EMERGING TRENDS IN INTERCORPORATE INVESTMENT IN INDIA: A CRITICAL ANALYSIS OF JUDICIAL DECISION

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DECLARATION BY CANDIDATE

I hereby certify that the work which is being presented in the thesis, entitled **EMERGING TRENDS IN INTERCORPORATE INVESTMENT IN INDIA: A CRITICAL ANALYSIS OF JUDICIAL DECISION** in fulfillment of the requirements for the award of the degree of Master of Laws (LL.M.) and submitted to School of Law, Galgotias University, Greater Noida is an authentic record of my own research work carried out under the supervision of (Dr.) Naresh Kumar Vats, Dean School of Law. The matter embodied in this dissertation has not been submitted by me for the award of any other degree in any University/Institute in part of full.

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16.Nazir Hussain and another Investment Corporation Ltd. v. Union of India and others (Delhi), (1981) 51 Comp. Cas. 487

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23. SATYAM FRAUD CASE

24. Sugar Mils Company Pvt. Ltd. v. National Industrial Corporation Ltd. (1968) 38 Comp. Cas. 384
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26. D Saumil Dilip Mehta v. State of Maharashtra and others AIR 2002 Bom. 174.
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29. YES BANK- DHFL CASE

<u>**</u>**

ABBREVIATIONS

No.	Abbreviation	Full Form
1.	AIR.	All India Report
2.	Art	Article
3.	Ch	Chapter
4.	C.LB.	Company Law Board
5.	C.N.N.	Company New & Notes
6.	C.S.	Chartered Secretary
7.	Dt	Date
8.	F.E.R.A	Foreign Exchange Regulation Act
9.	F.EC.C.I.	Federation of Indian Chambers of Commerce & Industry
10.	Govt.	Government
11.	Ins.	Inserted
12.	I.C.S.I.	Institute of Companies Secretaries of India
13.	ITR.	Income Tax Reporter
14.	JILI.	Journal of the Indian Law Institute
15.	M.R.T.P.	Monopolies and Restrictive Trade Practices
16.	No.	Numbers
17.	PHD.C.C.I.	Punjab Haryana and Delhi Chamber of Commerce and Industry
18.	Prof.	Professor
19.	Pt.	Part
20.	P.C.	Privy Council
21.	R.BI	Reserve Bank of India
22.	S	Section
23.	Ss.	Sections
24.	Subs.	Substituted
25.	Suppl.	Supplement
26.	SC.	Supreme Court
27.	Vol.	Volume

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CHAPTER : 1

INTRODUCTION

1.1 INTRODUCTION

Inter-corporate investments stand as a foundational pillar in fostering integration and collaboration among enterprises, facilitating financial synergy through the transfer of funds between companies. While essential for driving economic growth, categorizing these investments as inherently positive or negative oversimplifies their complexities. **However, recent research indicates a concerning trend: inter-corporate investments are being misused by management for personal gain, exploiting a legal gap in execution and oversight**. Reasonable inter-corporate investments play a pivotal role in stimulating entrepreneurship, job creation, and overall economic development by providing capital to promising ventures and facilitating the transfer of knowledge and best practices. Such investments enable companies to strategically deploy their financial resources, diversify revenue streams, access new markets, technologies, or expertise, and mitigate risks associated with their core operations. Additionally, they stimulate innovation and competitiveness within industries, fostering economic growth. However, reckless or unreasonable investments can lead to financial instability, reputational damage, and regulatory scrutiny, emphasizing the importance of robust risk management practices. Without proper due diligence and risk management practices, companies may misallocate resources and destroy value. Some investments may prioritize short-term financial gains over long-term strategic objectives, leading to adverse outcomes. To address these concerns, regulatory frameworks like the Companies Act of 2013 have introduced significant changes. Provisions have been expanded to cover a broader range of transactions, including loans to any person, not just related parties. This aims to prevent abuse of corporate resources and circumvention of regulatory oversight. Additionally, the Act emphasizes setting appropriate benchmarks for inter-corporate loans, promoting fairness and stability. By requiring companies to disclose details of their inter-corporate transactions, it enhances transparency and facilitates market monitoring. Responsible investment practices, coupled with vigilant regulatory oversight, are crucial for harnessing the potential of inter-corporate investments to drive sustainable economic growth and prosperity. Through these measures, policymakers aim to ensure that the benefits of inter-corporate investments are realized in a

manner that promotes the long-term interests of shareholders, stakeholders, and society at large.

1.2 LITERATURE REVIEW

Inter-corporate investments represent a complex and multifaceted phenomenon that has garnered significant attention in the global financial landscape. Scholars and regulatory bodies worldwide have grappled with the intricate dynamics and potential ramifications of these investments, aiming to strike a balance between corporate growth objectives and shareholder interests. Early inquiries, such as the Mundra inquiry in India, highlighted concerns regarding the misuse and interlocking of funds among numerous companies, leading to confusion and potential harm to investors and government stakeholders. Similarly, the **Vivian Bose Commission** underscored instances where a few individuals exploited inter-corporate investments for personal gain, at the expense of the broader investing public. These findings resonate with global experiences, where regulatory responses have sought to address such challenges through enhanced governance frameworks and transparency measures. Across jurisdictions, scholars and committees have advocated for expanded restrictions and disclosure norms to mitigate the risks associated with inter-company transactions and ensure fair treatment of all stakeholders. For instance, research **by L.C. Gupta** in India demonstrated that a substantial portion of aggregate equity capital was sourced through inter-corporate investments, indicating the reliance of companies on this mode of financing. Similarly, studies in other countries have corroborated these findings, highlighting the pervasive nature of inter-corporate transactions in shaping corporate ecosystems globally. However, alongside their contributions to capital formation and business expansion, concerns persist regarding the potential risks and conflicts of interest associated with inter-corporate investments.

2. **Bøhren and Norli's (1997) Research Paper** In the case study that Bøhren and Norli (1997) present, they focus on the details of intra-industry equity infusions by the use of the data of the Oslo Stock Exchange from the 1980s-1994. They elaborate on different theoretical assumptions that stand behind the venture of intercorporate investments like the idea of corporate governance, financial slack – turnover stimulant, by liquidity buffer. Strikingly, it turns out that no single item alone absolutely is responsible for the entirety of it, instead, the issue of ICI extends from the strategy of corporate governance and the

endless everyday financial management decisions.

3. **Mazy et al's (1993)** study attempted to provide answers to the issue of alternative company accounting methods selected by the management of associated Australian firms to generate firm value. In an outright contradiction of the rational motives, their research expose that such decisions are based on the procurement of information economies theory. Australian enterprises in 1984 considered accounting arrangements in an equity form as attractive as long as interdependencies between authors and funders were substantial. This further reveals the organization's strategic orientation of methods, which aim at producing the best overall firm value rather than finite selfish gain.

3. **Varta Jr(1997)**[1] The authors have illustrated how board members may fall short in fulfilling their responsibilities, suggesting that the mere presence of audit committees and robust governance processes within a corporation does not guarantee effectiveness.

4. **Sanjai Bhagat and Bernerd Black**[2]- Bhagat and Black had been using the data to examine the correlation of the composition of the company's boards and the company's performance. They notice that the independent board majority of the US-based companies can be seen through different behavior which often results in better corporate value. This could result in more capital to be attached to the investment portfolio of these businesses thereby facilitating possibilities for growth through capital expansion and reduction of financing cost.

5. **Author Richard M Orin**[3] Richard Orin, on the other hand, focuses on two areas that were key to the implementation of the Sarbanes-Oxley Act 2002 which was intended to bring honesty into financial market and regain public confidence. In the year of 2008 Orin published an article under the title of "Ethical Guidance and Constrains under Sarbanes-Oxley Act of 2002", highlighting the fact that the law was drafted in the period following the scandals of large business deals such as Enron, World come, Adelphia and Tyko. This Act expressed why good business ethics is critical and it had optional provision of company ethics codes though the contents were not defined. His essay comes up with an endorsement of the Act's principles alongside incorporation of the ethical implications into those general

[1] Varta JR 1997 available at: https://www.irvarma.in/papers/iimbr9.4.pdf (Last accessed on May 4, 2024)

[2] . Sanjai Bhagat and Bernerd Black

[3] Ethical Guidance and Constraints under Sarbanes-Oxley Act of 2002" by Richard M. Orin availabie at: urnals.sagepub.com/doi/I0.1177/0148558X0802300108 (Last Accessed on May 4, 2024)

rules and options. Also, it pinpoints the manner of their grasp of the Sarbanes-Oxley standards in the documents filed publicly after its issuance.

POSITIVES:

- Inter-corporate investments contribute significantly to corporate financing structures, facilitating capital formation and business expansion.

- They enable companies to diversify revenue streams, access new markets, technologies, or expertise, and stimulate entrepreneurship and job creation.

- Such investments foster innovation and competitiveness within industries, driving economic growth and development globally.

- Advocates argue that with responsible governance, inter-corporate investments can promote investor confidence and create a more resilient and equitable global financial system.

NEGATIVES:

- Misuse of inter-corporate investments by management for personal gain can lead to financial instability, reputational damage, and regulatory scrutiny.

- Reckless or unreasonable investments may prioritize short-term financial gains over long-term strategic objectives, resulting in adverse outcomes.

- Without proper due diligence and risk management practices, companies may misallocate resources and destroy value, posing conflicts of interest and fairness concerns in corporate transactions.

- Critics argue that inadequate oversight and governance frameworks may exacerbate risks associated with inter-corporate investments, potentially harming investors and broader stakeholders.

In response to these challenges, regulatory bodies and international organizations have advocated for enhanced oversight mechanisms and governance reforms to safeguard investor interests and maintain market integrity. Recommendations put forth by scholars and committees emphasize the importance of transparency, accountability, and ethical conduct in inter-company transactions. Moreover, there has been a growing recognition of

the need for cross-border collaboration and harmonization of regulatory frameworks to address the transnational nature of inter-corporate investments and ensure consistent standards of governance and disclosure.

Moving forward, addressing the complexities of inter-corporate investments will require a coordinated and multifaceted approach involving policymakers, regulators, industry stakeholders, and scholars from around the world. By fostering a culture of responsible corporate conduct and implementing effective regulatory measures, countries can mitigate the risks associated with inter-corporate transactions, promote investor confidence, and create a more resilient and equitable global financial system. Furthermore, ongoing research and dialogue will be essential to deepen our understanding of the evolving dynamics and implications of inter-corporate investments in an increasingly interconnected and complex economic environment.

1.3 STATEMENT OF PROBLEM

Inter-corporate investments, essential for industrial management, exhibit a dual nature—contributing significantly to economic growth yet carrying risks of potential misuse of corporate funds. Investigations, notably by the Vivian Bose Commission, reveal instances of financial manipulation and fund dissipation. Government interventions, exemplified by the Bhabha Committee, reflect concerns about economic power concentration. Studies by experts like L.C. Gupta emphasize the prevalence of equity concentration through these investments. This study delves into these intricacies, aiming to strike a balance between controlling economic power and fostering growth, ensuring inter-corporate investments serve as efficient tools for positive contributions to the economic landscape.

1.4 OBJECTIVE OF THE STUDY

1. **To** Examine the provisions governing Intercorporate investment.
2. **To** Investigate the factors contributing to the misuse of Intercorporate investment.
3. **To** Review judicial decisions and legal precedents related to Intercorporate investment.
4. **To** analyse the existing legal framework to identify gaps in regulating Intercorporate investment.

1.5 HYPOTHESIS

Intercorporate investment legal provisions are inconsistent with the companies law and SEBI regulations.

1.6 RESEARCH QUESTIONS

1. Brief analysis of the legal provision about inter corporate investment specifically related to Company law ?
2. What are the factors involved in misuse of inter corporate investment ?
3. What are the gap in legal provisions in misuse of inter corporate investment ?

1.7 RESEARCH METHADOLOGY

The research is written with the doctrinal approach, focusing on legal analysis and interpretation that has sampled a historical journey from Indian company act of 1913 to companies amendment act of more » the three main aims are to study the development of corporate law in India and evaluate what those legal alterations meant for inter-corporate investment. Secondary sources consist of online platforms and the global web for law reports, articles and other legal content. Doctrinal data is gathered from a perusal of environmental law literature, analysis of different works written by authors on corporate and company laws included with attention to relevant legal cases and studying the acts legislation regarding inter-corporate investment legislation. The analysis includes a thorough review of the collected data to understand how corporate law in India developed over time and what effects legislative alterations had on inter-corporate investment. The research methodology seeks to offer an in-depth understanding of the subject matter, with both primary and secondary sources being used coherently organized doctrinal approach.

1.8 SCOPE OF THE STUDY

The scope of this study is expansive, encompassing numerous dependent and independent variables within the domain of inter-corporate investments. The primary objective is to investigate whether inter-corporate investments align favorably with the interests of both shareholders and company management. The determination of fair inter-corporate investment practices is intricately tied to the effectiveness of governmental and judicial

mechanisms in ensuring fair and reasonable dealings in this domain. The study aims to analyse the impact of these investments on various stakeholders and assess the role of regulatory and legal frameworks in maintaining a conducive environment for equitable inter-corporate transactions.

CHAPTER SCHEME

1. CHAPTER 1_INTRODUCTION

The chapter will provide with an introduction and the reason why this topic and the real rationale behind the research based on Indian scenario as well as on international

2. CHAPTER-2 LEGISLATIVE FRAMEWORK TO REGULATE THE INTER CORPORATE INVESTMENT IN INDIA

The chapter begins by outlining the historical position before the Amending Act of 1936, highlighting the need for amendments and the subsequent passing of the Act. It then examines the situation after the Amending Act, focusing on the persistence of managing agency evils and the subsequent reforms, including the passing of The Companies Act, 1956. The narrative shifts to the period after The Companies Act, 1956, discussing Shastri's position and subsequent amendments, along with reports from committees and commissions. The Companies (Amendment) Acts of 1974, 1988, 1999, and 2013 are also explored, tracing the evolution of inter-corporate investments under the Companies Act. The chapter delves into factors leading to the amendment of Section 372, restrictions on inter-corporate investments, the Sachar Committee report, and judicial trends related to Section 372A. The Companies Act, 2013, and its implications for inter-corporate investments are analysed, followed by a conclusion summarizing the key points and developments discussed throughout the chapter.

3. CHAPTER 3 INTER CORPORATE INVESTMENT PROVISIONS IN SEBI ACT

Chapter 4 of the SEBI Act explores inter-corporate investment provisions, beginning with an introduction to the topic. It then delves into substantial acquisition of shares and takeover regulation, examining the regulatory framework governing such activities. The chapter also discusses a draft regulation for substantial acquisition of shares in listed companies, presented as a consultative paper. This paper outlines objectives, approach, guiding principles, and key

considerations such as disclosure requirements, negotiated purchases in the open market, and exemptions for certain categories. The chapter concludes by summarizing the main points addressed in the consultation paper.

4. **CHAPTER 2 EXPLORES INTER-CORPORATE INVESTMENTS IN INDIA**,

covering various dimensions of this intricate landscape. Beginning with a historical perspective, it traces the evolution of such investments over time. The regulatory framework governing these investments is likened to navigating through complex seas, examining laws, regulations, and policies. Statistical data and trends provide insight into the current investment scenario, while legislative developments shape future investment practices. The mode of investment is analyzed in light of financial trends, and international comparisons offer a broader perspective on global investment patterns. Looking towards the future, the chapter explores the catalyzing influence of impact capital and concludes by summarizing the changing dynamics of inter-corporate investments in India, highlighting the need for adaptation and foresight in navigating these evolving seas.

5. **CHAPTER-5 ANALYSIS OF JUDICIAL PRONOUNCEMENTS ON THESE CORPORATE FRAUDS**

Chapter 5 delves into a comprehensive analysis of judicial pronouncements on various corporate fraud cases, providing insights into the legal responses, implications, and future considerations. The chapter begins with an introduction setting the stage for the discussion. It then proceeds to examine specific corporate fraud cases, starting with the Satyam fraud case, detailing the role of regulatory bodies like SEBI and SAT, along with judicial analysis and accountability. Subsequently, the Sahara case and Kingfisher Airlines case are explored, shedding light on fundraising strategies, legal proceedings, judicial responses, and implications for inter-corporate investments. The analysis extends to other notable cases such as the Chidambaram v Directorate of Enforcement, Punjab National Bank fraud case, ABG Shipyard case, and Yes Bank-DHFL case, highlighting key aspects such as inter-corporate abuse, regulatory oversights, and recommendations for improvement. The chapter concludes with overarching conclusions and suggestions, emphasizing the importance of regulatory vigilance, legal reform, and enhanced oversight in combating corporate fraud and ensuring transparency and accountability in the financial sector.

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CHAPTER : 2

LEGISLATIVE FRAMEWORK TO REGULATE THE INTER CORPORATE INVESTMENT IN INDIA

The chapter, therefore, follows subsequent steps of describing the genesis of the shareholding power in the legal context of Indian company.

The Indian Company Law has a long history which started from the Act of 1850. During the period between 1857 and 1923 constitute of such statutes as the number of consolidating and amending acts were passed. There are two main aspects that guarantee business success: firstly, to adhere to market-driven changes; and secondly, to satisfy the changing needs of commercial life.

Company legislation in India can be traced back to the English Company Law, such as the Companies Act that was passed from time to time in India, with some modifications. India faced with the task of economic restructuring in response to the realities of changing economic environment and for the purpose undertook comprehensive revision of corporate laws. It is widely accepted the reform and updating of the basic legal framework for corporate entities is essential to unable sustainable economic reform.

Now we will going to discuss the legislative framework of different timelines:-

2.1 POSITION BEFORE THE AMENDING ACT OF 1936

The Indian Companies Act, 1913 came into effect from April 1 , 1913[4]. The Companies Act of 1913 , which was in force , without any major amendment, till the beginning of 1937, hardly contained any provisions relating to the inter-company loans and investments . [5]If the memorandum of association of company provided for the acquisition of loan to the different company , management of the other had taken liberty to invest their funds in shares or debentures more or less in giving loan or in standing surety to another different company.[6]

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[4] Act VII of 1913, Act was based on English Companies Act, 1908

[5] "The Indian Companies Act, 1913 (Act No. VII of 1913) (Repealed in Pakistan)" (https://www.nasirlawsite.com/laws/incoact.htm, July 6, 2017) <https://www.nasirlawsite.com/laws/incoact.htm> accessed May 6, 2024

[6] Rai D, "Interesting Facts about the Origin of Company Legislation - iPleaders" (iPleaders, October

a) NEED TO AMEND THE ACT OF 1913:

Government of India , through its Indian Companies Act ,1913,[7] was seriously worried by the proposals of certain amendments as early as in July 1914 sent by the Bombay Chambers of Commerce . Their decision seems to have been that while the Act was updated only in 1913 and 1914 a measure of experience should be had of the working of the new act before the revision of it was being contemplated:

(a) ANNOUNCEMENT OF DUTIES FOR APPOINTMENT OF OFFICERS ON SPECIAL DUTY TO ANNOUNCE AMENDMENTS TO THE INDIAN COMPANIES ACT, 1913:

In view of the test of public opposition to the early reform of the Indian Companies Act, 1913, the Government of India, in June 1934, passed the Companies Act. It was decided to appoint a special Director to examine all such proposals for amendment and to make general recommendations as to how the law should be amended. For this reason, the Investigative Committee Mr. Sunil C. Sen has been appointed as Officer on Special Duty in the Ministry of Commerce. w. to. e.g. 4 September 1934.

(b) BRIEF OF THE OFFICER ON EXTRAORDINARY OBLIGATION ON THE REVISION OF INDIAN COMPANIES 1913

SH. S.C. Sen[8]__He submitted the report ten days prior to the deadline, that being on February 4,1935. Every idea regarding the alteration of the said act that reached him over time was considered by him. The major components in his paper were from different sources.[9]

There are many other sources and recommendations are the Indian Companies Amending Bill of 1936 aftermath the report of the Special Officer which is not observed yet, the opinions of the Advisory Committee which was reviewed in 1936 by the Government of

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18, 2019) <https://blog.ipleaders.in/history-of-the-company-legislations/> accessed May 6, 2024

[7] Ed 6

[8] Sh. S.C. Sen. In The(Then) Department of Commerce w.e.f 4.9.1934

[9] Communication in the nature of suggestions made by local government. Associated Chamber of individuals

India and then the opinions were split into two parts.

