

Concept of Companies Under the Same Management under Section 370
(1-B) of the Companies Act, 1956: A Study of its Operation

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An examination of the provisions of the 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 deserve serious rethinking, more particularly in the wake of the developments relating to structure of corporate sector and the capital market in the country. Section 370 (1-B) of the *Companies Act* and the 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 the criterion for identifying 'companies under the same management', remained untouched. In the following, we attempt to illustrate the inadequacy of the definition and the consequential failure of other regulatory provisions which rely on the same.

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.¹

The Commission's recommendations seem to have been influenced by 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)²

Provisions relating to investment in bodies corporate under the same management thus also became applicable to loans given to such bodies corporate. The definition of 'companies under the same management' (CSMs) provided in sub-section (1B) of section 370 subsequently became a standard definition for various other purposes also.

In October 1991, with a view to providing for greater disclosure of information about a company issuing shares to the public, a few changes were introduced in the format of the prospectus. Of various such changes, one made 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.³

Insider trading regulation, 1992, formulated by the Securities and Exchange Board of India (SEBI), 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.⁴ Under the SEBI regulations, one of the criterion for determination of a company 'to be deemed to be a connected person' for insider trading, is 'a company under the same management or any subsidiary company thereof, within the meaning of sub-section (1B) of section 370, or sub-section (ii) of section 372 of the *Companies Act, 1956* 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*. On the other hand, while the criteria under 2(g) of the MRTP Act is on the statute, the requirement to register under the Act has been withdrawn. Moreover, even if registration was compulsory, not all companies whose shares are traded on stock exchanges would have attracted the MRTP Act due to limitation of size.

Inadequate Criteria for CSMs

The inadequacy of the criteria under Section 370 (1B) to satisfactorily represent corporate reality came out sharply from a perusal of company annual reports and prospectuses. Tables I & II contain illustrative lists of companies which claimed that there were no companies under the same management as defined under section 370 (1B). Some of the prominent ones belonging to large industrial houses falling in this category were: 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., Bombay Dyeing & Mfg. Ltd., McDowell & Co Ltd., etc. The list was prepared on the basis of either the auditor's reports of the respective companies or the companies' own declarations 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 (BILT) 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 BILT's 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 points 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 had admitted that there were such companies. And, second, even if a company admitted that there were CSMs it does not necessarily mean that the CSM criteria 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 as that of the Company

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)#
 * Indicates 25 per cent or more of foreign equity.
 # Joint Ventures with Indian industrial houses.

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)

Kirloskar

Kirloskar Brothers Ltd (1989-90)
 Kirloskar Pneumatic Co. Ltd (1988-89)
 Mysore Kirloskar Ltd (1990-91)

Shriram

Jay Engineering Works Ltd (1988-89)

Tata

Associated Cement Cos Ltd (1991-92)
 Associated Tyre Machinery Co Ltd, subsidiary of ACC, (1991-92)
 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 (1988-89)
 Tata Telecom Ltd (1989-90)
 Tata-Robins-Fraser Ltd (1991-92)
 Voltas Ltd (1988-89)

Wadia

Bombay Burmah Trading Corp. Ltd (1991-92)
 Bombay Dyeing & Mfg. Co. Ltd (1991-92)
 National Peroxide Ltd (1990-91)

- Notes:
1. While it can be said that there are dissentions in a number of houses and some prominent ones have already been split up into independent groups, the fact remains that the splinter groups also operate through a set of companies some privately owned by the family members and the others whose shares are traded publicly.
 2. Year of report is given in brackets.

