legal entity different from its owners and the same is managed by a set of people who are not owners. It is this separation of ownership and control that give significance to the role of Directors. The fact that managers of a company are not owners gave rise to possibilities where such managers may be either careless with other people’s money or abuse power and position and information to further their own ends at cost of company or shareholders. To counterbalance such tendencies concept of independent directors came into existence.

The Board of Directors of any company is considered to be the principal authority for a company’s governance, the structure and composition of the board would necessarily have an impact on the manner in which the company is governed. Among the various structural changes that have occurred in recent years

\(^{20}\) AIR 1962 SC 458
to improve the way in which companies are governed, the introduction of the concept of an independent director occupies a prominent position. The rise of independent directors in a model of corporation where dispersed ownership dominates is conventionally understood to address management-shareholders agency problem. “An active and independent board of directors working for shareholders clearly would seem to benefit the corporation by reducing the losses from misdirected ‘agency' inherent in the separation of ownership from control that is fundamental to the modern corporation.”

Two models have been dominating the corporate governance in the world- One, ‘outsider’ model where companies are dispersedly held, commonly found in US, the worry is that the management of the firm may be able to expropriate assets of the shareholders or behave in an opportunist or non-value maximizing manner. Second, ‘insider’ model where companies have a controlling shareholder, the principal corporate law concern is that the controlling shareholder may have damaging tendencies to the minority shareholders. For instance, frauds like Enron and WorldCom where the management and frauds like Parmalat and Satyam where the controller attempted to misrepresent financial performance or cover up expropriation. Laxity of auditors and independent directors were found to be factors in all these instances. Thus, interestingly even where corporate governance models differ, corporate frauds have demonstrated some sort of converging norms.

The seminal work of Kraakman et al\textsuperscript{22} identify three types of agency problems: (i) the conflict between managers-agent and owners, being shareholders-principal, (ii) the conflict between controlling shareholders -agent and minority shareholders- principal, and (iii) that between the company itself (agent) and other stakeholders with whom the company contracts, such as creditors, employees and customers-principal.

Considering the ownership structure of Indian firms, scholar Umakanth Varottil has comprehensively demonstrated that “due to the concentrated


ownership structures in Indian companies, it is the minority shareholders who require the protection of corporate governance norms from actions of the controlling shareholders. Board independence, in the form it originated, does not provide a solution to this problem.‖23 That the concept of independent directors evolved to solve first set of problem is beyond argument. However, present time concept of independent director may be extended to solve the third set of agency problem assumes criticality.

1.3 Statement of problem

Even today, a vast majority of Indian businesses, including companies listed on the stock exchanges, has a concentrated ownership in the hands of family business groups. At times even where the controlling family may have only modest ownership control, companies in India remain family-managed and promoted.24 In the events of corporate frauds such as Satyam, it is not only public shareholders but also stakeholders such as employees, creditors, customers, industry as a whole that suffers. A crucial question in Indian context is regarding agency problem between minority-majority shareholder and that between the company and stakeholders other than shareholders. That independent director’s holds solution to these agency problems especially in Indian model of closed ownership is a vital question.

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24 Id.
1.4 Research Questions

Based on this hypothesis the following research questions have been formulated:

1) What theoretical basis were responsible for evolution of concept of independent directors in the country of its origin United States and other jurisdiction such as United Kingdom?
2) What role and functionality was entrusted to independent director’s office in United States? How did judiciary respond to independent directors?
3) What is the scope and definition of independent directors in India?
4) What is the difference between corporate sector and governance models in India and United States?
5) Does Indian statute and regulatory bodies imbibe this concept and its role in clear and unambiguous terms?
6) Is it possible to effectively expand and assign independent directors the task to ensure protection of interests of minority shareholders and stakeholders?

1.5 Aims and objective of study

Amidst claims being made that independent directors, a transplanted concept, primarily meant to solve first level of agency problem i.e. the management shareholder conflicting interested, this study aims to decipher how far this concept can resolve other related agency problems. In the context of controlled or promoter-dominated firms in India, this study seek to explore what roles independent directors play at such firms where agency problems offer highly complex situation of minority v. majority and company v. stakeholders. Further in event of corporate frauds such as Satyam, how far independent directors and their functionality can avert such debacles in future or at least raise alarm for investors and regulators.
1.6 Hypothesis

This study is based on the hypothesis that solution to the minority-majority agency problem as well that between the company and stakeholders lies with independent directors. The scope and functions of independent directors in the Board of Directors can be effectively expanded in the statutory and regulatory framework to address the issues of not only minority shareholders against controlling shareholders but also for the other stakeholders.

1.7 Scope and Limitations of Study

The scope of this study is to thoroughly examine and understand the theoretical and historical background of the concept of independent directors and contextualise the same in the Indian scenario where insider model of governance dominates the corporate scene. The scope of research therefore extends to the country of origin United States and to some extent United Kingdom. In the process several significant provisions in relevant statues such as Sarbanes Oxley and committee reports have been studied. Also it is important to mention that the judicial response to independent directors especially the one of Delaware Court has been explored in greater details. This is primarily due to the reason that Delaware Corporate law and the state itself is considered to be amongst the most progressive and highly dynamic jurisdictions so far as company law in US is concerned. The adoption of this concept in India is largely routed through several committee reports and recommendations and therefore a study of the same is made. Comparisons have been drawn between the erstwhile Company Act 1956 which has been replaced with the Company Act 2013 while this study was still going on. Importantly, Clause 49 of Listing Agreement of the Securities Exchange Board of India i.e., SEBI finds frequent reference.

While there has been tremendous amount of literature and empirical research for the value of independent directors, the same question is considered to be out of scope for this study. Similarly the difference between concepts of non-executive directors, outside directors has not been dealt with at greater length.
1.8 Literature Survey

There exists a large body of literature that provides insight into historical evolution of company and its manner of functioning. Again there is no dearth of material about comparative company law, modes of governance. When it comes to independent directors a writings comprise of conceptual understanding, what is meant by independence, how one can ensure this independence, how one may differentiate independent directors from non-executive directors and so on. While on also comes across literature that has argued about whether or not independent directors are effective and what value, if at all, they bring to the Board and tested the same empirically as well; there is little that puts across how independent directors can also be an answer to stakeholders groups. Especially for country such as India which has family dominated and insider model of corporation, how scope and functionality of independent directors can be extended to accommodate minority v. majority and company v. stakeholder conflict.

1.9 Research Methodology

This study adopts a doctrinal method and referred to several books, journals, committee reports, Ministry websites, judicial decisions etc. Further a comparative, historical, critical and analytical mode of exploration has been adopted.
1.10 Significance of Study

There are lot of debates and deliberations throughout the different jurisdictions on the issue of independent directors. The study will help to understand the roles and responsibilities of the Independent Directors and their Impact on the Corporate World not only from the point of view of Indian Context but from the International Context too.

1.11 Contribution of study to the knowledge

Research work will be useful for legal fraternity as such and academicians, law students, legal practitioners and judiciary.