(i) MANAGING AGENCY SYSTEM

Managing Agency System was a form of business organization where single firm promotes, finances and administers one or more legally separate and independent companies. A relative and persistent shortage of entrepreneurial ability, risk capital and managerial talent, led to its development , both by the British and Indian trading merchants , who had acquired knowledge of the opportunities for industrialization thrown up by India's raw material and domestic markets . Gradually these managing agency firms came to control several companies in a few industries. in fact, these managing firms are themselves, in most cases, owned by industrial concerns frequently developed as family concerns, which are today popularly known as business houses. Under these circumstances, competition among the units owned and controlled by the single managing agency or business house , was for all practical purposes absent and economic power got concentrated in the hands of these business groups.

The managing agency system was peculiar to our country and it has a luxuriant growth in our country. Perhaps in early days of joint stock companies in played an important role , and it may be said that without managing agents many companies would never had come into existence.

The system which grew up as a useful institution, in course of time , came in for adverse comments both at the hands of the jurist as well as public . Even as early as in 1880's the abuses of this system have been noticed. In fact Lord Russel, while making observations on the Indian company act , 1882 lamented that there was no attempt in that act to restrain such abuses by the agents of companies who think that the laws of the country of their origin are no longer applicable after their departure for India. What started from this period is as a consequence the criticism for even such an early occasion has turned into the prevalent one, making the human resource management the pillar of support in all the future decisions.

Even though the managing agents have rendered many services in the process of industrialization, there is also another side of the coin, i.e. , the proliferation of evil and collusion among the managing agents without the involvement of companies act 1936 were unregulated powers and functions of the managing agents . They mostly work as a team or pair with garments imitating seasons or being in specific style. In general, In general, the

excesses arising from the audit powers over the finances of the managed companies in which the managing agents have limited or sometimes no risks involved either financially and yet wield full powers over the management of the aforementioned companies, the shifting of monies from one company to the other through loans and investments, different types of abuses in purchasing, controlling, and selling raw materials and inventories of managed companies for personal gains In the contrary, during that period, the managing agents were paid by their share in the profits but it would not matter if the firm did not get the profit.[10] Furthermore, the managing agency was thought that the System also gave rise to one dominant class in the persons of the managing agents and some powerful firms in the managing function. The first regulation attempt was in 1936 to limit the system and introduce some restrictions. Sections 87A and 87l was included in 1936 in this act which is specific to managing agent without considering other provisions which give the checks, limitations and the power of these agents.

Now, we will examine the Managing Agency System and pass some remarks from different important acts of A few of these prior works are commissions and committees e. g Indian Industrials Commission 1916-18; The activity board in its report of cotton material businesses 1926 more broadly its report on cotton material businesses 1932; Banding request committee in 1931-32[11] .

In report of the Tariff board(1932) in connection with the enquiry made regarding the grant of protection to the cotton textile industry , the matter to which exception was taken to be :

1. Inter- investment , or the investment of the surplus funds of one company to the other company run by the same managing agents (the results of this was stipulated to be the perpetuation of the thoroughly insolvent concerns which it would be the interest if managing agents and of industry to have closed down).

2. Against the practice of financial capital expenditure by the short-term loans (this was characterized by the board as an essential unsound policy . After examining the complaints , which it must be stated were mainly directed to the mismanagement by the

[10] “E. D. Sassoon and Company Ltd. Vs the Commissioner of Income-Tax, Bombay City. (with Connected” (Legal Authority) <https://www.legalauthority.in/judgement/e-d-sassoon-and-company-ltd-vs-the-commissioner-of-income-tax-bombay-city-with-connected-2803> accessed May 6, 2024

[11] Then the Fiscal commission, the income Tax investigation Commission , Planning commission

managing agents of the various companies in Bombay , the tariff board came to the conclusion that a sufficient case has been made out for an early legislative action to protect the interest to the investor from the abuse of managing agents as indicated above . These are the materials facts of the circumstances that the eminent companies involved in managing agents had failed, as well as the revelation of the ashamed truth on the terms of their accessions and the inquiries done which consequently made the inherent failures of the system disclosed, by the way.

1. The lack of the effective supervision and control of the directors is the problem here.

The shareholders finding themselves in a helpless situation when the managers are guilty of negligence or any breach of duty despite the reason being the impossibility of the governing clauses of removing the agents from office will be prevailing .

The system of managing agent may have ever been abolished since then, but the calls were regarding to the significance of that system and defining the limitations of terms on which managing agents can be appointed. Mr. Sen was originally recommended for the second alternate and not the first. It was not by statue but by shareholders only. Wells also consider the matter of whether limits to which the managing agents may be appointed can be imposed or not. Some proposals have arrived as to what measures should be included in the statutes. This can be enumerated as follow:-

1. That there should be no inter – investment of funds :
2. That managing agents should be subject to the control of the directors in matters of management

He mentioned the hardships of limiting the conditions on which the managing agents may be hired as they are significant. Among the crucial factor as to how a company or man or syndicate will become the managing agent is always on the understanding between the person on one hand and the company on the other. Through this way the legislative may put down whatever terms they want , however unless of individual is prepared to accept the given terms the agency will not be used up .

Secondly , existing managing agencies ought to be a major target.

Therefore, he was the one who pointed out the fact that it's the legislature's responsibility to make available the opportunity to the shareholders (who already don't have it) to assess the terms and conditions of the appointment and to choose the option that they would prefer. The facilities should also include the shareholders to be given the opportunity to remove the managing director. At the managing agents, agents for this kind of crime and misconduct. negligence and breaking the duty standard.

(i1) **TRANSFER OF POWERS BY DIRECTORS**:

e. Me Sen. was not contradicted to the truth that the board of Chiefs had the tact to assign most of its powers to overseeing specialists. On the opposite, he was of the conclusion that but the powers to borrow and to bargain with the resources of the company which agreeing to him may as it were be worked out by the Executive, other powers may be designated by the executives beneath as numerous impediments as has been endorsed by such a determination so passed within the Additional Conventional Common Assembly called for the reason.

ii) Loan to Directors:

Mr. Sen. The recommendations on intra-worker loans and investments, especially deal with the following items.

The power to invest should be solely vested in the directors by the directors themselves. Such power is being entrusted by them to whom it should not.[12] Special Unit staff explanation was that suiting Funds as a financer to the sister companies was not a gratifying matter. However, he did not propose any other redrawing (by the exception mentioned above). He contends that I have already suggested in the chapter relating to the Directors some proposals which will make it possible for the shareholders to decide as to how the surplus of the company should be utilized, and they will be able to make such decisions and, in that way, prevent any investment except on the very lines approved by the shareholders through appropriate exercise of their rights.[13]

2.2 PASSING OF THE AMENDING ACT OF 1936

[12] Muthukumarancs, "All about Loans to Directors – Section 185- Companies Act, 2013" (TaxGuru, February 27, 2019) <https://taxguru.in/company-law/loans-directors-section-185-companies-act-2013.html/comment-page-1/> accessed May 6, 2024

[13] Manu, "A Research Report on Inter-Corporate Loans and Investments" (Scholarticles, August 31, 2015) <https://scholarticles.wordpress.com/2015/09/01/sp7/> accessed May 6, 2024

In the month of November 1935, the Government of India prepared a provisional list of possible changes to the company law. Where the bill was being draft before it can be presented, the government was mandated to Have discussions with members of the Associated Chamber of Commerce and Industry, [14]

Government of India on November 25, 1935 forwarded a note to the Indian Federation of Chamber of Commerce, and Industries, Bombay Shareholders Association, Bombay Mill Owner Association, and banking industry in India inviting nomination. Therefore, a committee was constituted with the Left Hon'ble Sir N. N. Sircar, Law member of the Executive Council and the Committee met first time at New Delhi on 26.01.1935. Thus, the final draft included the following recommendations:

1. Taking the loans or giving the advances to the companies that are managed by the same company shall be prohibited.

2. Borrowing shall not have any relations with providing guarantees to banks or other sources of funds by the companies under the same managing agency.

3. Any transfer of shares or debentures of a company which is under a managing agency's control requires a majority vote of 3/4 of the board of directors in order to be affected.

4. The rights to SANs should only be vested in rectors or made executable subject to their authority of the rectors. Also, it was agreed that the appointment of the board of director should be in relation to the actual and class of investment.

Thus, based on the recommendations given above, the need to address the Companies Act of 1913 was proposed in the Legislative Assembly on the 23 rd. of March,1936.[15] The provisions outlined in the bill aimed to regulate inter-corporate investments and were structured as follows: The provisions outlined in the bill aimed to regulate inter-corporate investments and were structured as follows:

1. Paragraph 35 of the Bill included a new Section 87E to the Companies Act of 1913 which sought to affect the restriction of making of loans within the same management-controlled companies.

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[14] Mahawar S, "Section 186 of Companies Act 2013 - IPLeaders" (iPleaders, February 23, 2023) <https://blog.ipleaders.in/section-186-of-companies-act-2013/> accessed May 6, 2024

[15] advocatekhoj.com, "Loans, Etc., to Companies under the Same Management | Companies.Html | Bare Acts | Law Library | AdvocateKhoj" (Copyright 2024, advocatekhoj.com) <https://www.advocatekhoj.com/library/bareacts/companies/370.php?%20Title=Companies.html&STitle=Loans,%20etc.,%20to%20companies%20under%20the%20same%20management> accessed May 6, 2024

2. As stated in Clause 35 of the Bill the Division of Section 87F of the Companies Act of 1913 would be inserted into the Act. This section was to prevent the purchase by the

3. The proposal related to clause 35 was Clause 87G to be included in the Companies Act, 1913 by company law. The main objective of this part was to reduce the risk of abuse by the managing agents of the gains earned by the companies under their charge.

The motion for the introduction of the aforementioned Bill as a Select Committee was moved on April 15, 1936 and was adopted by the house on April 18, 1936. Moreover, the draft of the bill was also sent departmentally with a request for an opinion, on the last day of April 1936. All the views and views were put across to the select committee. The Bombay Stock Exchange (BSE) shareholders' associations opinion on Section 87E and 87F is worth mentioning here.[16]

This move aimed at section 87E to outlaw inter-locking loans among companies in the same management. Moreover, it endorses sections 87F which is as well compelled to present certain alterations regarding these two sections.[17]

This year 1937 represents the start of a new era in the development of the Joint Tock System in India. The Indian Companies (Amendment) Act, 1936 was a far-reaching reform in the entire legislative process. It has been stated that on this day Joint Stock System in India came to rise from its infancy age to manhood age. The laws governing companies in India were totally revamped and state of the art measures were adopted for uprooting the evils which had started spreading their tentacles and at last posed threat to Indian business. This Act of 1936 was not an amending but a consolidating Act.[18]

2.3 POSITION AFTER THE AMENDING ACT OF 1936

The scene of the Amendments Act of 1936 was that there is no major development in the Company Law for the duration of 15 years after that. The most crucial improvement in Company Law happened with the Government of India the pairing the Indian Companies

16 Published in the Gazette of India dated March 28, 1936.

17 Suhirid CA, “Loans and Investments by Companies under the Companies Act, 2013” CAclubindia (January 14, 2016) <https://www.caclubindia.com/articles/loans-and-investments-by-companies-under-the-companies-act-2013-25932.asp> accessed May 6, 2024

18 Saha T, “Loans, Etc., to Companies under the Same Management – TaxDose.Com” (July 25, 2018) <https://taxdose.com/loans-etc-to-companies-under-the-same-management/> accessed May 6, 2024

(Amendment) Ordinance, 1951 on July 21, 1951.

(a) CONTINUANCE OF THE EVILS OF MANAGING AGENCY SYSTEM:

The Amendments instigated in 1936 on the roles and powers of managing agents, it was found, by no means were sufficient to prevent the abuse of power by the managing agents. Furthermore, circumstances as well reality that became a factor in these evils. The war was certainly a double-edged sword that helped the top brass officers to alter the company's capital the way they wanted. The tine, Which be the cause, also gave a universal lawity to the presence of the evils. Two of the most serious charges directed against the managing agents of the companies were that are termed as: (i) stirring in and launching off of Companies' cash and (ii) sneaking in or evading the agents managing right.

(a) NEED FOR REFORM TO REMOVE THESE EVILS

During the World War II, in 1936 the Indian Companies (Amendment) Act was enacted. This Act caused the revision of the Companies Act of 1913, but there was the demand for further amendment to this Act once again after the World War II . The abrupt and hasty increase in the industrial production as a result of the rapid pace of war demands created several malpractices in the Companies Act, and the administration defects enabled some businesspeople and financers who had no long and traditions of the service to the community to amend and not to consolidate the Act.

In addition, sometimes the company law is utilized or perhaps it is not to serve the purpose of a few at the expense of the rest. The absence of an active organization which could manage the Act effectively and the idea of remedial measures through administrative methods is extremely hard to pursue.

The interim report recommended certain key changes to the Act and due to the fact that the Indian Companies Law has been fairly close to the existing English Company Law, the Government considered that the right time could never have been better to have a review of the law. Indian Companies Act.,[19] Consequently there was a demand for quick reform of the company laws.

[19] . (report of The Company Law Committee (1952), Manager, Government of India Press, New Delhi at para 1.)

(b) **REPORT OF THE OFFICER ON SPECIAL DUTY AND ITS EXAMINATION BY THE GOVERNMENT**.

Consequently, the first step of the Government of India was taken in March 1946 when Shri mandal's Dwarkadas was designated as an officer 'on Special Duty' to fully suggest ways for the Indian Companies Act to be revised not only with respect to the centers of the English Companies Acts but also in compliance with the new points in trading and industry in Indian since 1936. Either during the war, or in the aftermath, of war and post years. In 1946-1947 Shri Dwarkadas made a submission in three parts, however, he could not finish his work because of other engagements. Finally, the Government of India granted the name to Shri V K. Thiruvenkatachari, a member of the State Ministry, to carry out certain other researches in the matter and advise the Government. He handed in his work by 16 October, 1948.

The recommendations of Mr. Dwarkadas on inter-corporate investments and loans were as follows: The recommendations of Mr. Dwarkadas on inter-corporate investments and loans were as follows:

1. Section 87E of the Companies Act of 1913 was much more limited than section 212 of the Corporations Act of 2001 and applied solely to forms of loans between companies having the same management.

2. It was unlawful for a company to raise shares in other companies on the same management of the purchasing company without the conformity of the board of directors in accordance with Section 87F of Companies Act, 1913. Mr. Dwarkadas elaborated his fears in this regard by arguing that this provision is rendered virtually worthless when the directors are, in effect, appointees of the managing agents.[20] "

On the other hand, Mr. V K. Thiruvenkatachari made a proposition of replacing the term 'unanimous decision' with 'approved in writing', which should bear the signature of all directors of the purchasing company in Section 87F.

The proposals have been made with an extensive study by the Government of India in consultation with Mr. M. K. Mazumdar. The recommendations made by Mazumdar could be formulated after he went over the matter meticulously as he was the former Registrar of Joint Stock Companies of West Bengal. They are several memorandums written by the

[20] (Report on Company law Reform by Trieundas Dwarkadas and VK. Thireven Katachari (1950) at Para 86.

Bombay Shareholders' Association that he also reviewed concerning the avoidable corporate practices by managing agents for

borrowings,

loans and advances,

investments,

book debts and

interlocking dealings and transactions.

The memorandums provided evidence that borrowings were utilized for purposes outside legal boundaries. They highlighted instances where loans and advances of a non-trading nature were extended to friends and nominees, alongside engaging in illegitimate deals and transactions with affiliated entities. Additionally, they pointed out cases where assets of financially stable entities were mortgaged and debentures were issued not out of necessity for the concerns themselves, but rather to serve the personal agendas or plans of their managing agents.,[21] '

The memo of Mr. M. K. Mazumder identified some groups and then he recommended his own suggestions for them. However, these proposals and recommendations were documented in a memorandum on the amendment of the Indian Companies Act and distributed to all state governments as well as prominent industrial and commercial associations all over the country on 1 December 1949. There was confusion on the nature of the memorandum which gave the impression that the Government was still in the process of formulating its policies to open up for discussion instead of being an outline of the proposals which would be departmentally proposed and the ideas circulated in order to attract response. These issues caused misunderstanding and generated vast comments from the public, whereby feedback was obtained for six months in 1950.

In response, the Government of India under Resolution No. 23 (71) Law (C. The L. 39) date 28th October, 1950 constituted a committee under the leadership of Mr. C. H. Bhabha. They were the shareholders' representatives, the representatives from the accountancy or legal profession, the trades and industries, and representatives of the Central Government.

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[21] Memorandum of the Bombay Shareholder's Association on Managing Agents (1949))

Recommendation of the Company Law Committee: The 'Bhabha Committee' or the Company Law Committee looked into the points that were given in a response to the points raised in the memorandum from the Government. It is also imperative to state the panel heard all witnesses and made its final action on proposals on February 29, 1952. However, during this phase, some emergent changes were brought out to tackle the vices and the ill of managing agency system. Therefore, the Indian Companies (Amendment) Act, 1951 was passed merely as camouflage. This Act severely limited the scope of company operations in various ways: restrictions on the appointment or reappointment of directors or the number of directors; an establishment of rules on managing directors and managing agents; and on changes in the constitutions of managing agents. Police approval was needed for such matters, which came under the purview of Central Government. The rationale behind these provisions was to ensure that companies did not bear unjustifiable high-cost risks and that there were limited flippant changes in controlling interests.

Post World War II, specifically during the war and till the early 1980s, more cases of aggressive overinvestments and related scandals surfaced involving company loans. Accordingly, the Company Law Committee recommended that the proper measures should be adopted in order to prohibit inter-company loans or investments abuses in the future. Describe the problems of the existing lines that the Committee saw and the changes that need to be made to the lines according to the organization.

1. It is advisable to prohibit the funding of a company being managed by the same team, providing any guarantee or structure securing any company except whenever a special resolution is made.

2. A definition for what a company is deserved to be given.

3. Some companies were not subject to the Section and therefore were free from the operation of the Section.

Proposed to be included as a new Section 86CC is subsection C of the act. In consequence of this section, the contrast can be mentioned that no management agent of a business company may be given the power to invest the company's money which is contained in the Articles of the business company or otherwise.

4. By the unanimous consent of all the directors present in India, the directors of an investing company should be entitled to invest up to but not exceeding 10% of the

subscribed capital in which investment to be made and not exceeding 20% of the subscribed capital of the investing company in a 'particular group'. Normally, the limits involving transaction authorization should be determined by a special document, which will be confirmed by a resolution of the investor.

5. Some attempts were made to solve the issue of 'particular groups definition'.

6. The investment companies should also be subjected to the proposed amendments and all other companies that are not investment companies should prepare a list of companies in their group in which the investment have been made and attach it to their balance sheet.

7. Having said that, the suggestions mentioned here do not affect any existing investments and should be applied gradually, starting from the document publishing date.

8. If company happens not to be privately owned (it is not a subsidiary of the Public company), banking company, insurance company, Managing agency company while acting under their agency should not be listed.

9. The committee never proposed any limit on the investments made by a company on the shares of another corporation outside the 'particular group'.

10. In order to tackle the problem of the company directors using the corporate investments for illegitimate purposes the committee suggested a new section be added after Section 88 and it should include the stipulated that all the investments to be maintained by a company in the company's name, except the qualification shares if there is some nominated director requirement as this shares can be held by the company or its bankers.

One of the scenarios the committee looked at involved sale of the enterprise to either the central or local authorities whereby the director had immediately disposed of the sales proceeds, even without any prior consultation with the company.

2.4 THE COMPANIES (AMENDMENT) BILL, 1953

A bill[22] based on the recommendations of the Bhabha Committee was introduced in

[22] Published in gazette of India, Extraordinary, Part-II, Section-2 dated September 21, 1953.

September 2, 1953. The relevant clauses of the bill applicable to the Lok Sabha on inter-investment were as follows:

1. Clause 44----------------------- Investment to be held in the name of the Company
2. Clause 271---------------- ----- Certain powers to be exercised by the directors only
3. Clause 271 --------------------- Restrictions on power of directors.
4. Clause 352 ---------------------- Loans of managing agents
5. Clause 353----------------------- Loans etc. to the companies under the same management
6. Clause 355 the same group (1) & (2) ---- Purchase by company of shares, etc. of other companies in the same group (1) & (2)
7. Clause 356 -------------------- Investment before the commencement of this Act.
8. 8. Clause 357 ----------------- Penalty for contravention.