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 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 and 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 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 "There is no company within the meaning of Section 370(1B)".
Citicorp Securities & Investments Ltd 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 to 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". It was further mentioned 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 Reliance Polypropylene Ltd November 12, 1992	The prospectus mentioned that 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, <u>nor is there any listed company under the same management.</u> (emphasis added) Both these companies had Reliance Industries Ltd and Itochu Corp of Japan as co-promoters.
Onida Savak Ltd March 12, 1992	"ONIDA SAVAK LIMITED has been promoted by Mr. L.G. Mirchandani and his four sons Mr. Gulu L. Mirchandani. The promoters have also promoted Monica Electronics ltd and Mirc Electronics Ltd ... <u>In case of common items of manufacture the allocation is primarily based on different territories</u> " (pp. 6-7) (emphasis added). "PARTICULARS OF PREVIOUS ISSUES: The Company and the other listed companies of the Group <u>THOUGH NOT FALLING</u> within the meaning of Section 370(1B) of the Companies Act, 1956, is Monica Electronics Ltd and Onida Saka Ltd,....".(p. 8)
McDowell & Co. Ltd. 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 were: UB Ltd., Herbertsons Ltd., UB Petroproducts Ltd., Mangalore Chemicals & Fertilisers Ltd., Best & Crompton Engineering Co Ltd., Western India Enterprises Ltd.
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	The prospectus of the company claimed that it was jointly promoted by

Name of the Company/Issue Date	Remarks
June 21, 1993	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 Cos.
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.
Salora International Ltd March 2, 1993	"The Jiwrajka family, the present promoters and owners of the company as stated above, are managing the Company since 1977.... He (S.R. Jiwrajka, head of the Jiwrajka family and Chairman of the Board of Directors of the Company) is joint promoter and Joint Managing Director of Indo National Ltd and Joint Promoter and Chairman of Indo Matsushita Carbon Co. Ltd. Both these companies are joint venture companies with Matsushita Electric Industrial Co. Ltd., Japan. He is also the promoter and Chairman of Ericsson Telecom India P. Ltd., a joint venture company with M/s. Ericsson of Sweden <u>In managing the Group and associated companies, he is assisted by his four sons, who form the core team of the Group.</u> " (pp. 13-14). The company also reported that "There are no companies under the same management within the meaning of Section 370(1B) of the Act." (p. 18)

The Criteria for CSMs

As mentioned earlier, the Companies Bill, 1993 did not make any changes in the criteria for CSMs. 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 if:

- (i) Common Managing Director: the managing director or manager of the one body is managing director or manager of the other body; or
- (ii) Majority Common Directors: 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: 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: 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:** 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.

These criteria are examined in detail in the following.

(i) **Common Managing Director:** In the present situation, it is rarely that Managing Directors of large companies simultaneously hold Managing Directorship of other companies. Indeed, some of the large companies have more than one Managing Director or Whole-time Directors, Presidents, Joint Managing Directors, etc.

(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.⁵ Since companies have the freedom to adjust the composition of the Board and its size (within certain limits) it is not also difficult to imagine that in case of necessity companies would make suitable changes in their respective Board of Directors. Given the reality of the Indian corporate sector if any group of shareholders can elect a director they are more or less sure to fill 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 publicly traded companies are known to avail of it. Except for the institutional nominees on company boards, it would not be wrong to say that the remaining Directors are there on the Board at the pleasure of the controlling interests. It would 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.⁶

(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, such a criterion could cover 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 major companies 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 major companies are not 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 had a 38.6% of holding in ITC Bhadrachalam Paperboards Ltd.⁷ On its part ITC Ltd claimed that there was 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 within 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). This is because there was no single individual or body corporate having the 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 were under the same management. But ITC Ltd itself would not. While ITC may be technically correct to report that there were 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. An examination of share holding pattern of listed companies indicates that it is the smaller companies which are likely to get attracted by this criterion than the larger ones. Large companies are controlled more through inter-corporate investments than through direct personal holdings of directors and their relatives.

This brief discussion establishes the inadequacy of the criteria for CSMs to reflect the corporate reality. In this context, it may also be useful to mention that another study too found "all the five clauses of the definition of the 'same group' are defective".⁸ The study also provided hypothetical illustrations to this effect. In the present study, besides offering additional arguments, we referred to companies by name because giving examples in terms of Company 'A', 'B' or 'C' seems to have failed to highlight the extent of inadequacy of the provisions of the Section.

Specific cases of two Reliance Group Companies

In the foregoing the fact of many large companies avoiding the CSM criteria was illustrated as also the deficiencies of the criteria which seem to be responsible for the present state of affairs were explained. 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 manage to avoid common majority directors 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 were also on the Board of RPPL, no other director was common to the two companies. The particulars of other directors of RPEL & RPPL as reported by the companies in their prospectuses are given in Table III.

Table III

Relationship of Non-family Directors of RPEL and RPPL with Reliance Industries Ltd

Name of the Director	Position	In the Company
Reliance Polyethylene Ltd (RPEL)		
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
Reliance Polypropylene Ltd (RPPL)		
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

Source: Prospectuses of respective companies.

From the Table 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 was at least one outside Director on each of the Boards. On a closer examination it, however, turns out that M/s. Kanga & Co. were retained as Solicitors & Legal Advisors by not only RPPL and RPEL but also by RIL.

Thus, while all the Directors of RPPL and RPEL were 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". On the share holding side too one noticed an interesting strategy. Both the companies had equity participation of different sets of four investment and trading companies (termed as Indian promoters⁹) besides RIL as the co-promoter and Itochu of Japan as the foreign collaborator. As per the issue details, none of the Indian companies were to have more than 32 per cent share in either RPEL or RPPL. Needless to say, the general perception and the public participation in these two companies was influenced by their association with RIL and Itochu and not because they 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) possibly because none of the Directors of RPEL and RPPL were on the Boards of these two companies.

Status of Subsidiaries

It appears from the CSM criteria as also the claims of individual companies that subsidiaries are not specifically treated to be under the same management as that of the parent company. It may be because, provisions of section 370 do not apply to loans by a holding company to its subsidiary. In case of wholly-owned subsidiaries a rationale could be that the advantages would flow back to the parent company in full. It may, however, be noted that the interests of subsidiaries need not necessarily coincide entirely with those of parent/holding companies as there can be substantial outside share holding (up to 49 per cent). Subsidiaries of foreign companies operating in India and whose shares are listed on the stock exchanges are cases in point. There are Indian companies too. For instance, Shivaji Works Ltd., itself a subsidiary of Kirloskar Oil Engines Ltd (KOEL), claimed in its prospectus that there were no listed companies under the same management. This was irrespective of the fact that shares of a number of other Kirloskar house companies including KOEL are traded on stock exchanges. Similar is the case with McDowell Ltd - a subsidiary of UB Ltd and Special Steels Ltd - a subsidiary of TISCO. To what extent one can relate the interests of parent company with its subsidiary and vice versa remains a point of contention. Probably such a dilemma is reflected in the auditor's 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 its parent why are the auditors of the subsidiary required to comment separately on the transactions of the parent company with its subsidiary? In any case, many large house companies have taken advantage of the exemption given to subsidiaries and investment companies by floating subsidiaries with nominal paid-up capital and extending them disproportionately large amounts of loans.¹⁰

Applicability to Foreign Controlled Companies

What is the scope of Section 370 (1B) in case of companies with controlling interests outside the country? 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'. A quick look at the composition of their Boards suggest that the possibility of having majority common directors with foreign companies is remote. Do these cases suggest that the decision is left to the individual companies and their auditors, or they have been reporting on this matter out of abundant caution?

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. An ineffective criteria for identifying CSMs has implications not only for loans but also for regulation of inter-corporate investments and better corporate information disclosure. 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. Unfortunately this did not happen with the CSM criteria. The bane of Indian regulations was that either the authority

associated with them was not exercised or there was no proper follow up action to achieve the stated objectives. Regulation of CSMs had been no exception.

The business reality is that whether a company in India under the control of a business house or a company which is a part of a transnational corporation are made to operate to the overall advantage of the house or TNC as the case may be, instead of working to the best interests of all the shareholders of the respective company. Legislative provisions should seek to identify the ultimate beneficiaries and their interest in any transaction with a particular company to the detriment of the non-controlling interests and the exchequer. There may not always be an undue transfer of profits when dealing with companies in which the owner/manager has a stake. But the very fact that for certain services in-house companies are used provides an advantage to the controlling interests in securing business to the exclusion of others who may be able to deliver the service at more competitive terms.

Thus, there is a need for fresh thinking on the criteria for 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. For that a comprehensive approach needs to be evolved 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 supported by appropriate information base.