A major change was to include the recommendations of the Bhabha Committee made to the Government.

1. Another important amendment in Sections 87F toward the recommendations of the Committee to the current manifestation was the substitution of the contents of the phrase 'particular group by guys' to the same group as those similar men's. Hence, the technical terms used in drafting in the definition was also very high.

2. The proposal elaborately stated that the proposals take effect as of the date when the report is published, i.e., March 10th, 1952. This was also slightly modified as the Government put a clause in the Bill that Clause 335 will take such kind of hold from April 1st, 1952.

3. The Committee recommended that all the investments that the company holds should be registered under the name of the company. The bills except nominee director which states as qualifying share. The Committee suggested that such stocks, being in the name of director, could be registered as such. The Government took a more practical approach and made it clear in the Bill that such shares could be registered jointly in the name of it and of everyone. Contravening this provision became punishable with a penalty and it was already provided for in the Bill.

(f) JOINT COMMITTEE ON COMPANIES (AMENDMENT) BILL, 1953

The motion for reference of the Bill to Joint Committee of the two Houses was moved in the Lok Sabha by (then) Minister of Finance, Shri C.D. Deshmukh, on April 24, 1954[23]. The Committee held 61 sittings in all. The Committee heard the evidence tendered before them by trade association from July 3, 1954 to August 16, 1954. The Joint Committee after considering the comments and memorandum by various interests submitted its report on May 2, 1955.[24]- It made the following modifications:

(1) MODIFICATIONS IN CLAUSES 369 & 370 (ORIGINAL CLAUSES 352 & 353)

If a company gives a guarantee, or provides any security, in connection with a long made to any other person by its managing agents or any other associate of its managing agent, the prohibitions contained in these clauses should obviously apply. The committee have secured this result by adding the words "or, to any other person by, in the opening paragraph of the Clauses.

(2) MODIFICATION, IN CLAUSE. 372 (ORIGINAL CLAUSE 355)

The Committee considered it unnecessary to provide for the passing of a special resolution committee considered it more useful to add the safeguard of approval by the Central by the company for making the investments referred to in sub-clause (3), Instead the Government. Further the Committee added sub-clauses (5) & (8) to provide for the maintenance of a register of investments and for all consequential provision thereto.

(3) MODIFICATION IN CLAUSE 48 (ORIGINAL CLAUSE 44)

The committee that, this clause which requires a company to hold all the investment in its own name should not apply to an investment company whose business consists of buying

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23 Joint Committee Report, Published in gazette of lndia, Extraordinary, Part-Il Section 2 dated May 2, 1955 at Para 2.

24 See the Joint Committee On The Companies Bill, 1953 Evidence.

and selling of the shares, stock, debentures or other securities Deposits of securities in a bank for the collection of dividend or interest and deposits or transfer by way of security are permitted In case of investments held by a company at the commencement of the Bill, the period of six months allowed by the bill as introduced for compliance with the provisions of companies act been increased to one year. The Committee have also provided for the keeping of a register of all. securities belonging to but not held by a company in its own name.

(4) MODIFICATION IN CLAUSE 373 (ORIGINAL CLAUSE 356)

Here also the requirement of special resolution had been altered to ordinary resolution coupled with the approval of the Central Government. Time limit with in which existing investments must be disposed of (if other formalities not completed had been extended from one year to two year.

(g) PASSING OF THE COMPANIES ACT, 1953

The Companies Bill, 1953, as modified by the Joint Committee was discussed in the Parliament. The Lok Sabha made some alterations in Sub-Clause (4) of Clause 372 before adopting it. The Bill was passed and the New companies Act came into force on April 1, 1956. Sections 372, 373 and 374 were the main sections dealing with inter-corporate investments. Under provisions of the Companies Act applicable on inter-corporate investment are as follows:

1. Under Section 49 all the investments (subject to some exception) made by company on 1S Own behalf shall be made and help by it in its own name.
2. According to Court. Section 292 power to of directors of a company. However, such power can be delegated to some persons.
3. According to Section 293 sale proceeds resulting for acquisition can be invested only in trust securities.

2.5 POSITION AFTER THE COMPANIES ACT 1956

4. The Companies Act, 1956 came into force on April 1, 1956. Only after 13 and half months of its enforcement, the Government of India by its order of May 1957 constituted a Committee under the Leadership of Shri A.V Visvanathan Shastri, Retired Judge of Madras High court

(a) SHASTRI'S COMMITTEE REPORT:

The Committee examined the views and suggestions of the (then) Department of Company Law Administration with regard to remedying defects and removing difficulties found from experience of the working of the Companies Act, 1956. The Committee also heart, examined a discussed with the preventatives of shareholders, trade, industry workers, bank. professional accountants, millionaires and lawyers. The Committee submitted its report to the Government of India in November 1957[25]. The recommendations of the committee on inter-corporate investments were as follows:

INTER-CORPORATE INVESTMENTS

1. It was pointed out by a chamber of commerce that when a new company is sponsored by an existing company, if often becomes necessary that a substantial block of shares, in the new enterprise should be taken up by the sponsoring company, with a view to get confidence of the public and that the limit of 10% is inadequate. The committee rejected the proposal.

2. Section 372(9) of the Act to be made more Clear. This was proposed to be done by inserting the words during the Course of the Financial year as well as those in which Shares or debentures held by it at the end of such year after the words made by it

3. The Committee also did not suggest any restriction on investments made in companies outside the same group.

4. The Shastri Committee do suggested some modifications in Sections 49 and 293 and in the definition of same group.

(b) **THE COMPANIES (AMENDMENT) BILL, 1959:**

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[25] See, report Of the Companies Act Amendment Committee, Published by Government of India, Dept. Of Company Law Administration, New Delhi, (1957).

A Bill to amend the Companies Act was presented in the parliament on May 1, 1959. In the Bill, the Government not only incorporated the recommendations of Shastri Committee, but also includes objects and reasons to the Bill

The Government had commented on Section 370-373 of the companies Act, 1956, in First Annual Report on the Working and Administration of Companies Act, 1956 as follows.

It will be pertinent to emphasize, in the Context, that the scope of Sections 370-373 of the Companies. Act which deal with inter-corporate loans and investments, is limited to loans and investments made to or in the companies under the same management. Even in regard to inter-company investments to and in companies under the same management group, the provisions of these sections will apply only if two or more companies conform to the definition of companies with in the same management group, as laid down in Section 372. The experience of working of these provisions had disclosed obvious loopholes in these definitions, of which advantage has been taken by several companies. The informal committee on the amendment of the Companies Act went into this matter and suggested some changes in the definition of companies under the same management' with the object of plugging some of these loopholes and of otherwise strengthening these sections. Those who support the view claim that as the Government have already accepted, in principle, the need for regulating the utilization of company reserves in the public interest, this principle should specifically embodied in the provisions of Section 370-373 of the Act which are primarily concerned with inter-company investments[26]

This way the experience of the first year of the working of the Companies Act, 1956, i.e. year ended in March 31, 1957. The Government further commented on the inter-corporate loans and investments as follows:

The report of, the inspectors appointed to investigate into the beneficial ownership of shares of a public company, revealed that the shares of the company had been cornered very successfully by means of inter-corporate investments. Thought the Companies were not in Same group with in the meaning of; Section 370 and 372 of the Act, they were unquestionably being controlled nominees in question. This case has once again highlighted the need for extension of the whether the companies concerned are or are not in the same group, or defined in the Act. As stated in the First Statutory report, this is an issue of police

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[26] Annual report on the working and administration of the Companies Act, 1956 dated march 31, 1957

which will be considered when the by the same amendment of the companies Act is considered,[27] individual. The directors in all cases were dummies, being the 24

Mentioning the experience gained during March 1, 1956 to March 31, 1959, Government further added:

The experience gathered during the last 3 years since the present Act came into force, has shown that while the restrictive provisions of these Sections has had some salutary effect on inter-company investments with in the same managing group, these clearly requires further strengthen and Some obvious loopholes has to be closed. It has been further disclosed that is undesirable inter-company investments have to be prevented the scope of Section 372 would have t to be suitably extended also to include companies outside the same management group. In particular the existing definition of companies in the same group as was given in section 370 hod been found to be extensively narrow. It is, therefore, proposed to amend the definition of companies in the same group by adding a new criterion, and also to extend the rest strive provisions of Section 372 to all inter-company investments; [28]

The Bill of 1959 as it was originally introduced merely sought to provide a more comprehensive definition of the expression companies under the same group in the light of the experience gained of the working of Section 370. The other amendments proposed were either of a classificatory nature or to remove drafting defects.

In the, Bill a new Section 372 was drafted to substitute the existing Section. Main charges were as follows:

1. Shastri Committee's recommendations on the modifications of sub-section (7) of Section. 372 was accepted and include in the Bill. Here as below.

2. Extension of the scope of section 372 to bodies corporate outside the definition of the same management, It was proposed in the Bill that the aggregates to the investments made by one company in all other bodies corporate (Whether in the same management group or not) should not exceed 30% of the subscribed capital of the investing company. This important change was included in the Bill from the experience gained Since the submission of S Shastri Committee's Report till the presentation of the Bill.

3) Two more particulars were proposed to be shown in the register of investments.

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[27] Annual Report On The Working and Administration Of The Companies Act, 1956 dated March 3 1, 1958

[28] annual report of the Working and Administration Of the Companies Act, 1956 dated March 31, 1959

3. JOINT COMMITTEE ON THE COMPANIES (AMENDMENT) BILL, 1959

Various Trade and industrial Associates gave their view and suggestions on the Amendment Bill. 14 associations also tendered Oral evidence before the Joint Committee.

Tata Industries (P) Ltd. The Associated Chamber of Commerce of India, the Indian Chamber of commerce, Calcutta and FICCI, all proposed the proposals regarding Section 372 of one ground or the other. The FICCI observed that Industrial development of the country might be seriously affected by the provisions of Section 372. Some of them suggested that the investment in the right shares should not be subjected to percentage ceilings of 20 or 30% as proposed in Section 372[29].

After considering all the suggestions the Joint Committee modified the Bill on the following Iines:

1. Section 370 would be attracted also in the case of a loan made or guarantee given by a company to a firm, any partner of which is a body corporate under the same management as the lending company.
2. Every leading company should company should keep a register showing the names of all bodies corporate under the same management as the lending company.
3. Detailed particulars regarding the loan made, guarantee given, etc. should be entered in the register
4. The register should be open to inspection by the members of the company.
5. Failure to maintain the register must be made punishable with the fine.
6. 1n applying the limits of investments of companies outside the same group investments in the shape of debenture should be left out because acquisition of debentures do not help in the acquisition of control over these companies.
7. Investments in n right shares should not be subjected to percentage ceilings. According to the committee, the investments in the right shares does not formally means acquisition of a greater degree of control over the invested company and are sometimes absolutely necessary if the investing company is to maintain its existing position in relation to the

[29] See report of the Joint Committee, published by Lok Sabha Sectt. (1960).

conduct of affair of the o other company. But it was made clear that the investments made in the right shares must be taken into account for the purpose of applying the limits when further investments are to be made in shares other than the right shares.[30]

8. The infringement of the provisions of sub-section (6) & (7) of the proposed section might be punishable additionally with a fine of Rs. 50/- for everyday during which default continues.

9. Finally. the committee proposed that the investments companies should attach to their balance sheet a statement showing only the investments existing on the date of the balance sheet.

The Bill (after being modified by Joint Committee) was discussed in both the houses of the Parliament. The Parliament added few words in sub-section (1) of section 372[31] as to include indirect investment by companies in shares of other companies

(d) REPORT OF COMMISSION OF INQUIRY (VIVIAN BOSE COMMISSION)

1.) The action which in the opinion of the commission should be taken to act as a preventive in future cases.; and
2.) The measure which in the opinion of the commission are necessary in order to ensure in the future the due and proper administration of the funds and assets of the companies are firms in the interest of investing company.

A number of cases came to the notice of the Commission where investments were made by Companies in other even though such investments were clearly not in the interest of the Investing company but were made from a variety of motives, e.g. to gain control over the affairs of the investee companies, to obtain loans and advances with or without securities for the inverse companies .

[30] , "Purchase by Company of Shares, Etc., of Other Companies | Companies Act, 1956 | Bare Acts | Law Library | AdvocateKhoj" (Copyright 2024, advocatekhoj.com) <https://www.advocatekhoj.com/library/bareacts/companies/372.php?%20Title=Companies%20Act,%201956&STitle=Purchase%20by%20company%20of%20shares,%20etc.,%20of%20other%20companies> accessed May 6, 2024

[31] advocatekhoj.com, "Loans, Etc., to Companies under the Same Management | Companies Act, 1956 | Bare Acts | Law Library | AdvocateKhoj" (Copyright 2024, advocatekhoj.com) <https://www.advocatekhoj.com/library/bareacts/companies/370.php?%20Title=Companies%20Act,%201956&STitle=Loans,%20etc.,%20to%20companies%20under%20the%20same%20management> accessed May 6, 2024

The commission submitted its report in October 1962. The commission suggested[32] that obtain loans and advances with or without securities from rank at par with inter-company investments and should be subject loans should to the same restrictions as the later. Accordingly, the companies (Amendment) Act, 1965, omitted the words which is under the same management as the leading company from sub-Section (1) of Section. 370 of the Companies Act, 1956.

At the instance of the Government of India, a committee of lawyers (C.K. Daphtary and AV Visvanathan Shastri) was appointed to made the recommendations for the amendment and administration of the Companies act in the light of the Report of the Dalmia-Jain Commission. An amendment bill was introduced in the Parliament based on the suggestions and recommendations of the Dalmia-Jain Commission and the Daphtary-Shastri Committee Report, and was passed as the Companies (Amendment) Act, 1965.[33]

It seems that Committee did not examine the effectiveness of the regulatory framework of section 370 and 372 in detail and as a consequence they failed to point out some of the major deficiencies of these sections.[34]

(d) SUMMARY OF THE MAIN CHANGES INTRODUCED AFTER AMENDING ACTS OF 1960 AND 1965

After the Companies (Amendment) Act, 1960,[35] but before the enactment of the Companies (Amendment) Act, 1974[36] the following changes were made in the law elating to tie inter-corporate loans and investments.

1. Experience of the working of the Act showed that he definition of same management needed further tightening up if widespread evasion of the spirit of the section 370 was to be presented. Accordingly, the companies (Amendment) Act 1960 attempted to strengthen this section.

2. The companies (Amendment) Act, 1965 management as the lending company, from sub-section (1) of section 370 of the companies Act 1956. Consequently, all loans made by a

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32 See report of The commission of Enquiry, Published by Government of India, (1963), at Para 32.
33 Act No. 31 of 1965
34 See report of the Daphatry and Shastri Committee
35 Act No. 65 of 1960.
36 Act No. 41 of 1974

company to other bodies corporate came under the purview of the section. Hither to the section applied only to the loans given to bodies corporate under the same management. The amendments to Section 370 implements the suggestions that inter-corporate loans should rank at part with inter-corporate investments and should be subject to the same restrictions as the later.

1. Section 370A was inserted by the Amendment Act of 1960. omitted the words which is under the same

2.The scope of the section 372 was widened in the Amendment Act of 1960 to include all public companies and p private companies which were subsidiaries of public companies irrespective of whether or not the companies were under the same management as defined in Section 370 of the act.

3. Investment Companies were exempted from the operation of sub-section (5) of Section 27) This was incorporated on the representation of some chambers of commerce by Section 47 of the Companies (Amendment) Act, 1965.

Reference to managing agents and secretaries and treasurers were omitted as they ceased to exist from April 3, 1970.

(d) ADMINISTRATIVE REFORMS COMMISSION-REPORT OF THE WORKING GROUP

ln sponsor an in-depth study on several major issues relating to the corporate sector the Administrative Reforms Commission decided to set up a working group under the Leadership of Shri D.L. Majumdar on August 11, 1967. The term of reference laid down for the working group included, inter-alia, to examine whether the provisions of the Companies Act relating to inter-corporate loans and investments and other financial restrictions are suitable designed to secure wide dispersal of ownership and avoidance of concentration of economic power and to consider the extent the which they have been effective.[37]

[37] See Administrative Reforms Commission, Report of The Working Group, Company Law Admn, (1968), at Para 2.

The view was expressed[38] that the limits with in which a public company could invest in the shares of another company were unduly restrictive. It was contended that, in depressed state of the money and capital markets, they deprived newly formed as well as existing companies from drawing formation source of capital and thereby acted as disincentive to the Further, complaints were made about the delay in the sanction of on an important of the capital. inter-company investments beyond the prescribed limits even in cases where such investments were such investments were such investments were otherwise fully justified.

The working Group examined the statistics relating to the applications submitted to the Government under Section 372 of the Act and is not found that the operation to the application submitted to the Government under Section 372 of the Act and did not found that operation of the statute has been unduly severe or the powers conferred on the Government have been exercised with undue rigidity. The Working Group[39], However emphasized that in considering applications for inter-company investments in excess of the limits laid down in section 372 of Companies. Act the administration should take due not of desirability and importance of encouraging investments in priority industries provided the management of the companies concerned could be relied upon to make good use of such investments and investing company permitted in such investments with detriment to its own legitimate needs:

In the case of inter-corporate loans, it stated that the criteria to be taken into account by the Administrations in dealing with application under Section 370 of Act should include:

(i) Financial position of the applicant company:

(ii) The financial position of the borrowing company;

(iii) The security offered;

(iv) The rate of interest on loans'

(v) The term and conditions for the repayment of the loans;

(vi) The purpose for which the loan was proposed to be given;

(vii) The present position of the loans and investment portfolios of both the lending

38 Of Several witness who appeared before working group.

39 Gyan D, “Notes of Inter-Corporate Loans Chapter 10 CS Executive Company Law” (Deep Gyan®, April 4, 2022) <https://deepgyan.com/loans-and-investment-by-companies-chapter-10/> accessed May 6, 2024

and borrowing companies.

In the end it stated that there is no room for any legitimate apprehension about the effects of provisions on company practice or on the orderly growth and expansion of corporate business. [40]

(c) **THE COMPANIES (AMENDMENT) ACT, 1974**

The Companies (Amendment) Bill, 1972[41] was introduced in Lok Sabha On August 11, 1972. Major reforms in the aw relating to intercompany loans and investments were introduced in the BILL in two respects. Firstly, a new definition of under same management was proposed. Secondly, a new set of section 108A to 108G was proposed to be incorporated to check takeover bids by groups or combines.[42]

The Government felt that the provisions of section 372 of the Companies Act were not adequate to regulate the takeout of the Companies. The Joint Committee, however, rejected the incorporation of the new definition 'same management'. At the instance of Committee. the definition conditioned in section 370(1B) of the Companies Act has some obvious lacuna. For example, close relations and nominee of the same person may serve as managing directors of two companies of may control of their voting power without such companies failing with in mischief of the definition.

(h) **THE COMPANIES (AMENDMENT) ACT 1988**

The Amendment Act, 1988 further expanded the scope of section 372 of the Act. The amendment Act modified the parameters. The percentage limit of investments by the board /which) will be, of course, prescribed by the rules) is to be computed with reference to either the subscribed equity capital or the aggregate of the paid up equity and preference capital whichever is less. Similarly, the percentage ceilings for the purpose of computing the aggregate investments made in other bodies corporate in terms of the proviso to sub-section (2) would be with reference to an enlarged base that is, the aggregate of the subscribed capital and free reserves of the investing company. The limit of 30% of the subscribed capital of the invest Company is however to be computed on the basis of full normal value of the shares of that Company proposed to purchased or to be subscribed.

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[40] ——, "A Research Report on Inter-Corporate Loans and Investments" (Scholarticles, August 31, 2015) <https://scholarticles.wordpress.com/2015/09/01/sp7/> accessed May 6, 2024

[41] Published in Gazette of India, Extraordinary, Part II, Section 2, dated August 11, 1972.