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. But, this did not happen. Except those of a few trusts of the M.K. Mohta group and some others, none of the hundreds of trusts and other entities belonging to large industrial houses could be covered by the Act.¹¹ Indeed, persons belonging to some of these houses floated new companies (sometimes even as small scale units) without recourse to the MRTP Act and have even offered shares to the public.¹²

It may further be interesting to note that some of the top most private sector shareholders in certain large companies, obviously representing the controlling interests, were not registered under the MRTP Act. In other words, even under the supposedly repressive criteria of inter-connected undertakings under the MRTP Act which was considered quite comprehensive by corporate circles, the top most private shareholders could avoid being termed as inter-connected with the house. 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 (*e.g.* ECE Industries and Periclase India) reflect the ground reality as also the extent to which one needs to go to establish relationship.¹³ In the

case of ECE (then known as Electric Construction & Equipment Co. Ltd) the CLB noted as follows:

... in determining the control under a Statute like MRTP Act, we will have to take an overview of the situation and appreciate the totality of circumstances. There are situations where different parameters, specifically provided in the Statute in terms of mathematical ratios may not be satisfied, but control may still exist. It will not be a defence that a case does not come within the purview of each of these parameters (either of shareholding or of directorial involvement) as seems to be the case here. Had the case of Union of India been based on one parameter, i.e. of shareholding being less than 25%, the position would have been different. ... They have brought out certain other important factors also such as continuation of the same persons, who were secretaries and treasurers as directors, a definite pattern of voting and electing a fixed management. This coupled with the fact that the admittedly interconnected group held the largest single shareholding leaves no doubt that the defacto control is being exercised in this case by the petitioner in association with others enumerated by the Union of India, particularly if regard is had to the fact that a large and dispersed membership is not participating in the management.¹⁴

It may be noted that ECE also claimed that there were no companies under the same management.

Another case of relevance is that of Rasoi Ltd. In the case of purchase of shares of MOI Engineering Ltd by a set of trading and investment companies it was stated by the representative of one of the companies namely, Foster Consultants & Investments Pvt Ltd., that his company neither belongs to Rasoi Group nor can it be covered under the definition of "company under the same management". He further stated that there were no common directors between Rasoi group of companies and his company. The representative, however, admitted that inter-corporate loans were taken from Rasoi Group.

The CLB in this case noted that

... the admitted facts also leave no doubt that there is single controlling hand behind the acquisition of these shares. The facts clearly show that these acquisitions have been made by M/s. Rasoi Limited and its associate companies and even though the shares are purchased in the name of different entities, the resources have come from M/s. Rasoi Limited and its associate companies. In the fact of the facts on record the denial made by Foster Consultants & investments Pvt. Limited of any connection with Rasoi Limited is devoid of any force.¹⁵

There is considerable evidence which indicates that many sections of the Indian corporate sector have under their control multiple companies whose main purpose appears be to circumvent one or the other regulatory provision or to take undue advantage of public policies or their control over companies with public participation in risk capital or merely to serve as tools in the control mechanism.¹⁶ 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* get involved in such efforts. The magnitude of the problem the regulatory authorities need to face is enormous. 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 the antecedents of hundreds of companies every time the need arises.

Moreover, at present, there is a tendency to use multiple definitions even by the SEBI. These range from CSMs to related persons for the purpose of monitoring insider-trading to the criteria under Section 2(g) of the MRTP Act to what constitutes the promoter and promoter group. Keeping in mind the specific purposes the definitions may be put to, there is a need for harmonisation of the definitions and concepts. Once this is done, the computerisation of the operations of the Registrars of Companies can be taken advantage of to have data on share holding pattern, inter-corporate investments and directorships in a readily usable form. Company registration numbers and Election Commission Identity Card numbers for directors now required to be submitted along with the Annual Return can be made use of to relate information for different companies for better monitoring of the corporate sector.

Notes and References

1. India, Ministry of Commerce & Industry, Dept. of Company Law Administration, Report of the Commission of Inquiry, (Inquiry on the Administration of Dalmia-Jain Companies), 1963, p. 802.
2. ibid., p. 23.
3. Disclosure and Investor Protection Guidelines for Rights Issues continue to adhere to CSM criteria under 370 (1B) for information on capital issues made during the preceding three years. See: RMB (DIP Series) Circular No. 1 (1995-96) dated 23.5.1995.
4. Issued by SEBI vide F.No. LE/6308/92; published in the Gazette of India Extraordinary in Part III, Section 4, dated 19.11.1992.
5. A. Ramaiya, Guide to Companies Act, Eleventh Edition, 1988, Reprint 1991, p. 170. The Guide indeed mentioned that "What Parliament apparently intended was that both the companies should not be under the control of the same directors. But the language of the clause does not give effect to such intention of Parliament".
6. The ineffectual and ornamental role of non-executive directors on company boards is well recognised not only in India but even in the developed countries.
7. Prospectus of ITC Hotels Ltd., p. 16.
8. Vinod K.Singhania, Economic Concentration through Inter-corporate Investments, Himalaya, Bombay, 1980.
9. These were : (i) Riyaz Trading Ltd., (ii) Clarion Investments & Trading Co. Pvt Ltd., (iii) Abhinav Finance & Leasing Co. Pvt Ltd., and (iv) Orson Trading Ltd in the case of RPEL; and (i) Sanatan Textrade Ltd., (ii) Fiery Investment & Leasing Ltd., (iii) Dainty Investment & Leasing Ltd., and (iv) Saumya Finance & Leasing Co. Ltd. in the case of RPPL. It may be noted that both RPPL and RPEL were also initially incorporated as investment and leasing companies namely, Nim Investment & Leasing Ltd and Sincere Leasing & Investments Ltd respectively. Further, it will be interesting to study the incorporation and growth of these 10 companies and how they came together to promote such large ventures.
10. J K Synthetics Ltd., Ceat Ltd., Asian Cables Ltd., Oudh Sugar Mills Ltd., Greaves Cotton & Co Ltd., and Reliance Industries Ltd are cases in point.
11. Notable among the trusts which did not register were those of Birlas as identified by the Director of Investigation, MRTP Commission. A number of trusts under the control of Birla group were described in the Final report on Birla Interconnection which was published in India, Ministry of Law, Justice & Company Affairs, Report of the MRTP Commission and Orders thereupon of the Central Government under Sections 21, 22 & 23 of the MRTP Act, 1969, Vol. IV, Section 22, pp. 63-323. Seventy two public charitable trusts set up by the Garware group were listed in Lok Sabha Secretariat, Public Accounts Committee (1982-83), Hundred and Forty-fourth Report : Direct Taxes -- Irregular Exemptions and Reliefs and Wealth Escaping Assessment, 1983.
12. Maegaware Computers Ltd floated by a scion of the Mafatlals is a case in point. Other directorships of the directors of Maegaware indicate the possible presence of many other companies which did not get themselves registered under the Act. A study of TVS House also noted the "incorporation of a large number of private limited companies that have escaped the MRTP net by taking advantage of some provisions of the Act". See: Padmini

Swaminathan, "Business Houses in South India: A Case Study of the Structure and Functioning of the TVS Group", Madras Institute of Development Studies, Working Paper No. 59, 1985. Another interesting example is that of the Niky Tasha set of companies promoted by the Nanda family. For details see: S.K. Goyal, K.S. Chalapati Rao and Nagesh Kumar, "Small Scale Sector and Big Business", Indian Institute of Public Administration, New Delhi, 1984, p. 109. Default notices were served on a number of companies for non-registration under the MRTP Act. But many of them managed to remain outside the purview of the Act even after the strengthening of the criteria under 2(g).

13. (i) "In the Matter of Section 2A of the MRTP Act, 1969 and In the Matter of M/s. Electric Construction & Equipment Co. Ltd versus Union of India, through the Department of Company Affairs" as reported in Company News & Notes, Vol. XXIV, No. 12, June 1987, pp. 57-64; and (ii) "In the matter of petition under Section 2A of the Companies Act, 69 and In the matter of M/s. Periclase India Ltd." as reported in Company News & Notes, Vol. XXIV, No. 12, July 1987, pp. 75-81.
14. op. cit., pp. 63-64.
15. In the matter of M/s. MOI Engineering Ltd and in the matter of Section 247/250 of the Companies Act, 1956, cases 13, 14 and 25/90 CLB as reported in Company News & Notes, Vol. XXVIII, No. 10, April 1991, pp. 69-74.
16. The study on registration of multiple companies by large houses and inter-state networks is in progress at the Institute. The study examines a number of issues relating to the growth of the Indian private corporate sector since the beginning of the 'eighties.