[42] Raje S, "Inter Corporate Loans and Investments" (Law Times Journal, January 30, 2019) <https://lawtimesjournal.in/inter-corporate-loans-investments/> accessed May 6, 2024

So, at present, regulatory framework on inter-corporate investment is contained in Shon 372, 373, 374 of the companies act, 1956. These have been discussed in next two chapters:

(IV) THE COMPANIES (AMENDMENT) ACT, 1999

By an amendment introduced i by the Companies (Amendment) Act, 1999, the provision of section 370 elating to inter-corporate loans and those of section 371 relating to inter-corporate investments have been revised by abrogating them and then substituting them by a single section, namely 372-A. The amendment had the effect of saying that the provision of section 30 and 372. shall not apply and those of section 372A will take over the matter of such loan's investments. The main and most primary change is that the requirement of Central Government approval, has been dispensed with. The companies are now thus free the shackles of control of the inter-corporate loans and investments. The only control mechanism now is wholly internal, The board of directors now invests and advances up to 60% of their own decision and I beyond that will the special resolution of the shareholders.

2.6 THE COMPANIES ACT, 2013

The Companies Act, 2 2013. has come with a change in the concept of loan and investments in the companies. The new Act provide erstwhile The companies Act, 1956.

Further. the exemption available from the provision of section 372A of the 1956 of the 1056 Act to private Companies as well as loans and investment given or made by a holding company to its subsidiary company are no longer available under the 2013 Act. [43]

(VI) CONCLUSION

The subject of inter-corporate investments is perhaps as old as the institution of Joint Stock Company itself. Its growth is a logical is a logical and integral part of corporate growth. Its history through Indian Company Law can be traced liked this.

1. The companies Act of 1913, which was in force, without any major amendment, till the beginning of 1937 hardly contained any provision relating to inter-company finance. If the memorandum of association of a company so provided it was free to finance another company.

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[43] Corporate Law Reporter, "Inter-Corporate Loans and Investments Post CA 2013 - Corporate Law Reporter" (Corporate Law Reporter - The Daily Journal, December 28, 2014) <https://corporatelawreporter.com/intercorporate-loans-investments-post-ca-2013/> accessed May 6, 2024

2. This position virtually remained unchanged till the Companies Act, 196 came into force. The company Law Committee or Bhabha Committee knew very well the scope and severe limitations of these sections in the changed circumstances and thought it necessary to amend the sections extensively. The recommendations of the Committee served the basis for drafting sections 372 of the companies Act, 1956. [44]

3. Here again human ingenuity worked and unscrupulous persons found ways to manage a manners as not to affairs in management. Although defect they were "companies under the same management" de-jure they were not fall in the category of Companies under the same

4. Here Vivian Bose Commission suggested that inter-company loans should rank at part with inter-company investments and should be subject to the same restriction as the Jater. Accordingly, the Companies (Amendment) Act, 1965. Omitted the words which is under the same management as the lending companies" The Companies Act of 1956 provides regulation on loan transactions under Section 370 subsection (1) of the law stipulates that all loan transactions conducted by a company with other corporate entities fall under the act's purview. Furthermore, leading changes to Section 370, subsection (2), prohibited the operation of this provision to investment companies unless exempted under section 372(5).

5. The Working Group and the Reports of the Task Forces did not make any further proposals concerning this subject as the Administrative Reforms Commission (ARC) in their report in 1968 did not contain any recommendations peacocked in this regard.

6. It is, however, important to note that the Companies (Amendment) Act of 1974 did not make any changes on the provision of Section 372.

7. The Section 372 of the Companies (Amendment) Act of 1988 which refer to the reports broaden the explicit notice of affirmation and the circumstances in which it should be given to incorporate advancing quarterly and annual statements and exact details of their daily and periodical financial information. The restrictions related to investments in shares; this means that, directly or through subsidiaries, the company was prohibited from subscribing

[44] Author G, "Companies Act of 1956 and 2013 Explained with Differences and Amendments" (WritingLaw, April 4, 2024) <https://www.writinglaw.com/companies-act-1956-and-2013/> accessed May 6, 2024

for or purchasing the shares in any way. This was the case regardless of whether it was for the company's own structures, or in respect to an individual, or an association, for or on behalf of the company provided that it was for their benefit. "

8. With the Companies (Amendment) Act, 1999 the provisions of section 370 and 372 were abrogated and a new section 372-A was added. as such, they are no longer limited only to in the zone of investment between companies.

9. By the new Companies Act, 2013[45] some changes has been introduced in loans and investment in companies through of its section 186.

Now we will going to briefly discuss the provisions relating to inter corporate investments in companies act 2013

FACTORS WHICH LED TO THE AMENDMENT OF SECTION 372

Despite much pains taken by the drafting committee to make the provisions of section 372 clear and ambiguous, certain aspects of section 372 have resulted in misleading interpretations, The corporate lawyers have tried hard to show escape ways to the corporate HOuld form the rigorous of the regulatory wall constructed round the inter-corporate investments.[46] Section 372-A relaxes the rigors on inter-corporate investments. To understand 41 the reasons behind lead to ambiguity. |the amendment let us first study the section 372 itself and see its provisions lead to ambiguity. [47]

(a) SUB-SECTION (1) TO SECTION 372

Investments contravening the section will be invalid as the expression shall not be entitled to subscribed for or purchase" shows that the provision is mandatory.[48]

Sometimes companies require shares of other companies by virtue of scheme or

[45] Ithelp, "Insight on Section 186 of the New Companies Act, 2013" <https://rna-cs.com/insight-on-section-186-of-the-new-companies-act-2013/> accessed May 6, 2024

[46] Changes, made by Company (Amendment) Act, 2000.

[47] Negi S, "Financing Transactions between Group Companies: Regulation of Investment, Inter-Corporate Loans and Guarantees under Companies Act, 2013 - iPleaders" (iPleaders, July 23, 2014) <https://blog.ipleaders.in/financing-transactions-between-group-companies-regulation-of-investment-inter-corporate-loans-and-guarantees-under-companies-act-2013/> accessed May 6, 2024

[48] Changes made by Company (Amendment) Act, 2000.

reorganization and arrangement under section 394-A, it has been decided that approval of this department under section 372 will not be necessary to investments made in such cases.[49]

(b) SUB-SECTION (2) TO SECTION 372

The board of directors of the investing company shall be entitled to invest in any shares of anybody corporate up to such percentage of subscribed equity share capital, or the aggregate of the paid-up equity and preference share capital, of such body corporate, whichever is less, as may be prescribed:

Provided that the aggregate of the investments so made by the board in all other bodies corporate shall not exceed such percentage of the aggregate of the subscribed capital and free reserves of the investing company as may be prescribed.

Provided further that the aggregate of the investments made in all other bodies corporate in the same group shall not exceed such percentage of the aggregate of the subscribed capital and free reserves of the investing company as may prescribed.

Any presumption[50] to the contrary will be derogatory to the clear mandate of the legislature down in the opening words of section 372 of the act . In this regard , the words A company (Investing Company shall not be entitled to subscribed for or purchase are very significant. It may be noted that the concerned section not only prohibits the subscription of shares, but also prohibits the subscription of shares in excess of the limits the subscribed capital of the other body corporate.

In calculating the limits of 30 percent laid down in sub section (2) of section 372 of the Company Act, the cost of investment (i.e. the cost price to the investing company of the share purchases) should be taken into consideration. However, in calculating the limit of Ten percent of the subscribed capital of the other body corporate, the nominal value of the shares of such body corporate should be taken into account obviously the percentage limit

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49 Madanlal Khetan V Kedar Nath Kheran, (1977) 47 Comp. Cases 185 (S.C.)

50 Clarification And Circulars on Company Law, Ministry of Law, Justice and Company Affairs, Govt. of India, New Delhi, Para 73.30.

prescribed is to be determined after excluding the investment exempted under subsection otherwise the proviso will be conflicting with subsection.

(c) UNREALISTIC LIMIT TO INVESTMENTS:

The provisions of section 372 are for more stringent as the percentage limits land down therein bear no relaxation to the capacity to invest. While section 370 links the percentage to the total equity base, viz, share capital plus free reserves, in section 372[51] the twenty percent and 39 percent limits are linked only to the subscribed capital of the investor company, irrespective of its quantum of reserves. It is pointed out that there is not rationale in linking limits to investment to subscribed capital while limit to loans are to capital plus free reserves.

(d) COMPANIES WITHOUT SHARE CAPITAL- COVERED UNDER THIS SECTION OR NOT

The use and effect of section 372 is further questionable in so far as companies without share capital are concerned; or in the event that it is applicable to the latter kind of companies, the manner in which such a company's "subscribed capital" is determined. The purpose of enacting Section 372 of the legislature was to curb the flow and kind of investments and similar activities for companies only for the companies who have subscribed capital. However, if this promise or prospect is not there in the form of any subscribed capital then Section 372 is inapplicable. This View was supported by the decision of the Supreme Court.[52]

(e) CENTRAL GOVERNMENT APPROVAL- PRIOR OR EX- POST FACTO

The judgment of Calcutta High Court regarding the meaning the meaning and scope of scion 372 in Mathura Prasad Saraf VCBB,[53]"has raised a contrary because from the language condition in precedent for the validity of the investments made in excess of percent limits fixed by of section 372, it is not evident whether or not the approval of Central Government is a the sub-section (2) of section 372 of the ACT. The CLB has

51 Mahawar S, "Companies Act Amendments: Reasons as Well as Motivations - iPleaders" (iPleaders, October 4, 2021) <https://blog.ipleaders.in/companies-act-amendments-reasons-well-motivations/> accessed May 6, 2024

52 C.I.T.VB.C. Sriniwas Shetty, 128, I.T.R. 294

53 12. (1979) 49 Comp. Cas. 371.

clarified that approval of the Central Government referred to in section 372 is prior approval cannot be granted ex-post-facto, The reason given being that the word previous is not used before the words "Approval by the Central Government:

This however does not appear to be in constant with the intension of parliament as, in the event of approval being refused, the financial position of company may be irretrievable in several cases.

The decision of the Calcutta High Court does not appear to be sound at it will create difficulties for the investing company. The word approval does not always men approval of a past act already done, but may also mean approval of future act to be done. As the Central Government will not accord ex-post facto approval to any investment attracting section 372(4), any such investment without the prior approval of the Government would attract the penal provisions of section 374.

Because from the language of section 372, it is not evident whether or not the approval Central Government is a condition precedent for the validity of the investments made in excess of percent limits fixed by sub-section (2) of section 372 of the ACT. The CLB has clarified that approval of the Central Government referred to in section 372 is prior approval and thus such approval cannot be granted ex-post-factor.

The reason giving being that the word previous is not before the words Approval by the Central Government."

This, however does not appear to be in consonant with the intention of parliament as, in the event of approval being refused, the financial position of the company may be irretrievable in several cases.

There can be no doubt that the object conceived of enacting section 372 is not gully realized because of this lacuna in as much as prior security of the proposal of investment in the other company shares gets escaped. The observation of the learned judge in the context of the department's directive to the companies Act, that a company can be directed to sell its investments and the department approval has not been obtained under section 372(4). In such case section 373 is not attracted.

In these premises, it would be reasonable to amend section 372 suitably so as to add the word "Previous" they provide for the previous approval of both the company in general meeting and the Central Government.

(f) SUB SECTION (5) TO SECTION 372

Though the provision here acquiring the consent of all the directors present at the meeting seems to be apparently in conflict with section 292 (1) (d) of the Companies Act it is really not in conflict as the provision here is special and it's required to be complied with only by those companies to which it applies.

Sub section (5) applies to all cases of investments on body corporate to be made by the board of directors and not only those mentioned in sub section (2). The board can act under sub section (5) only be a unanimous resolution of the directors present at the meeting and not otherwise. Thus, the resolution cannot be passed by circulation and it cannot be passed be a majority vote.

The reference in sub section (5) to investments in pursuance of sub-section (92) is not intended to restrict the operation of sub-section (5) to cases in which investment is to be made by the company within the percentage specified in subsection (2). If the words "In Pursuance of Sub-section (2)" are interpreted to mean that a unanimous resolution of the board of directors shall not be required when the investment is to be made under sub section (4) an anomalous position will arise because for investing in the shares of another body corporate within the percentage specified in such section (2), a unanimous resolution of the board will be necessary but where expenditure on shares intended to be invested in exceeds the percentages prescribed in sub section (2), as resolution passed by a simple majority of the board will be sufficient.

Such a situation could not have been contemplated by the Parliament while framing the Act, Sub Section (4) cannot be interpreted as excluding the operation of subsection (2) in respect of investments by a company in the shares of other bodies corporate.

(g) THE REGISTER OF INVESTMENT (SECTION 372 (6)

An investing company is required to keep a register of all investments made by in the shares of any other body corporate of bodies corporate (whether in the same group of not), showing in respect in respect of each investment the following particulars:

1. The name of the body corporate in which the investment is made.

2. The date on which the investment has been made. 3. The date on which body corporate came in the same group as the investing company (wherever applicable); and

4 The names of f all bodies corporate in the same group as the investing company. Particulars of ever investment must be entered in the register within seven days of making thereof. The present law does not even require to record nature and number of vestments in the register of investments. It should be amended to cover these two details.

LIST OF INVESTMENTS IN BALANCE SHEET (SECTION 372 (10)

The section needs to be revised to mandate companies to disclose supplementary information concerning inter-corporate investments in their balance sheets.

1. Registered address of the company who might become licensed under the Easy tax

2. The number of paid-up capital needed for the equity as possessed by the investor company and all the bodies corporate associated with the same management of the investor company.

As for quoted shares/debentures, give the name of a Stock Exchange within which these quoted and the quoted value at the Closing of the Account(Date). In the poem which he penned and published in 1732 titled "Letter to a Young Lady on the Mode," Jonathan Swift takes his readers through the disturbing bend of society with obsession of fashion.

The total gross amount of dividends and interest which has been received from the investment and rate of returns obtained on investment made in shares or debentures which has matured for certain amount in other companies (each investment in the total investment should be separately distinguished).

This information will also help shareholders of the investor company to have knowledge of the return they got from their investment made in corporate securities. Moreover, it will be useful and valuable for the shareholders and for the common public as they find out their franchise to vote in other companies.

(b) **RELEVANCE OF DEBENTURES BEING COVERED BY SECTION 372**.

Section 372, subsection (12) indicates that the prohibition shall extend to inter-corporate investments in any debenture. However, because debentures constitutes the inter-corporate loans, the restrictions with respect to debenture should be incorporated in Section 370 instead Section 372.

(h) GUIDING PRINCIPLES FOR CONSIDERING APPLICATIONS UNDER

THE SECTION:

The old Department of company Law Administration and the later C.L.B. issued guidelines from time, on basis of which applications for approval to inter-company investments requiring the consent of the Central Government would be considered by Ae Administration. [54]Necessarily, these guidelines were largely of an indirect or negative character in the sense that certain types of intercompany investments were not considered to be sound, and rightly so, both because of their purpose and the guidelines. Government impliedly acknowledged this fact in their leading guidelines on this subject and made it known to all concerned that applications for approval under this section of the Companies Act would be considered "on their merits and in the light of the facts and circumstances of each case," Given the twin objectives of the restrictive provisions of section 372 of the Act and the multifidous forms in which inter-company investments can be made, it is not easy to see what other policy could be followed. These guidelines had. indeed, been duly considered by the Technical Advisory Board of the old Department of Company Law Administration, and in their present final form were based on their prior approval.[55]

The Annual Reports of the Old Department of Company Law Administration till about 1963 (e.g., the 5" Annual report on the working and administration of the Companies Act ended March 31, 1962) also considered clarifications arising out of individual cases of improper or undesirable inter-corporate investment which come to the notice of the Department. The decision taken on the more important of their cases, used to be briefly set out in these reports and provided on additional source of guidance to the business community on Government policy regarding inter-company investment. It is to be regretted that this practice was abandoned after 1963. Even so, collectively, the guiding principles laid down from time to time in the Department circulars since 1961-62 have done much to elucidate administrative policy in the board field of inter-corporate investment.

(i) Review of Guidelines Necessary:

It is pointed out that these guiding principles which was valid in 1961 cannot valid now, especially in the current economic conditions. It is argued that these guidelines are vague

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[54] "Company Law: Brief Study" <https://legalserviceindia.com/legal/article-8602-company-law-brief-study.html> accessed May 6, 2024

[55] ——, "Inter Corporate Loans and Investments" (Law Times Journal, January 30, 2019) <https://lawtimesjournal.in/inter-corporate-loans-investments/> accessed May 6, 2024

and It is pointed out that these guiding principles which was valid in 1961 cannot valid now, discretionary as the applicant cannot be sure that this request will be allowed. Further, the guidelines appear to take a limited and narrow view of the interest of the investor company.

It is suggested that the parameters must be enlarged to recognize the effective role that inter -corporate investment and provide a positive opportunity to corporate savings to encourage further growth. There are various areas wherein such investment should now be allowed, e.g. new projects, substantial, expansion. reconstruction and revival schemes, etc. therefore it is pleaded that a review of the guidelines show fund flow can play in industrial development. These must now should be undertaken when the flow of finance from various other sources such as public, banks and financial institutions had considerably reduced. It is also pointed out that a large number of small and medium companies have become public companies in view of the section 43A bringing them within the net of section 372 of the Act.

(i) **FUNCTIONAL RELATIONSHIP**:

The guidelines of giving sanction to applications for investment in excess of the prescribed limits or with a view to form a subsidiary include a provision that such investment would be permitted only if there is a functional relationship between the business of the () New Projects: investor and investee company, But it is submitted that diversification leads to considerable capital formation plugging back of profits. The criteria functional relationship should not be applied if the project is sound satisfies the other criteria. This should be included in the guidelines.

(ii) NEW PROJECTS

The first link in new projects financing is raising of promoters' share capital and sometimes bridging loans form the promoters, only then do the institutions step in with assurance of matching loans and a viable project can raise capital by public issue. Since obtaining substantial promoters' funds is difficult, consortium investment and financing by a new companies becomes necessary. According to the stipulation of the government financial institution, to promoters should continuously hold between 30 to 40 percent of the equity share capital of the investee company. Therefore, specific liberalization for investment of the nucleus capital in the new industrial projects is called for.

(iii) LIQUID RESOURCES

The Department of Company Affairs has laid down that surplus of overdraft facility i.e.

unused overdrafts, cannot be called a surplus a company's funds to be utilized for investment in another company. The point made out in this regard in that even if a company 's operational results generate cash surplus, they will not be available for investment in resources in if in the interim period, they will not be available for investment subsidiaries if in the interim period, they have been used for reducing overdrafts. But if this money is kept in a separate fixed deposit account perhaps it would satisfy the liquid subsidiaries institutions. the Department's resources criteria needs to be reconsidered and relaxed. Further. It is pointed out that there are no clear guidelines for determining as to what constitutes liquid resources.

On the other hand, others say that it necessary that such restrictions are in vogue to protect the interest of minority shareholders and financial institutions. It is also pointed out that if there are surplus funds in a company why should they apply for loans from financial

(iv) ACQUISITION OF CONTROL:

According to the guidelines of the Department, where proposals for investment relate to the acquisition of control, the same will not be permitted. Investment in excess of 10% of the investee company's subscribes capital are, as a general rule, discouraged... This whole concept, it is submitted needs to the changed.

It is the efficiently managed companies which general surplus ingestible funds and with deployment of funds in the investee company, managerial skills and entrepreneurship also flow to the latter. This assumes special significance where the investee companies have not fares satisfactorily, inspire of having the potential. Such takeovers are beneficial to the investor, the investee and to the community as they enable optimum utilization of productive resources.

The interest of the minority shareholders should be protected, but they should not act as an obstacle to healthy takeover bids. Such government restrictions only lead to indirect takeover with attendant evils.

In the light of suggestions given above and the changed circumstances , it is necessary that the guidelines on Section 372 which were issued in 1962 are required to be reviewed, if, it is necessary after inviting suggestions from the industry and profession.

Again, there are many deserving cases in which, despite compliance of these guiding principles, the Department lot of Company Affairs have kept the applications pending for

months and years, Very good proposals for making the investments, which could have produced excellent results, Particularly for rehabilitating needy sick units which, it properly financed, rendered irredeemable because of the inordinate delay in granting the approval by the would have become healthy with the potential of good dividend paying capacity, being Department of Company Affairs,

If, as proclaimed, the objective of these regulations is to achieve socio economic power of the common detriment [56]

It is mentioned that the objectives underlying section 372 of the Companies Act are laudable and the guiding principles Jaid down by the Government years ago are well intentioned, the administration of these statutory provisions are far from satisfactory and have become an avoidable irritant to the law abiding corporate entitles and their executives, advisors, etc.

(I) <u>INVESTMENT BY INVESTMENT COMPANIES</u>

The rest for an investment company is whether its principal business is being nursed as shown in the memorandum of association. As such the company does not cease to be an investment company for the purpose merely because its income of other source is more.[57] The words Whose principle business is the acquisition of shares.[58] The provisions of Section 372 apply to an investment company as well with the following exceptions (i) the aggregate limit of 30% of the subscribed capital of the company will not be applicable; and (i) the approval of the board in the manner stated in sub-section (5) will not necessary as form October 15, 1965. It will still be necessary for Such company to obtain approval for the investment in terms of sub-section (1) (d) of Section 292 unless the authority is delegated as stated in that Section group to be made These conditions also extend to investment companies, contingent upon approval from the shareholders of the investing company in a general meeting and from the Central Government.

i. <u>INVESTMENT COMPANY</u> –

Meaning It we take the ordinary meaning, an investment company would mean a company whose only or main business is of investment i.e. holding securities. The object may be twofold: (a) retain control over the investee company, and (b) to earn income on

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56 PB. Menon, "I Inter-Corporate Investment and Loans," 1981

57 Asst. ROCVH.C. Kothari [19921 75 Comp. Cas. 688 (Madras)

58 DC. Kothari v Asstt. ROC [1993] 78 Comp. Cas. 520 (Madras)

investment. The term "investment company" ; is only indirectly defined in the Companies Act. One is in the proviso to sub-section (10) of Section 372 and other is in the note (1) of Schedule VI which prescribes the form of balance sheet. This definition indicates that an investment Company is a company whose principal business is the acquisition of shares stock debentures or other securities and hold them for a reasonable time. There is a clarification by the. Department of Company Affairs regarding the above definition. It the Department's opinion whether a company is or not an investment company and the business which it should or should not transact to fail within the meaning of the section 372 (10) is actually a question of fact. It seems that if a trading company whose whole or substantially whole business is t in shares, etc. is also engaged in other businesses to an appreciable extent, it will not t be considered to be an investment company. It is, therefore, a question of fact which has to be determined in relation to the actual business transacted by it, i.e. the nature and extent of the business.

(ii) PRIVATE INVESTMENT COMPANIES – WHETHER COVERED BY SUB SECTION (13) OR (14) OF SECTION 372.

Inspire of a number of clarifications given by the Department of Company Affairs, considerable confusion still prevails about the extent to which the restrictions contained in Section 372 (2) apply to investment companies which are private limited and the investment companies which are public limited ones. The question whether sub-section (13) or (14) of Section 372 will apply to a private company which is also an investment company still remains to be answered. The amendments to the law suggested by the Sachar Committee to do decide the issue.

(iii) **PROVISO TO SUB-SECTION (10) OF SECTION 372**

The main investment companies shall distinguish between the provisions of sub-section 372 (10) according to that they shall not attach their balance sheets a document containing the names of all bodies corporate where they have invested some amount. However, they shall maintain the records of all investments that they have carried in the form of shares within these various companies as it is directed from 372 (6) sub-section. As transactional, the books of investment company would always record purchases and site of shares. Therefore, no use of declaring the existence of the stock register under Section 372 (6) of the Companies Act. Since the details of sales are the business, there is no useful purpose of recording the full details of every transaction in the register of investments and this and the

sales of all the shares are kept by the investment company in its books of account. Eliminating all forms of monetary and remuneration systems is unrealistic but should be considered.

The firms with invested outrun act as a stimulant in setting up novelty's undertakings by their means of capital. Overall, even when they invest in the existing projects, their main goal is to ensure that the projects are carried out for the company. The government need to consider investment company for its efficient provision of services which is offered by investment company as it is hard for the government to be able to make investment to excess of 10 % of subscribed capital of the investee company one due to lack of finances. Therefore, it cannot be justified of the investment company whole of sub-section (2) of section time to time causing problems to investment companies in the course of its operations .

(m) **INVESTMENT IN SUBSIDIARY COMPANIES**

Another significant aspect of Section 372 is the exemption granted under clause (d) or sub-section (14) of that section. It is stipulated that section 372 shall I not apply to investment by a holding in its subsidiary. It is unmistakably provided that is exempt is an investment by holding company in the subsidiary. It is, therefore, clear that in order to avail of this exemption in relationship of holding and subsidiary between the investing company and that investee company must exist at the date of making an investment as otherwise it would not be an investment by holding company in its subsidiary and hence not eligible for exemption Unless such relationship already subsists on the day of making the investment, no exemption under section 372 (14) (d) will be available and provision of section 372 well be attracted. This is unequivocal. In its circular the department had rightly stated that the exemption under sub-section made is already a subsidiary of the investing company. It should thus be clearly understood that the proposed investment in the shares of another company should not be a Source of establishing holding subsidiary relationship between the two companies as per Section 4(1) (ii) of the Companies Act as one of methods of creating this relationship.

It is interesting to note sub-section (14(d) provides exemption from the whole section as far as investment of holding company in its subsidiary are concerned. It may, therefore, be observed that the investments of the holding company in its subsidiary shall be exempted

from the conditions of percentages of investments contained in sub-section (1) and (2), as well as the manner of computing the aggregate percentage in terms section (3) and (4). Since the funds of holding company can be invested in its subsidiary without any restriction, it is possible to prepare a scheme of corporate investment by a holding company, through its subsidiaries, favor of holding and subsidiary companies are primarily responsible for most of the corporate which could be investment companies. In fact, section 372, and exception contained therein makeovers and indirect control of interest in bodies corporate.

The most questions, however, is if the relationship of holding-subsidiary is brought into being by adopting the method of controlling the composition of the board of directors of sub diary company by the holding company which is one of the criteria recognized by section 4 of the act tor crating holding-subsidiary relationship then whether or not it is valid or, is it Contravention of statutory provisions under the Act? This question was examined by two High Courts recently in two cases.[59]

In the case (i) Kerala High Court held that it was open to a company to make another its subsidiary by appointing such number of additional directors as would constitute the majority of the latter 's board. The view held by the Department that the combined effect of Section 255(1), 256(1), and 257 7 of the Companies Act stood in the way of making any provision in the article of a public company empowering another company to appoint the majority of its n SO as to make the former a subsidiary does not apply where the company was converted into a subsidiary by the method of appointing additional directors. This has reduced section 372 of the Act of the Act to nullity.

In the case (ii) the Delhi High Court in its judgments of July 28, 1980 held that the words save as otherwise expressly provided in this (Companies) Act in Section 255 (1) were of commanding significance and the provisions in Section 4(2) of the Act for the appointment of directors in a subsidiary company being an express provision, was not circumscribed by Section 255(1).

It is submitted that the view of the High Court that Section 255(1) (a) is subject to Section 4(1) (a) is not correct. Section 255(1) (a), unlike section 255 (1) (b), is not subject to any other provision of the Act. Therefore. because the company has made an arrangement with another pay agreeing to the exercise of power to control the composition of its board of

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[59] 15a (1) M. Velayyudhan V Registrar of Companies (Kerala), (1980) 50 Comp. Cas. 33(11) Oriental Ihdustrial Investment Corpn. Ltd. Vs. Union of India and Others (Delhi) (1981) S1, Comp. Cas. 487.

directors, cannot be said that the provisions of Section 255 (1) (a) do not apply at all. It is submitted that directors appointed pursuant to the exercise of the power to nominate will hold office till they entire in accordance with Section 255 (1) (a), the first company will, however, on investment of power immediately become a holding company.

The practice usually followed by a company intending to invest in shares of another company Or to advance loans to that other company is to acquire the status of a holding company under an arrangement which satisfies the requirement of Section 4 (1) (a) and before the next general meeting at which the directors are liable to retire by rotation to acquire the status of a holding company under clause (b) or (c) of Section 4 (1) and on that account to continue to remain f Sections which prohibit investments in shares or for outside the operation of Advance of loans in excess of the prescribed limits.

The effect of the above judgment was that a company could convert another company into its the majority of the directors in the latter's board whether that by appointing ordinary directors or additional directors. This could be done by a simple agreement between the two companies. The idea in making a company a subsidiary under sub-section (14) (d) of section 372 was that there was no restriction on investment made in a subsidiary.

It is suggested that Section 372 (14) (d) should be amended to exclude such subsidiary Companies as became so by virtue of controlling the composition of the board method. The de Committee has recommended to amend this provision of clause (d) of sub-section (14) king the words other than a subsidiary within the meaning of clause (a) of sub-section (1) of Section 4 of the Act after the existing words in that clause.

2.7 RESTRICTIONS ON INTER- CORPORATE INVESTMENT:

(a) ORIGIN

In accordance with the provision of section 291 of the Companies act 1956, the conduct of e management of the affairs of the Companies is vested in the board of directors. But, there er large numbers of statutory restrictions governing the exercise of those powers by the directors Or these, the most important restrictions governing the exercise of those powers by the directors. But there is large number of statutory restrictions governing the exercise of those powers of the directors.[60] Or the, the most important restriction is in respect of

60 ——, "Companies Act of 1956 and 2013 Explained with Differences and Amendments"

making inter-corporate investments. The statutory regulations of restrictive nature have had its origin mere the enactment of the Companies Act 1956.

Statutory restrictions first originated with the addition of a new section 87F to the Indian Companies Act, 1913. These were enacted after drastic modification, as section 372 of the Companies Act 1956 was widened in the Amendment Act of 1960 to include

All Public companies and private companies which are subsidiaries of Public Companies irrespective of whether or not the companies were under the same management. Subject to this modification, the original structure of section 372 of the Companies Act, 1956 remains practically unchanged until the Companies (Amendment) Act, 2000 which brought a new section 372-A relating to inter-corporate investments.

(B) The following are the provisions of law on inter-corporate investments under section 372-A of the Companies Act, 1956.

A BRIEF SUMMARY OF SECTION 372-A [61]

SECTION 372-A HAS FOLLOWING FEATURES:

--Ceiling on company power to make investments.

-Unanimous resolution of the board of directors and public financial institutions.

-- Provides rate of interest. Prohibit the company which has defaulted in making investment in ways provided under this section.

--Requirement to keep register

--Central Government may give guidelines

-Exclusion of application of section

-Penalty provisions

in the context of section 372A of the Act a question arises on the effects of its sub-section (8) Sub-section (8) starts with nothing contained in this section shall apply," and thereafter moving for blanket exemption for certain loans, investments, guarantees and securities.

(WritingLaw, April 4, 2024) <https://www.writinglaw.com/companies-act-1956-and-2013/> accessed May 6, 2024

[61] legal Service India, "Companies Act 1956 and Company Bill 2011" <https://www.legalservicesindia.com/article/1459/Companies-Act-1956-and-Company-Bill-2011.html> accessed May 6, 2024

exemptions have been specified. Since nothing contained otherwise in section 372A will apply of these exempted items it is reasonable to interpret that not they are exempt as they are from the restrictive provisions investment, etc. are made coming under the exemptions they should interpretations is at variance with the last proviso of section 372(4) (now not in operation) o ignored even for any now investments, loans, guarantee, etc. in non-exempt areas. This were subscribing to right issue while [62]exempt was to be taken into account when fresh investment is made non-exempt cases. Since previously mentioned proviso to section 372(4) was stand Penalty provisions sed provision, the same effect cannot now to the given to the exemption specified 3724 (8) which includes the exemption to subscription to rights issues. In this regard it will be worthwhile to refer to the discussion in para 2501 (para 157) of company law by A.N. Chakraborti (1994) Edition) under the heading "Exempt Investments and Computation of Ceilings' wherein the reconsidered views of the Department of Company Affairs was cited in regard to investments. The department held the view that "investment enumerated under sub-section (14) are to be excluded from calculation in considering the limits prescribed in sub-section (2) and the proviso thereto." While this view was in reaction to investment. the principle underlying this view equally holds good for loans, guarantees and securities. In other words, exempt transaction under section 372A (8) should not come into calculation for determining whether a special resolution will be necessary so long the non-except transaction by themselves do not surpass the ceiling laid down in section 372 A (1). EGM held without giving notice to majority shareholders. The CLB in Martin Castelino v Alpha Omega Ship Management (P) Ltd. inter alia, held that the EGM held was not valid as notice of the meeting Was not given to the group holding majority shares.

OTHER RELEVANT, PROVISIONS:

1. SECTION -373 : INVESTMENTS MADE BEFORE THE COMMENCEMENT OF ACT

Section -373 where any investments have been made by a company in any other body corporate in the sane group at any time after the first of the April 1952. Which, if section

[62] "Bond for Administration under Section 291 of Indian Succession Act |Format Download" <https://www.aaptaxlaw.com/Legal-Formats/administration-bond-under-section-291-of-indian-succession-act-format-download.html> accessed May 6, 2024

had been therefore in force, could resolution and the approval of C Central Government shall be obtained to such investments, with six months from the commencement of i its Act, and if such authority and approval is not so obtained, the Board. of Directors of the company shall dispose of the investments. In So far, they may be in excess of the nor have been made except of the authority of a limits specified in sub-section (2) of Section 372 and second proviso to that Sub-section, within two years of the commencement of this Act.

1. **SECTION 374**:

PENALTY FOR CONTRAVENTION OF SECTION (AMENDMENT) ACT, 2000. Its default is made in complying with the provisions of [section 372 (excluding sub-section (6) and (7) or section 3731, every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees. The amount of fine is reduced to five thousand rupees from fifty thousand rupees by the Companies .

2. **SECTION 91:FURTHER ISSUE OF CAPITAL**:

Under section 94 of the Companies Act a company can at any time by passing a resolution at its general meeting resolve to increase its capital by such amount as it think expedient by issuing new shares. The time at which and the persons to whom new shares are to be allotted is an important question in company law. If the directors or the majority of the shareholders are allowed to disperse the new issue at their discretion, they would naturally offer it to their nominees, thus adding to their own majority and reducing the strength of the minority, Section 81 partly deals with problem.

SHAREHOLDER'S PRE-EMPTIVE RIGHT OR RIGHTS SHARES:

The section come into play whenever it is proposed to increase the subscribed capital of the company (with in the authorized capital) .by allotment of further shares after the expiry of two years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier

3. Section-293: Powers exercisable with general meeting approval:

a further section 293 imposes important restrictions on the power of directors of a public company or any subsidiary of a public company. According to section 293 of the Further, Section 293, imposes important restrictions on the powers of the board of directors Act the board of directors of a public company or its subsidiary can invest the amount of compensation received by the company in respect of compulsory acquisition of its property in securities only. If the board of directors desire to invest such amounts in other than trust

securities, it has to obtain the consent of the shareholders in general meeting. Further section 05of the Act regulates loans to directors.

(VI) SACHAR COMMITTEE REPOPT, ON INTER-CORPORATE INVESTMENTS

In paragraph 9.1 to 9.8 of its report, the High-Powered Committee on Companies and MR.TP Acts headed by justice Rajinder Sachar has made detailed suggestions. It has not recommended the removal of tall restriction but has suggested widening of the scope for corporate Investments

(a) **THE. COMMITTEE HAS MADE THE FOLLOWING RECOMMENDATIONS**:

1. There is no justification for embodying stringent provisions in the Companies Act in regard to M.R.T.P. angle which would best be looked after by the M.R.T.P. Act. The expression 'same group" and "same management" should be omitted from the Companies Act Sections 108A to 108H thereof transferred to the M.R.T.P. Act.

2. The investment companies are often used as an intermediary for corporate control. In order to prevent any such practice a revised definition of investment company has been suggested. The committee has also suggested that an investment company should be included within the m undertaking" of the M.R.T.P. Act and an investment company shall not allowed to invest beyond 10% of the paid-up equity capital of the investee company.

3. The committee has suggested widening of the meaning expression “investment" to include contribution by way of capital participation in firms, joint ventures or other association of person.

4. The committee felt that the investment in preference shares and debentures (the latter in case of companies under the same management) should be excluded from the purview of section 372.

5.existing exemption in favor of private companies in the matter of inter-corporate investment should continue.

6. To ensure that Inter-company investments to not operate as an instrument of insidious corporate control. the committee recommended the future inter-corporate control, the committee recommended the future inter-corporate investment should be restricted to:

(1) promoting a new company (i) taking over sick unit; and (iii) taking over an existing company after making an offer to buy shares from all the shareholders of such company,

Any other type of investment should be made only with the approval of the Central G Government which should record its reasons for granting approval.

7. In the committee's view subscribed or paid-up capital should normally be visited in company's own assets.

8. The capacity for investment of a company should be related to free reserves and company should be permitted to invest 30% of such reserves in corporate securities with a condition that any investment beyond 10% should be made only if it is approved by a company's own fixed assets

9. The committee suggested that an absolute ceiling should be prescribed beyond which no company should made investments or give loans. This ceiling has been proposed to be 60% 6 in the aggregate of which investments should in no event exceed 30%.

10. The requirement of seeking Government approval for inter-corporate investment should 1978) special resolution, be dispensed with.[63]

11. The provisions for inter-company investments and loans be combined into one section. The Committee has given a combined redraft of sections 370 & 372.

12. The committee expressed the desire that its recommendation relating to inter-corporate investments and loans put into effect immediately.

(B) REVIEW OF RECOMMENDATIONS:

The recommendation of the Sachar Committee as at item (1) above is based on sound reasoning. The approach that M.R.T.P. angle should be dealt within the M.R.T.P. Act and not through the Companies Act is very desirable one of the factors which contributed to the complexities of the companies Act. 1956 can be traced to the fact that l00 many concept not directly relevant to the subject matter of the company law have been allowed to get into the scheme of this Act. A drastic pruning is very necessary.

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63 Report of The High Powered Expert Committee on Companies and MRTP Acts (August 1. 1978)

1. Investment companies

While defining an investment company as a public company limited by shares and carrying on business of only underwriting or dealing in corporate : securities, the committee has suggested that investment companies should continue to enjoy exemptions under section 372 o long as investment does not exceed 10% of the equity paid up capital and not effective paid up equity capital For controlling a company effective paid up equity is relevant rather than capital-of Investee company after deducting share holdings of the public financial institutions. whole equity paid up capital. This limit should be based upon effective paid-up equity Moreover for computing after deducting share holdings of the public financial institutions, Moreover for computing 10% limit, shareholdings enjoyed by other companies of the same business house should also be companies should be transferred to the Central Government. Further, to allow the continuance of present exemption enjoyed, it is not enough that investment company should be public company limited by shares. It counted. Alternatively, the voting rights of investments this recommendation is carried out in the future amendment of the companies Act, then, private investment companies cannot be formed at al| .

The committee felt that the definition of investment company" as given in sub-section (10) of the Section 372 of the Companies Act was unsatisfactory in as much as a company which merely holds certain shares with the interest of exercising control over other companies is by definition also an investment company. The committee is of the view that one of the ways adopted to avoid the provisions of section 372 of the Companies Act is to form an investment company as a catalyst for corporate control. But even the revised definition does not make a distinction between investment company proper and share trading or dealing company. It is suggested that the definition of an investment company may been the lines of the Canadian Income Tax Act.
An investment company can invest without limit as its own capital and at the same time without any limit if it is a private company without the necessity of government approval.

As regards investment companies the best policy will be to allow small scale investment companies, say, with a paid-up capital or not more than rupees one crore, to continue, for they help small investors choose efficient portfolios. But the establishment and continuation of large investment companies should be banned. The existing large

companies should be required to disband themselves within a fixed period of time.

Registration of such companies with a specified authority has also been advocated. Power may be given to the specified authority to treat the company as a none investment company after notice to the company and inquiry. The definition of investment company given in Non-Banking Financial companies (Reserve Bank) Directions 1977 may be adopted for this purpose: Investment Company means and company which is a financial institution carrying on S principal business the acquisition of securities. To distinguish such company from a share ding company, the words and bolding " may be added after the words "acquisition."

Private Companies:

The committee has recommended that the resent exemption available to a private company in the natter of inter-corporate investment should continue. Specific brought to the notice of the committee where business houses used private companies as a tool for making investments in corporate securities to gain corporate control. Few anomalies were also pointed to the committee. In order to check investments by private companies and To enhance the effectiveness of the scheme outlined in Section 372 for private companies, the following modifications are proposed: To enhance the effectiveness of the scheme outlined in Section 372 for private companies, the following modifications are proposed:

It was proposed in Sub-section (1B) of Section 43A of the Companies Act that the calculation base for the 25% threshold should be the paid-up equity capital but it was framed with reference to the total paid-up share capital.

ii. Given this background, the exemption provided under Sub section (6) of Section 43 A should not apply to sub sections (1 A & 1 B) of Section 43 A.

iii. The impact is as follows – No private company whose net worth is of not less than Rs 50 lakhs or no private company with inter-corporate investments which is of not less than Rs [lakhs] (as per the book value) should be exempted under Section 372 of the Companies Act.

iv It will be seen that above recommendation regarding the continuance of an existing exemption is only in relation to private companies which are not investment companies.

The committee have not suggested any provision regarding the existing private investment companies and what exemption are to be continued.

2. <u>INVESTMENT IN SUBSIDIARY COMPANIES</u>:

The Committee has recommended that investment in subsidiary companies should be exempted on the lines of section 372 in all cases except investment in a board controlled a Subsidiary company within the meaning of section 4(1) (a) of the Companies Act.[64] It is argued that the limits specified in Section 372 regarding investments by a company would not be applicable to shares held in a subsidiary as also the acquisition of shares by a company for the purpose of making the investee company a subsidiary. But the C.L.B., it is pointed out, maintains that any investment made for making a company a subsidiary would attack the Principal business the acquisition of securities. To distinguish such company from a share ding company, the words and bolding " may be added after the words "acquisition[65]." The committee has recommended that the resent exemption available to a private company in the natter of inter-corporate investment should continue. Specific brought to the notice of the committee where business houses used private companies as a tool for making investments in corporate securities to gain corporate control. Few anomalies were also pointed to the committee. In order to check investments by private companies and for making the scheme of Section 372 more effective the following Private Companies: modification are suggested: i In Sub-section ((IB) of section 43A of Companies Act, the base for calculating 25%[66] should be paid i up equity capital and not total paid up share capital; i. exemption given by sub-section (6) of section 43A should not be applied to sub-section (1A) and (1B) of Section 43A, and cases were also i. Private companies having net worth of not less than Rs. 50 Lakhs or private companies having inter-corporate investments of not less than Rs lakhs (book value) should not be exempted under section 372 of the Companies Act: R will be seen that above recommendation regarding the continuance of an existing provision is only in relation to private companies which are not investment companies. The committee have not suggested any provision regarding the existing private investment companies and what exemption are to be

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[64] Editor_4, “Restriction on Layering of Companies: Should We Go Back to the Drawing Board? | SCC Times” (SCC Times, May 27, 2023) <https://www.scconline.com/blog/post/2023/05/27/restriction-on-layering-of-companies-should-we-go-back-to-the-drawing-board/> accessed May 6, 2024

[65] ——, “Section 372A of the Companies Act” <https://legalserviceindia.com/article/l299-Section-372A-of-the-Companies-Act.html> accessed May 6, 2024

[66] Furtado R, “All about Holding Companies and Investments Made through Holding Companies - iPleaders” (iPleaders, November 9, 2016) <https://blog.ipleaders.in/holding-companies-investments-made-holding-companies/> accessed May 6, 2024

continued. 3. Investment in subsidiary companies: Ihe Committee has recommended that investment in subsidiary companies should be Competed on the lines of section 372 in all cases except investment in a board controlled Subsidiary company within the meaning of section 4(1) (a) of the Companies Act. It is argued that the limits specified in Section 372 regarding investments by a company would not be applicable to shares held in a subsidiary as also the acquisition of shares by a company for the purpose of making the investee company a subsidiary. But the C.L.B., it is pointed out, maintains that any investment made for making a company a subsidiary would attack the provisions of this section and prior approval of the Central Government would be necessary.[67] Further, the CLB. provided hat while calculating the aggregate of investment in all other body corporate for the purpose of computing percentages specified in sub-section (2) of ton 322 the investments made by a company in its subsidiaries must also be taken into ad hoc committee, however, did not commented on this anomaly though pointed to them. In Subsidiary this anomaly should be made clear. Moreover, it is pointed out that if a company starts as undertaking as a separate division, no sanction is necessary under Section the same activity, 2 but, for complied with. Since expansion of an existing undertaking is conductive to industrial growth of profits is the best means of the industrial financing, it is pleaded that the requirement relating to subsidiary should be withdrawn. , it a subsidiary is promoted, all procedural formalities should be withdrawn.[68]

On the other hand, it may be pointed out that the exemption under sub-section 14 (d) of Section 382 of the Act was introduced only to cover investments already made in subsidiary companies by a holding company.

1. Promoting a New Company etc.

The recommendations should be modified to the effect that an industrial company should be permitted to promote a new company either independently or jointly with any person only in the priority sector within the limits stated by the committee. An industrial company should be permitted | to promote a company in a non-priority sector only if it is sanctioned

[67] Vijay CaK, “Layering Restrictions on Formation of Multiple Subsidiaries | Company Law” (V J M & Associates LLP (Chartered Accountant), May 10, 2022) <https://vjmglobal.com/company-law/layering-restrictions-on-formation-of-multiple-subsidiaries/> accessed May 6, 2024

[68] ——, “Section 372 | Companies (Central Government | Rules | Law Library | AdvocateKhoj” (Copyright 2024, advocatekhoj.com) <https://www.advocatekhoj.com/library/rules/companiescentral/11c.php?Title=Companies%20%20%20(Central%20Government&STitle=Section%20372> accessed May 6, 2024

by a special effective. resolution of the shareholders of investing company in general meeting and with the approval of the Central Government. The term 'sick unit' should be defined to make the law more

5. Capacity to invest: Free reserves"` have been taken as a sole criteria for judging surplus funds. The committee has made a distinction between capital and reserves. The term “free reserves" means all Serves by whatever name called including statutory reserve created under any other law and credit balance of profit and loss account, but excluding any sum set aside for redemption of preference shares or reserves created on revaluation of fixed assets or 1eserve created to meet any other ability. This reserves along with the bonus issues present, a surplus or say extra money' which can be made available for other purposes, viz, to develop and diversify either directly or through other undertakings. This, it is felt, would reduce the investing capacity of a firm immediately by at least50 to 60%.

6. Limit of 30% of Free Reserves:

The Limit should be supplemented by provision to the effect that if future investment (within 30%) of reserves of investor company) is excess of 5% equity paid up central of it of investee company and the aggregate shareholding along with shareholding of other companies of the same business investee a special resolution of investor and investee should be required or in such a case a prior approval of the Central Government should be made obligatory.

Absolute Ceiling:

7. If this recommendations of the committee is fully implemented then that would drastically reduced the quantum of funds that would be available for inter corporate investment. This would completely retard the growth of investment in private sector. It is felt that this further curb would be unnecessary as under the M.R.TP. Provisions no company can invest more than 10% of capital without the prior approval of Central Government. house in excess 10% of equity paid up capital of the

(C) MATTER NOT DIRECTLY WITH BY THE COMMITTEE

1. **EXISTING INVESTMENTS**:

As the existing investment are not affected by the recommendations, there will be no scope

existing investments are in excess of 30%% of free reserves and on the other side they will a free to increase (even without the government's prior approval) inter-corporate shareholdings of those companies where existing investments are below 30% of free reserves.

2. **INVESTMENT OUT OF BORROWED FUNDS**:

The committee's recommendation as to capacity to invest is based on the assumption that paid up capital (not free reserves) are normally invested in fixed assets and a company having reserves has genuine spare funds to invest in corporate shares even if it has resorted to borrowing from others for its requirements. Such an assumption is intended to benefit the management rather than shareholders, The recommendation of the committee should be pigmented to the effect that a company which has resorted to borrowing should be presented to the effect that a company which has resorted to borrowing for its own purposes or intends to finance its investments by borrowing should not be permitted to invest in Corporate securities even if such investment is within the limit of 30% of the free reserves. for reducing the companies via inter-corporate shareholdings. In fact, on the one side the business houses will be able to hold inter-corporate investment in the cases of those companies

3. **DIRECT INTER-LOCKING OF EQUITY AND CIRCULAR CHAINS OF INTER -CORPORATE INVESTMENT:** The committee has suggested some measure to control direct inter-looking of funds to the effect that when A invest 25% of paid up capital in B,B cannot invest in excess of 5% of paid up capital, Therefore, 25% and 5% limit of provision should be based upon paid up equity p capital in A, To control a company equity paid up capital is important rather than the entire capital after deducting shareholdings of public financial institutions. Moreover, to make the legislation more effective, a stricter view should be taken on the lines of the French Company Law.

Objectives namely corporate control" and "corporate growth" are conflicting considerations, and cannot go together. While such investments are necessary in the interest of corporate growth. there is also the aspect of proliferation of control which has undoubtedly been aided through inter-corporate investments, leading to concentration of economic power. The committee appear to have taken a balanced view and their recommendations, while providing necessary safeguards against abuse of inter-corporate investments, have also provided sufficient scope for such. Investment in the director in

which these are necessary in the interest of the growth of the company.

The implementation of the recommendations of Sachar Committee along with suggested modifications will go a long way in effectively regulating inter-corporate investments and at the same time providing, facilities for corporate growth.

(VII) JUDICIAL TRENDS AND SECTION 372-A [69]

The recent VSNL controversy over the reported decision to invest Rs. 1.200 crore in Tata Teleservices Ltd. (TTL) has ostensibly blown over, if media reports are to be believed.

If not, it is believed that at least a temporary truce has been reached between the Ministry of Telecommunications and the Tatas, after an acrimonious exchange of strong viewpoints from either side and the Ministry of Disinvestment coming out unscathed, though caught in the crossfire.

Mr. Pramod Mahajan's tirade against the Tatas cannot be dismissed as unjustified, keeping in view the way the agenda of investment was allegedly pushed and rushed through at the board meeting.

The Minister has every reason to get irked over the attempt to divert the staggering funds of VSNL in one of the subsidiaries of Tatas, soon after acquiring stakes in VSNL.

In this regard, much has been discussed about the so-called shareholders justify the investment decision. However, Ministry of disinvestment has not acquired itself well while trying to make the fine distinction between "asset-stripping" and utilizing cash reserves'" and thereby tacitly justify the controversial decision of the VSNL board to Invest in TL. discussed about the so-called shareholders, agreement to roof Disinvestment has not acquired itself well while trying to make a Justifying the comprehensiveness of the shareholders agreement, it has been said that Section 372A of the companies Act covers utilization of cash reserves by strategic buyers rooted to have stated for investments in group companies, and accordingly, the Ministry of Disinvestment is Government" "Since this is already covered under law, we need not have to include any more clauses in the agreement for utilizing cash reserves for inter-corporate investments. But utilization of cash reserves for giving loans and advances, among other things, to entities that are not part of normal business requires the affirmative voting right to the Government .

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[69] Chen J, “Subsidiary Company: Definition, Examples, Pros & Cons” (Investopedia, March 27, 2024) <https://www.investopedia.com/terms/s/subsidiary.asp> accessed May 6, 2024

The VSNL board meeting controversy has definitely brought to the fore the non-adherence to the Secretarial | Standard-l on "Meetings of 1 the Board of Directors" prescribed by the Institute company Secretaries of India (the ICSI). This Secretarial Standards was perceived to be a don in the direction of toning up the corporate government mechanism. The Secretarial Standard of the ICSĺ states at the outset, though over-ambitiously, that in the initial years, adherence by a company to this Secretarial Standard will be recommendatory. Though the legal mandate and authority for ICSI to prescribe mandatory secretarial Standards for adoption by the corporate sector is subject under the existing legal framework, the ICSI is perhaps well within its rights to prescribe secretarial standards to be followed by its members, viz, company secretaries as professional code.

In the context of the alleged allegations by the Government nominees on the VSNL board Regarding the various aspects of the conduct of the controversial board meeting and the reported official stand of the VSNL as conveyed by its Company Secretary, it is apposite to examine the provisions in the Secretarial Standard on "Meetings of Board of Directors". This standard I seeks to prescribe a set of principles for the convening and conduct of Meetings of the Board of Directors and matters related 1 thereto with effect from December 13, 2001.[70] backdrop of the basic issue raised Against the important and question. aforesaid Secretarial Standards, let us examine some of the in regard to the convening ad conduct of the board meeting in It was reported | what while one nominee director could not attend the board meeting. which was convened | at short notice, the other dissected to the proposal at the board meeting. Further, it was also alleged that the two Government nominees had been sent the notice and agenda of the meeting on two separate dates, “not giving them enough time to reflect "full notice," on the importance of the whole issue." It was also charged that the agenda papers did not provide complete information on the investment decision and, as such, cannot be treated as Therefore., the moot question is what is the effect, relevance and role of the much touted and trumpeted secretarial standards prescribed by the ICSI in dealing with its errant members to justify its commitment towards ensuring edifying corporate governance standards? The committee on corporate governance recently constituted by the Department of Company Affairs (DCA) to suggest ways and means of strengthening corporate governance is a short in the arm for the ICSI, and manifests the DCS's continued patronage to the ICSI.

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[70] Anbca, “Can Subsidiary Company Invest in Holding Company” (AN Bhutada & Co, September 8, 2020) <https://www.anbca.com/subsidiary-company-invest-in-holding-company/> accessed May 6, 2024

To cap it all, this Committee has been empowered to devise its own procedure. From the composition of this Committee constituted by the DCA, packed with only company secretaries, one gets the feeling that the DCA believes that company secretaries are the only repositories of corporate governance!

There cannot be any second opinion to the voice of concern vis-a-vis the composition of use Committee constituted by the DCA, The committee is bereft of those individuals and institutions who have made seminal contribution. Had there been representation for other professional bodies, chambers of commerce, IIMs and captains of industry and proved experts in the field., the composition of the Committee would have been broad-based and the credibility and stature of the committee should have enhanced. Perhaps the DCA believes in a cost-effective committee on corporate governance, by picking only those who are closer to the condors of Shastri Bhavan! The salutary principles of corporate governance need to be developed and crystallized at the Carlist to pre-empt any further unsavory corporate episodes. The present committee enquires to be revamped and broad-based immediately, to enhance credibility and stature, if the DCA is really serious about evolving edifying corporate governance standards. The above given account regarding the VSNL episode is taken from an article by D. Vardharajan in the H Hindu. There are certain more examples in this field but this one is trend setter and has lead to further pondering over the section 372-A.

2.8 THE COMPANIES ACT, 2013:

(a) INTRODUCTION:

The 2013 Act has introduced Several new concepts and changes to the existing provision related to the loans and investment by company. Provision relating to caps on inter corporate loans and investments extended to include loan to any person. The rate of interest on inter Corporate loans not to be lower than the prevailing yield of one year, five year, or ten-year Government security closest to the tenor of the loan. Loans (as also guarantees/securities in respect thereof) and investments by a private company or by a holding company to or in its wholly owned subsidiary would also be covered by the provisions.

(b) CHANGES INTRODUCED BY 2013 ACT:

The Following are the Key changes:

• The company cannot make investment through more than two layers of investment company subject to the following exclusion (new):

- Acquisition of a company incorporated outside India if this company has more layers of investment. Subsidiaries under the laws of the relevant country.
- Subsidiary company having a greater number of investment subsidiaries for the purposes of meeting the requirements under any law for the time being in force.
- The provisions are applicable in relevant an investing by each company. Therefore, two layers need to be determined in relevant to an investing company and not the ultimate holding company of that investing company.

- The New Act has amended the definition of "Subsidiary which provide that certain (types of companies are not to have more than the prescribed layers of subsidiaries. The above condition should also be considered over and above the aforesaid conditions,

- The Existing Act restricted a company from giving a loan to other body corporate or making investment in other body corporate in excess of the specified limit of 60 percent. of its paid-up share capital, free reserves and securities premium account, or 100 percent of its free reserves and securities premium account.

- The scope of sec 15 is enlarged to include loans to persons other than body corporate (new). ,

- The existing Act provides that free reserves should be as per the later- audited balance sheet. No such charity is provided in the New Act.

- The Provisions seem to apply only to new investments/loans, therefore, existing investments/1 loans seem to be impliedly grandfathered. •

- The company shall disclose in its financial statements particulars of Ioan/investments/guarantee/security given and the purpose for which it is given and the

purpose for which it is even as well as the purpose for which the recipient of the guarantee will use it (new). ,

- A company, registered as broken or other intermediary u/s. 12 of the SEBI Act and Such class of companies as may be prescribed, cannot take inter-corporate loan or deposits exceeding the prescribed limits (new). According to the rules, the prescribed limits would be as notified by SEBĺ under the relevant regulations.

- The rate of interest on the loan which was limited to the bank rate under the existing rate now limited to the prevailing yield on approved Government Security closest to the tenor of the loan.

- The existing provision exempted (a) Private limited companies and (b) loan given or investment made in WOS from applicability of provision. Under the New Act, these exemptions are withdrawn and the new provision is applicable to both the categories.

- The exemptions to investment companies relating to the giving of loans and providing securities are withdrawn.

c) LOAN AND INVESTMENT U/S. 186 OF THE COMPANIES ACT, 2013: [71]

INTRODUCTION:

The Companies Act, 2013 (Act) has come up with a change in the concept of 'Loan and investment by Company.[72] The new Act provides that inter-corporate investments not to be made through more than two layers of investment companies. There is no such provision under section 3724 of erstwhile Companies Act, 1956.

APPLICABILITY:

In pursuance to the provisions of Section 186(1) of the Act, a Company shall make

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[71] "Loan and Investment by Company | Companies Act 2013 | Section 186 – Chandan Agarwal – Chartered Accountant Firm in Kolkata" <https://cachandanagarwal.com/loan-and-investment-by-company-companies-act-2013-section-186/> accessed May 6, 2024

[72] ——, "Insight on Section 186 of the New Companies Act, 2013" <https://rna-cs.com/insight-on-section-186-of-the-new-companies-act-2013/> accessed May 6, 2024

investment through not more than two layers of investment companies.

layer' in relation to a holding Company means its subsidiary or subsidiaries [explanation (d) of Section 2 (87) of the Act.

investment Company' means a Company whose principal business is the acquisition of shares, debentures or other securities"[73]

2.9 CONCLUSION OF THIS CHAPTER

There are of o course weighty reasons for controlling inter-corporate investments for preventing consternation of economic power and other adverse consequences. At the same time there are also equally weighty reason for allowing a more freer flow of inter-corporate investment for economic growth which the is the crying need of the country. What is needed is a balanced approach and a proper sense of priority in deciding the course of action to be following in such a vital matter. There is no dispute over the point that whenever the control of a body corporate is acquired through inter-corporate investment a certain degree of concentration of economic power is inevitable. But that in itself is not bad. It, however, there is conclusive proof that the concentration of economic power of a particular class is operating to the "Common detriment" ten alone there is a case for imposing regulatory control in consonance with the Directive Principles of State Policy in the Constitution.

what 1s required in carving out the constitutional mandate is first to make an objective Tor finding out an answer to the question whether a particular class of concentration of economic power can be branded at failing within the mischief of the expression "common determent". . If so, the remedy lies in breaking or regulating such concentration only on a selective basis. There is no point in making the law more stringent and in the process making it more impracticable in the quite of controlling or regulating all type of concentration of economic power including the beneficial ones. The remedy lies in handling the "evils" on a selective basis and not ion an omnibus manner. At the same time, business should also regulate itself in such a manner that it harmonies its growth with general well-being of the community.

The Companies Act, 2013 has given the new direction to the inter corporate investment due

[73] Act S 186 of C, "Section 186 of the Companies Act 2013" (Registerkaro, December 22, 2023) <https://www.registerkaro.in/post/section-186-of-the-companies-act-2013> accessed May 6, 2024

to which there is there is transparency in the investment process and has pre-specified that the inter-corporate investment will be dealt as other loans with the determine interest rate to safe the interest of the investors and shareholders of the companies.

All through the corporate sector inter-corporate investments play a very useful role. The policy of the government in regard to inter-corporate in investments, which was constantly being reviewed in the light of developments, might be said to be broadly based on the need to create a climate favorable to rapid but planned growth of our economy. It is, therefore, felt that any amendment of law pertaining to inter-corporate investment should in future be based on the following principles;

- Inter-corporate in investments should be allowed a more freer flow for corporate growth economic development of the company.
- The aspect of concentration of economic power to the "common detriment" involved inter-corporate investments should be allowed to be tackled through the M.R.T.P. Act
- of SEBI Act which is the proper instruments should be allowed to be tackled through the M.R.T.P. Act of SEBI Act which is the proper instrument.
- Built in mechanism should be provided in the law itself for preventing any abuse of the system of inter-corporate investment.
- An absolute ceiling based on a specified percentage of the subscribed capital and free reserves (as is commonly understood according to Accounting Standards)
- Investment beyond that ceiling (absolute) should be made to entail the freezing of the voting rights of the investing company in regard to its shares in the investee company or companies.

The requirement of obtaining government approval should be kept confined to specified category of exceptional cases only.

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CHAPTER : 3

INTER CORPORATE INVESTMENTS UNDER SEBI ACT 1992

3.1 Introduction:

After the enactment of SEBI Act 1992,[74] the most of regulatory work of other institutions relating to the, administration of Companies have been taken by it and numerous guidelines are issued from time to time to have better and effective control on the working of the companies.

Securities Exchange Board of India has come up with securities and exchange board of (India (Substantial Acquisition of Shares and Takeovers) Regulations, 1994[75]

3.2 SUBSTANTIAL ACQUISITION OF SHARES AND TAKE-OVER REGULATIONS

(A) BACKGROUND

First attempt with a view to regulating bulk acquisition of shares in take-over bids. certain restriction were first imposed in April, 1984 on the transfers of shares of listed companies, through the listing agreement by inserting therein a new clause number 40. In April 1990, the said clause 40 of the listing agreement was amended by substituting for it new clauses 40A and 40B. Initially, the provisions of these clauses were applicable only to shares of listed companies. In May 1990, the word 'securities' was Substituted for the word 'shares' thereby making them applicable to all kinds of listed securities. These clauses had come in the wake of the take-over bids which compelled the Government to make improvements in public polity to protect the interests of the shareholders and also to ensure more transparency in take-overs .

(B) SEBI'S CONSULTATIVE PAPER-

In 1991, the SEBI had come out with a consultative Paper, namely Draft Regulations for substantial acquisition of Shares in Listed Companies'. [76]

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[74] Act 15 of 1992

[75] Notification No. SO 800 (E),, dated 4 November, 1994

[76] Taxguru_In, "Compensation Agreements under SEBI Regulations" (TaxGuru, November 12,

The Consultative Paper emphasized that the process of substantial acquisition of shares should be fair. transparent and equitable to all parties concerned in the process and above all the rights of' shareholders are protested in such events. The Consultative Paper therefore presented an Outline for a transparent ad orderly frame work for substantial acquisition of shares of companies listed on the stock exchange by any person a corporate entity or otherwise, whether or not be covered in listing agreement . therefore, envisaged a wide scope than the clauses 40A and 40B of the Listing Agreement which is restricted to listed companies only and s effective only when. either of the parties in an acquisition is a listed company.

(C) GUIDING PRINCIPLES

The Consultative Paper of SEBI Enunciated the following guiding principles on which the Draft Regulation were stated to be based:[77]

1. Equality of treatment and opportunity to all shareholders.

2 Transparency in acquisition of shares.

3. Fair and truthful disclosure through public announcement.

4. Availability of sufficient time for shareholders to make properly informed decision.

5. Avoidance of undesirable practices in sustainable acquisition of shares and clandestine transactions.

6. Protection of rights for small and minority shareholders.

7. Avoidance of use of price sensitive information concerning a public offer by all persons privy to confidential information of their own profits.

In exercise of the powers conferred by Section 30 of the SEBI Act, the SEBI notifies the "SEBI (Substantial Acquisition of Shares and Take-overs) Regulations, 1994" on 4h November, 1994. Important aspects of those Regulations were explained in the following

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2016) <https://taxguru.in/sebi/compensation-agreements-under-sebi-regulations.html> accessed May 6, 2024

[77] Murali, “SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011 – Securities Laws and Capital Markets Important Questions” (April 16, 2024) <https://gstguntur.com/sebi-substantial-acquisition-of-shares-takeovers-regulations-2011-important-questions/> accessed May 6, 2024

circular of the department of Economic Affairs, Ministry of Finance:[78]

1. Regulations pertaining to the substantial acquisition of shares and takeovers have been noticed today in the Gazette of India Extraordinary. These Regulations issue under Section 30 of the SEBI Act have the approval of the Central Government [79]

2 The main objective of these Regulations is to provide greater transparency in the information. Under certain circumstances, a public announcement of the intention to acquire at 20% of the shares of the target company would also need to be made.

3. The Regulations provide trigger points for disclosure. Any acquirer whose aggregate shareholding to the company, and to each Stock Exchange where the Company's shares are listed, within 14 working days. Similar is closure would also need to be made if at least 5% is ready held at the stage when these regulations come into force.[80] Further, if an acquirer holds more than 10% shares in a company, he would be required to make half-yearly disclosures to stock Exchange about the extent of his shareholding. Such disclosure are expected to ensure greater transparency in share acquisition and to alert the existing management about the possibilities of a change in management.

4. The Regulations deal with three types of takeovers negotiated takeovers, open market take overs and bail-out takeovers and provide a trigger point for a public announcement.

5. The Regulations empower SEBI make investigations into the acquisition or sale or - securities in order to ascertain as to whether any person has violated the provisions of the - regulations. SEBI has powers to issue directives or to initiate criminal prosecution under section 24 of the SEBI Act.

The Central Government believes that these Regulations represent an important measure he ongoing process of reforms in the capital market. It is expected that the regulations will mote the orderly functioning of stock market and foster investor protection.

(D) EXTENT OF. APPLICABILITY OF THE REGULATIONS:

Regulation 3 exempts the cases of acquisition of shares stated therein from the provisions

[78] Jha A, "SEBI Act: Regulating and Monitoring Stock Market - GetLegal India" (Getlegal India, June 9, 2022) <https://getlegalindia.com/sebi-act/> accessed May 24, 2024

[79] Takeover Code - an Insight" (Takeover Code - an Insight) <https://legalserviceindia.com/articles/takeover.htm> accessed May 24, 2024

[80] "SEBI (Substantial Acquisition of Shares and Takeover) Regulations Act, 1997" (August 11, 2010) <https://www.mbaknol.com/legal-framework/sebi-substantial-acquisition-of-shares-and-takeover-regulations-act-1997/> accessed May 24, 2024

of Chapter -III of the Regulations. Accordingly, the acquisition of shares by any person

Irrespective of the quantum, in the following six cases fall outside the purview of Chapter III which deals with negotiate and open market take-overs. However, these cases are not exempt hm Chapter II dealing with disclosures; [81]

a) Public Issue

b) Underwriting

(c) By brokers in ordinary course of business

d) Shares of unlisted companies

e) Scheme of arrangement/ amalgamation under section 392/394 of the Companies Act.)

(f) BIFR scheme under Section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985.[82]

Regulation-4 empowers the SEBI to exempt from the provisions of Chapter III acquisition of shares in excess of 10% of the voting rights in the company in only those cases which are specified therein.

(E) <u>SUBSTANTIAL ACQUISITION OF SHARES</u>

Threshold Limit- [83]

The expression 'substantial acquisition of share has not been defined in the Regulations. The word 'Substantial' is used with reference to the threshold limits stipulated in Regulations 6 of chapter I of the Regulations i.e. 5% of the shares thus, any acquisition of shares by which the existing shareholding exceeds this threshold limit would amount to substantial acquisition requiring disclosure thereof this threshold limit would amount to substantial acquisition requiring disclosure thereof in the manner laid down in Regulation 6.

[81] Team T, “SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011” (TaxGuru, March 1, 2019) <https://taxguru.in/sebi/sebi-substantial-acquisition-shares-takeovers-regulations-2011-2.html> accessed May 24, 2024

[82] “Sick Industries, Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) and BIFR” (A N a R & Co, January 5, 2015) <https://caasmeet.wordpress.com/other-laws/sick-industries-sick-industrial-companies-special-provisions-act-1985-sica-and-bifr/> accessed May 24, 2024

[83] “Pulling the Veto Pen out?: Veto Rights as a Threshold for Control under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 - AZB” (Azb, September 22, 2021) <https://www.azbpartners.com/bank/pulling-the-veto-pen-out-veto-rights-as-a-threshold-for-control-under-the-sebi-substantial-acquisition-of-shares-and-takeovers-regulations-2011/> accessed May 24, 2024

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DISCLOSURE OF ACQUISITION OF SHARES:

Regulations 5 and 6 require disclosure of shareholding in certain cases. Regulation 5 had limited life as it was a transitional provision. According to Regulation 6, any acquirer, who is hold 5% or less than 5% shares in a company, must make a disclosure 6, any acquirer, who is. hold 59% or less than 5% shares in a company, must make a disclosure of acquisition of any further shares which results in bis holding exceeding 5%[85]. Moreover, aggregate holding of any Arsons covered in the definition persons acting in concert is to be considered for the purpose of the limit of 5%. T7he required disclosure of the acquisition has to made by the acquirer to the company within 4 working days of the

receipt of intimation of allotment of shares in the case of acquisition through a public issue and, in other case, within 4 days of acquisition of shares.

In turn the company will make a disclosure of the acquisition to the stock exchanges where the company's shares are listed, within 7 days of the receipt of intimation to make a disclosure to the SEBI when called for:

Continual Disclosure: Regulations 8 (1) provides that every acquirer including a person 2overed under Regulation 5 who hold more than 10% shares in any company, shall make half-yearly disclosure to the stock exchange on which the shares are listed in respect of his holdings as on 31st March and 30th September of each year.[86]

The obligation to make disclosure under sub-regulation (1) shall continue till such time the holdings in the company is either reduced to 10% of increase up to 75% of the voting rights of the company.[87] Thus under Regulation 8, any person or acquirer holding more than 10% ores is required to make disclosure of the shareholding to the concerned stock exchanges so

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[84] "TOC - Regulation 3 | Companies Act Integrated Ready Reckoner|Companies Act 2013|CAIRR" (Companies Act Integrated Ready Reckoner|Companies Act 2013|CAIRR, October 23, 2011) <https://ca2013.com/toc-regulation-3/> accessed May 24, 2024

[85] "SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011 – Securities Laws and Capital Markets Important Questions" (April 16, 2024) <https://gstguntur.com/sebi-substantial-acquisition-of-shares-takeovers-regulations-2011-important-questions/> accessed May 24, 2024

[86] "Before a Public Takeover Bid" (Before a Public Takeover Bid, June 1, 2022) <https://resourcehub.bakermckenzie.com/en/resources/global-public-ma-guide/europe-middle-east-and-africa/france/topics/before-a-public-takeover-bid> accessed May 24, 2024

[87] Monika, "Disclosure, Delistings and Approvals during Acquisition- in Brief" (Ipleaders, March 14, 2019) <https://blog.ipleaders.in/disclosure-delistings-and-approvals-during-acquisition/> accessed May 24, 2024

ng as the holding is beyond 10% but not exceeding 75% of company's total number of voting rights. No disclosure is necessary if the holding does not exceed 10%. [88]

3.3 DRAFT REGULATION FOR SUBSTANTIAL ACQUISITION OF SHARES IN LISTED COMPANIES A CONSULTATIVE PAPER

A takeover bid is generally understood to mean an the holders of securities carrying B rights in a company or convertible into securities carrying such rights, to acquire their securities for a consideration, the purpose of the offer usually being to acquire control if the company or consolidate control by the existing management.[89] This being so, any substantial acquisition of shares in a company may be made with different objectives in view. It may primarily before the purpose of seeking management.[90] This being so, any substantial acquisition of shares in a company may be made with different objectives in view. It may primarily before the purpose of seeking management control of the company or its consolidation by the existing management

Difference sets of circumstance can also be envisaged under which substantial Acquisition of shares may take place. Often, this take place with the approval and the existing management, agreement of resulting in a friendly takeover of the company, in Nh cases shares are acquired negotiations. These may also be cases, where a person, a corporate entity or otherwise, or a group of persons acting in concert, acquire shares from the open market or by otherwise, or a group of persons acting in concert, acquire shares from the open market or by negotiations without the knowledge of the existing management, to obtain management control of the company; these will be case of unfriendly or hostile takeovers. There may also be some potentially sick companies in which large amount of institutional funds are locked up and public interest is involved and in which 2 charge in management can help bring about the revival of the unit; these are cases of brail out takeovers and would need to be treated on a different footing form

other takeovers. Substantial acquisition of shares can also result in circumstances when as Indian promoter may bay out the shares of a foreign partner who may like to disinvest for a variety of reasons, or a foreign partner who may like to disinvest for a variety of reasons, or . foreign partner may like to take advantage of the present liberalization policies and

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[88] Ibid.
[89] Ibid., 86
[90] Ibid..,86

notice his stake in the business, there could also be an inter so transfer of shareholdings among various persons or entities belonging to the same management group.

It is therefore important that the process of substantial acquisition of shares is fair, transparent and equitable to all parties concerned in the process and above all the rights of shareholders are protected in such events.

The consultative Paper therefore present at outline for a transparent and orderly framework for substantial acquisition of shares of companies listed on the stock exchanges Yeny person a corporation entity or otherwise, whether or not he is covered by the listing agreement. It therefore has a wider scope than the present clauses 40A and B of the Stock exchange Listing Agreement which is restricted to listed companies only and is effective only hen either of the parties in an acquisition is a listed company,

The objective of the Consultative Paper is to elicit views of the industry and the various intermediaries who are involved in such transactions on the Regulation.

3.4 OBJECTIVE AND APPROACH

If industry has to thrive in a deregulated market, it would be prepared to accept the discipline and protective bureaucratic governance. Regulation, where necessary, has to be kept to the competition of minimum.

Keeping in view these new tents and in the spirit of the recent changes in policy having greater freedom for the interplay if market forces with minimum bureaucratic intervention, the Regulation for Substantial Acquisition of Share in Listed Companies, has been devised to provide an orderly the market place without relying on the dead hand of framework within protection of the interest of shareholders.

Guiding Principles-

The Regulations is s based on the following principles:

1. Equality of treatment and opportunity to all shareholders.

2. Transparency in acquisition of shares which such transactions can take place and for the

3. Fair and |truthful disclosure through public announcement.

4. Availability of insufficient time for shareholder to make properly informed decision. clandestine transactions. disclosure: .Avoidance of undesirable practices in substantial acquisition of shares and

6. Protection of rights for small and minority shareholders.

7. Avoidance of use of price to confidential information for their own profits.

DISCLOSURE

The objective of the provisions of this section is to bring about a greater degree of transparency in the holding and acquisition of shares of a company, y any person, and in the market operations of financial institutions, mutual funds and discretionary fund managers. is fits in with the overall objectives of the Regulations to provide a transparent and -orderly framework of substantial acquisition of shares.

(i) If on date of coming into effect of this Regulation a person, holds shares, which taken together with shares held by person acting in concert with him, carry 5% or more of the voting capital of a company, he shall disclose his aggregate Shareholding together with that of the person acting in concert with him, in a manner prescribed by SEBI, to

a) SEBI, and

b) All the stock exchanges on which the shares of the company are

listed, within two months of coming into effect of this regulations.

In such cases, the company shall also on its own be required to notify SEBI and all the stock shareholding of all persons and of those who in the judgment of the company are acting on concert with them, hold 5% or more of the voting capital of the company, within two months of coming into effect : of this Regulation. exchanges, in which the company's shares are listed, the aggregate [91]

When a person holding less than 5% of the voting capital of a company, acquires (whether by a series of transaction or otherwise) shears, which, taken, together with shares held or acquired by person acting in concert with him, carry 5% or more of the voting capital of the company but less than 10% he shall disclose his aggregate shareholding together with that of the persons acting in concert with him , in a manner prescribed by SEBI, to

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[91] Staff, “SEBI Revisits the Concept of Promoter and Promoter Group” (September 29, 2021) <https://vinodkothari.com/2021/06/sebi-revisits-the-concept-of-promoter/> accessed May 6, 2024

a) SEBI, and

b) all the stock exchanges on which the shares of the company are listed, within four days of sending the such shares for transfer of registration to the company.

In such cases, the Company on its own shall also notify SEBI and all the stock exchanges, the aggregate shareholding of all persons who in the judgment of the company are acting in concert with them, hold %% or more of the voting capital of the company, within four days of receipt of such shares for transfer.

(iii) When a person, becomes entitled to exercise voting rights in shares through conversion or partly or fully convertible debentures, which taken together with him existing holding in shares and the shares held or acquired by persons acting in concert with him, carry 5% or more but less than 10% of the voting capital of the company, he shall disclose the aggregate shareholding together with that of the persons acting in concert with him, in a manner prescribed SEBI, to

a) SEBI, and

b) all the stock exchange on which the shares of the company are listed. Within four days from the date of such conversion.

(iv) When a person becomes entitled to exercise voting rights in no-voting shares of a Company held by him which taken together with the existing holdings in shares and the. shares and non- -voting rights shares of persons acting in concert with him, carry 5% or more bur less than 10% of the voting capital of the company, he shall disclose the Aggregate holding together with that of the person acting in concert with him, in such format as s may be prescribed I by SEBI, to

A) SEBI, and

b) All the stock exchanges on which the shares of the company are listed.

With four days of voting rights in such non-voting rights becoming active .

Negotiated Purchase and purchases in the Open Market.

A distinction has to be made in dealing with cases involving acquisition of shares in the open market and the acquisition of shares by private negotiation with some of the existing shareholders.

In the case of private negotiated purchase, the public shareholders should not have the same opportunity as in the case of open market transactions, either in terms of a fair price

or in terms of option to sell. In such cases where the acquisition exceeds certain limits, it would be necessary to cast an obligation on the purchaser, to offer to acquire specified amounts of shares from the public a fair prices.

Open market acquisition places all shareholder and investors on an equal footing, with freedom to buy or sell shares at prevailing market prices.

NEGOTIATED PURCHASES:

a) As on date of coming into effect of this Regulation, person who holds shares in a company which taken together with the shares held by persons acting in concert with him which carry more than 10% of the voting rights of the further shares, and [92]

b) a person holding less than 10% of the voting capital of a company has agreed to acquire further shares through negotiations, which taken together with shares held or acquired Dy persons acting in concert with him, would carry 10% or more of the voting capital, he Shall not acquire any share which taken together with his existing holdings and that of parties acting in concert, would carry more than 10% of the voting capital of the Company.

Unless he makes.

him which carry more then 10% of the voting rights of the further shares, and

A public announcement of an offer to the remaining shareholders of the company, lowed by a letter of offer in a manner prescribed and approved by SEBI, to acquire shares in the s same proportion from them as through the negotiations, but not exceeding 0at minimum offer prescribed in Section (4.1) of the Regulations.[93]

PURCHASES IN OPEN MARKET

a) As on date of coming into effect of this Regulation, a person holds shares in a company which taken together with the shares held by persons acting in concert with him, carry more than 10% of the voting rights of the company, he shall not Purchases in open market:

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[92] Srivastava CA, "New Takeover Code: Disclosure Requirement" (CAclubindia, July 10, 2012) <https://www.caclubindia.com/articles/new-takeover-code-disclosure-requirement-14354.asp> accessed May 6, 2024

[93] Team T, "All about Pledging of Shares" (TaxGuru, March 12, 2019) <https://taxguru.in/sebi/pledging-shares.html> accessed May 6, 2024

acquire any further shares, and

b} a person holds shares which taken together with shares held or acquired by person acting in concert with him carry less than 10% of the voting capital of the company, he

shall not acquire any share which taken together with his existing holding would carry more than 10% the voting capital of the company in (b) above unless he makes

A Public announcement of his intention to acquire such additional shares through open market prescribed by SEBI. [94]

In either case he shall not acquire in the course of his open market purchases, a larger number of shares from any person associated directly or acting in concert with the existing management of f the company than from the general public.

Such purchases made in conformity with the above provisions, shall be reported to court within a week of the purchase or within a week after the completion of all the formalities of market operations, Whichever is earlier.

No acquisition of shares shall commence earlier than the day of public announcement. A person who has announced his intention to acquire shares under the above provisions and reported the purchases to SEBI, shall not acquire shares under the above provisions and reported the purchases to SEBI, shall not acquire further shares Without making a further announcement on the lines prescribed above and such further announcement of intention. the company in (b) above unless he makes,

INSTITUTION OPERATIONS

A) Public financial institution shall not sell any shares exceeding 1% or more of the paid-up capital of any company by negotiation, whether through a single transaction or otherwise, Operations: the same person or persons acting in the intention to sell the block of shares, the number of shares to be sod and the price, and unless they have given an opportunity to other bidders or considered other offers within a period of one month from the date of announcement and have accepted the highest bid .

(b) Mutual funds shall also follow the same procedure in case of any negotiated sale.

[94] Lawpavilion and Lawpavilion, "THE PROPOSED COMPANIES AND ALLIED MATTERS ACT 2018: WHAT'S NEW? - LawPavilion Blog" (LawPavilion Blog - No1 legaltech resource in Africa, October 21, 2019) <https://lawpavilion.com/blog/companies-and-allied-matters-act-2018-whats-new/> accessed May 6, 2024

(c) Public financial institution selling in the open market, shall make a public announcement of the sale and in cases where it is one percent or more of the paid-up capital of f the company within two days of the transaction. This shall also apply in case of sales by any mutual fund in the open market.

EXEMPTED CATEGORIES:

Provisions contained in Section (1) and (1) are not applicable in the following cases:

a) an acquisition of shares by will or by operation of law;

b) an acquisition of shares by way of allotment in purchase to an application made under a public issue;

(c) an acquisition of shares to underwriting arrangement in the event of under subscription of the public issue;

(d) an acquisition of shares in the ordinary course of business by a registered member of a stock exchange on behalf of clients;

(e) acquisition which may be specifically exempted by SEBI in writing subject to conditions as may be prescribed by SEBI.

SEBI may grant exemption to the provisions of Section (1) and (1V) of the regulation in any other case and to any other institution or agency.

3.4 CONCLUSION:

It is must protect the interest of the shareholders and those for the Government has taken necessary steps through SEBI REGULATION to impose certain restriction and to make the investment cycle more transparent.

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CHAPTER : 4

EMERGING TRENDS OF INTER-CORPORATE INVESTEMENTS IN INDIA

4.1 INTRODUCTION

The progress of Indian PE (i.e. Private Equity) is a complex choreography between capital, innovation, and control. This dynamic field managed to overcome the economic turbulences which are observed since the nineteen-seventies and nowadays is considered an international player mostly in venture capital investments. The Indian PE market first started to emerge from the very early stage and then moved on to focus more on the Information Technology sector. It is remarkable, without a doubt, how it progressed to its current status in the midst of a rapidly changing startup landscape, which is an attractive tale of adaptability and sustainable growth.

4.2 HISTORICAL PERSPECTIVE

A genuine craze of the Information Technology as a sector came into existence in the early 2000s, led by enthusiastic interest of inter corporate investment investors. Even though the beginning of the dot-com bubble and financial crisis ruined the nation's economy, it still served as a catalyst for interest in technology. Turning point of PE investments has found its narrative at those difficult times particularly on July 2012; the announcement of the USD 150 million[95] from IVCD made as the fourth round of funding for Flipkart. Despite the enormous tailwinds on the cumulative impact of public equity investment on technological innovation, knowledge spillovers, and new firm creation in India would be inevitable.[96]

4.3 REGULATORY FRAMEWORK: NAVIGATION OF THE SEAS

SEBI's AIF Regulations (introduced in 2012) have brought a massive change in market

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[95] Audretsch DB and Belitski M, "Frank Knight, Uncertainty and Knowledge Spillover Entrepreneurship" (2021) 17 Journal of Institutional Economics 1005 <https://www.cambridge.org/core/journals/journal-of-institutional-economics/article/frank-knight-uncertainty-and-knowledge-spillover-entrepreneurship/F300A918645A049FA78307C3FABE5865>

[96] Qi R, "Does the Cumulative Effect of R&Amp;D Investment Exist in High-Tech Enterprises? ≪ Br/≫—Empirical Evidence from China A-Share Listed Companies" (2020) 08 Open Journal of Business and Management 1122 <https://www.scirp.org/journal/paperinformation?paperid=100057>

favouring inter corporate investments in India. These regulations brought much-needed clarity and structure to the industry; they categorized funds into two main groups: Category 1) that will target the funding of either startup or SMEs, and Category 2) comprising both inter corporate investment funds and debt funds.

What is more, it is not merely a form of officiating but actually of changing inter corporate investment operations in India is totally true. The framework it provided addressed the diverse nature of investments: many startup companies had a great success, and big sized PE funds moved on diversification of portfolios. The industry embraced the necessity of this regulations; by the end of 2016 the corresponding figures amounted to nearly 270 surpassing the pre-2016 level by far thanks to the capital attracted.

Structuring PE Funds in India: Entities like Trusts, Companies of all sorts, Associations, Foundations, Societies, Partnerships and Cooperative Societies will be able to file their incorporation documents online.

The regulatory regime and the malleability provided in this regime, play the key roles in the PE funds establishment in India. Frequently, these investments are made through the SEBI registration form of alternative investment funds under the AIF Regulations. Nevertheless, in this case, a company with a structure provided by the Companies Act may be formed or one can register as a Limited Liability Partnership (LLP) under the LLP Act.

Trusts, because of their regulatory ease, continue to be a popular choice: while on the one hand companies can be hard to form, they do offer certain perks as well. Highly demanding processes for companies and newness of LLPs, India create Liquid limited partnerships (LLPs) which are not only preferential but also the most common. The AIFs registration, as a case in point, went up to roughly 270 in the year 2016. This suggests that structurally, this technique is adapted to the changing society and has enormous popularity among the people so that it is widely applied.

4.4 STATISTICS AND TRENDS: THE NUMBERED CARPET.

The historical progression of physical education in India is a memorably interesting story

especially if we look at the figures. In order to describe this, in 2014 the pressure equity investments raised an aggregate of $11.5 billion only. This not only represented a significant rise from the previous year by 17%, but also very importantly, published the high level of doors the sector was being put through. Nevertheless, there was a noticeable change. It is the real estate sector that had had a quarter of PE funds in last decade that became 75 percent by the end of the 10-year area under inspection. The statistics provide the real-life evidence at the gender equality has for business.

The Indian unicorns' startups population boomed another notch and now the total number of unicorns in India is estimated as a whopping 70 at the end of the year 2021. These escalations made India no more a third largest startup hub but a marketplace and it was an affirmation of its vibrancy and hype. They should be read not as something that is quantitative per se but in all its qualitative determinants of investment scenarios. They signified a rebirth of numerous fields and saw an emersion of uncountable small businesses, which had a similar place on the market.

4.5 LEGISLATIVE DEVELOPMENTS: THE LEGAL RIB.

The legislative backgrounding the Companies Act, 2013, the Income Tax Act, 1961, and the Foreign Exchange Management Act, 1999 are deeply interlinked and play a big role in the governance of inter corporate investment investments in India. Further, regulations and order formulated by SEBI for the purpose of supervising listed organizations to build more meaningful and sustainable system for the PE funds.

In 2012 the AIF Regulations came into existence as a substitute for the Venture Capital Funds Regulations. This event was marked with an introduction that implied a drastic change. The move in this direction provided for PE funds to be registered under these new rules and allowed them to either go on with their existing regulatory framework or change overs, all with an option of seeking investor consent. On the subject of company incorporation and running a business, the Companies Act of 2013 provides the required framework, while income tax aspects of the Inter corporate investment transactions are prompted by the Income Tax Act from 1961.

Inter corporate investment has brushed aside the curtain and secures the corner stones of the system namely, transparency, accountability, and investor protection by the judiciary

system.

Mode of Investment: Faces the Financial Tide

One of the most dominant features of inter corporate investment investments in India is the appropriate investment route. Multiple options are incorporated by the investors in Indian PE realm to carry out transactions, these instruments include equity shares, compulsorily convertible preference shares (CCPs), and compulsorily convertible debentures (CCDs) – which majorly route the investments through these channels. While ECB Normal is a regulation that applies to different borrowing instruments, except when they are fully and inevitably convertible to equity, these are considered debt.

In flow of FDI into India takes place under the stewardship of FDI policy and Foreign Exchange Management Rules (ext.).

Budget 2024: India's startup ecosystem got a Shot in the Arm when PM Modi announced the vaccination programme as part of Aatm Nirbhar Bharat campaign.

A venture of ours (Silver needle Ventures)

Fintech deals are booming, and case laws are resulting in setting the precedents and evolving the industry, the direction of which is shown in the evolution of the inter corporate investment legal environment in India. Rather typical resolutions often deal with problems like identifying the path to get out, obligations that are reflected in a legal document, and how well protected are the investors may differ from situation to situation.

Often, experts will go a head to work out one case that is exceptional because the company here switches towards IPOs from the joint-venture strategy. A few notable mergers and acquisitions happened esteeming 45% of all exits in the country via IPOs in Q1 of 2021 to list them as a separate entity and this indicates a switch from usual methods of partnership through acquisition.

4.6 INTERNATIONAL COMPARISONS: INTERNATIONAL AFFAIRS

One of the most important things in inter corporate investment development for India is to make an exemplary comparison of global vestures. According to The McKinsey Global Inter corporate investment Report 2021 (pg. 13), the inter corporate investment has been reaching new highs all over the world, and this has been accelerated by the advantageous low-interest rate environment and strong equity markets. The national movement in India

fully considers global of patterns, which is indicated by similar tendencies. Hence, the consideration enables the company to improve and leave a good impression of a wider range.

India, aware of its increased weight in the world inter corporate investment playing field, but that also needs to overcome multiple long-term problems. However, the teams that continue in their efforts are the ones to gain on the ground the land as a destination for global PE funds. Its core responsibility is the improvement of the different notions related to the ease to operate, the lack of regulatory transparency and the overall investment environment.

Navigating the Future: These barriers and opportunities are critical both for economic growth of nations and the well-being of its people.

In spite of the evident expansion of the inter corporate investment arena in India, it evidently finds itself struggling with many hairs, such as complicated crowding out and persistent taxation uncertainty, that, up to date, was a nagging issue that did not have a clear exit strategy. The other side of things is that economic conditions like global fluctuations and external factors like geopolitics may change investors' future prospects thus creating more pressure.

Problems have dual edge, they present challenges and uplift the courage to overcome such obstacles. The enlarged emphasis on Environmental Social Governance (ESG) factors, that have been engendered by technological innovation and mere investments in the emerging sectors, creates election straits for growth. For coping with these challenges, the joint efforts must be explored. It takes the government or agencies, industry players, and policymakers' joint effort to enable the establishment of an environment that will not only remain innovative but also attract foreign capitals hence grow into a sustainable expansion.

Last month, twenty firms pledged to invest $1.5 billion into the communities across the United States over the next sixth years, as the White House met to discuss the impact investing. Putting that figure into perspective, by and large, it makes up around half the aggregate amount raised by impact-oriented enterprises in India in the last fourteen years. Nevertheless, in the perspective of the world $10-10,6 billion per year is about the size of it.

Lower figures compared to other emerging markets, the number of impact entrepreneurs in India indicates a significant contribution towards achieving the global SDGs against a

backdrop of rising international recognition of the unique Indian approach.

From only $1.17 million was invested in 2000 to today's amounts of $250M / year since when the numbers started to increase and already hit $1.6B spread over 220 for-profit impact enterprises.

India's story is, therefore, not about the number of impact investments; it is about the how the investment ecosystem has evolved and the role of impact capital. At least half of the enterprises that the impact reports of IntelliSnap have conducted after 2010 took off only post-2010. The capital still ranks as the greatest hurdle, and such banks has become a formidable source of financial coverage for these companies. Impact funds started significantly with the introduction of first Indian and foreign funds such as Aavishkaar and Acumen in the beginning of the 2000s. More than 50 impact funds have come up over the years since then. These financers are a typology of venture capitalists and implicitly a catalyst as they generated an avenue for the capital needed in social enterprises..

It is amazing how the past years with a consistent background of the impact investors have come out with more acceptance and unity on the approach of investment in India. On the skilled emulation of the funding strategy of the well-known venture capital firms, they hypothesize it also for impact enterprises. This occupation approach, on the other hand, is implying investing in early stage, profit-seeking enterprises that run in spaces with underserved markets and critical sectors. It is characterized by:

Early-stage investing and pioneer risk: 33% OF all investments in impact enterprises during the period 2000-2000 were made at the stage of seed investment that is common in unspecified risky areas, often in unproved business models or developing the new markets.

Scale and sustainability: As demonstrated by the 30 percent of businesses having first-round funding received before 2011, that had second round closed investments applauding their investors' confidence in the scale-up and operations sustainability of the company.

Non-financial support: Beyond giving financial support, non-content support such as technical assistance, capacity building, customer education, and driving behaviour change is an addressed approach employed by impact enterprises.

4.7 CATALYZING INFLUENCE OF THE IMPACT CAPITAL

Impact investors have tried the venture capital approach by not just being limited to financial support but will catalyse growth in your beneficiary organizations and

communities. (Intellecap analysis: Source)

Impact investors India forms a bridge that helps in removing the business risks of impact enterprises to attract mainstream investors. They send signals of the succession of SME periods and "leap ability" by making follow-on investments before pulling off the exits eventually.

We link the role of influence funds as a structure process with a three stage context. For instance, microfinance institutions (MFIs), faster in pioneering impact investments. At the beginning of this century, most of the first round funds, in addition to margins cases, were made by development financial institutions and MFIs-oriented impact funds which were able to bear high risks resulting from insufficiently profitable market models. Yet during this period, a small number of mainstream venture capital and private equity investors, moreover, have bought large chunks of the major MFIs, which is an indicator of this model being better comprehended and accepted by the community of investors. Despite these funding challenges, the Microfinance sector has nevertheless attracted more than $458 million in foreign investments from mainstream investors spanning all circle of investments across the past 14 years. While of this aggregate figure, the mainstream investors spent about $225 million as secondary investments on deal rounds that didn't incorporate any impact investors.

(Illustration courtesy of Intellecap Analysis)

Microfinance stands out from the others to brag about attracting the mainstream capital of $ 449 m compared to only $ 216 m for other impact sectors that took operation since 2000. Even among the financial sector, recent deals in the field of financial inclusion and healthcare, requiring millions of dollars of capital from traditional investors, serve as a good sign. These deals proved out the capacity of India impact funds to catalyse the capital flowing across the mainstream to India.

The road mapped out for impact investing in India, albeit not free from obstacles, remains promising. Some key problems are that local funds are hardly present; since most impact capitals come from abroad. Similarly, the sector with only 15 exits according to the record still struggles with funding of long gestation projects that are host to slow scaling up. The direction of majority of the impact funds in India towards growth of scalable business models means that there is vast sparsity of capital to invest in impact enterprises that create deep impact, beyond the scalability factor. Considering the gap which is to be connected,

including a new group of investors who are much closer to these risks and have developed new financing tools, other than equity financing, will be essential to see these models survive and bring success.

4.8 CONCLUSION: GOING THROUGH THE CHANGING SEAS.

India's inter corporate investment sector has grown into an agile, changing and ever-transforming arena for financial investors that endure the ups and downs of the economic cycles. At first, when the idea was still fresh during the IT boom, it became key for the e-commerce landscape, but then it passed through a lot of hiccups, nevertheless, it got over and managed to achieve its aims. This is not just a story of how finance business is evolving in India but also we can read the comprehensive narrative of how India's economy is being transformed.

Need to accept the coexisting reality of regulations and diversification in inter corporate investment systems while navigating in the uncharted future. Entrance of India into the world of inter corporate investment shows an enthusiastic outlook of what ought to come and how the doors are to be opened for the possibilities. As our investigation goes in, we find out about countryside dense with development-promotion chances – circumstances for continuous growth and improvement.

4.9 CONCLUSION OF THIS CHAPTER

In conclusion, the evolution of intercorporate investment in India reflects a remarkable journey marked by resilience, adaptability, and innovation. From its nascent stages with a focus on information technology to its current prominence as a significant player in global venture capital investments, the landscape of intercorporate investment has undergone profound transformation.

The establishment of regulatory frameworks, such as SEBI's AIF Regulations, has been pivotal in providing clarity and structure to the industry, attracting both domestic and foreign capital. This regulatory clarity, coupled with the adoption of diverse fund structures and the embrace of a venture capital approach, has laid a robust foundation for sustainable growth and development in the sector.

Furthermore, the catalytic role played by impact investors has been instrumental in bridging the gap between impactful enterprises and mainstream investors. By providing not only financial support but also validation of the viability and scalability of these ventures, impact investors have stimulated increased interest from mainstream investors, fostering

further growth and innovation in the impact investing space.

Despite the progress made, challenges persist, including the dominance of foreign capital, limited exit opportunities, and the need for funding for non-scalable impact enterprises. Addressing these challenges will require concerted efforts from all stakeholders, including policymakers, industry players, and the government. Looking ahead, India's trajectory as a global hub for impact investing appears promising. With a growing emphasis on environmental, social, and governance factors, coupled with ongoing legislative developments and international comparisons, India is well-positioned to continue its journey towards sustainable economic growth and societal impact in navigating the future, it will be crucial to focus on overcoming barriers, fostering innovation, and creating an enabling environment for investment. By doing so, India can unlock its full potential as a destination for global capital, driving inclusive growth and prosperity for all stakeholders involved.

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CHAPTER : 5

ANALYSIS OF JUDICIAL PRONOUNCEMENTS ON THESE CORPORATE FRAUDS

5.1 INTRODUCTION

In the sphere of shareholding relationships and negotiation in financial markets, cross-shareholding appears to be critical for major economic push, diversification, and the strategic partnerships among corporations. Nevertheless, as financial transactions have grown more intricate and people have resorted to outsize expansion tactics, corporate capital has become a good home for fraudulent systems, manipulation and wrongdoing. Keyhole judges' decision on investment fraud among corporations is the most crucial way of unveiling the intricate legal dynamics and multifaceted challenges posed by regulations in addition to the judicial responses to investment fraud.

Understanding Inter-Corporate Investment Fraud: Corporate-to-corporate fraud in the investment field encompasses a range of deceptive practices that companies employ in fileting other entities, and it would involve activities like issuing misleading financial statements, insider trading, and market manipulation, among many others, with sole purpose of deception of the investors, regulators, and stakeholders. The most prominent obstacle in the way of detecting, investigating, prosecuting, and bringing to justice the perpetrators of such cliquish fraud is the anonymous character of such schemes. This clearly calls for a robust legal framework and watchful judicial oversight.

The Legal Terrain of Inter-Corporate Investments: Inter-corporate relationship is developed pivoting on the complex legal system which is based on company law, securing regulation, and fiduciary duty shouldered by corporate officers and directors. For instance, Statutory periodicals like the Companies Act, the Securities Exchange Act, and the statutes which regulate securities trading make the conduct of business to be deemed equivalent to the disclosure of material information in the interest of the shareholders/owners and also the maintenance of transparency. The judgments made by courts leave an indelible mark in demarcating the obligations, protections and liabilities of participating corporate actors given their role in cross-border investments.

Judicial Pronouncements: Adequate Insights and Reflective Precedents: In the view of judicial pronouncements of inter-corporate investment fraud, they supply quite useful insights into the standards which are keep evolving and enforcement systems along with judicial precedents which are shaping corporate governance among securities. Two landmarks cases provide the cornerstones principles regarding disclosure obligations, fiduciary duties, and shareholders' remedies in the corporate governance field involving inter-corporate investments. These cases are Securities and Exchange Commission v Texas Gulf Sulphur Co. (1968) and Smith v Van Gorkem (1985). At the end of the day, studying judicial awards, scholars will be able to figure out the evolving judicial trend, conduct doctrine as well as judge's method to deal with inter-corporate investment crime.

Challenges and Complexities: The unfair practices going on as a result of inter-corporate investment fraud make legal systems and regulatory enforcement mechanisms work very hard to keep up. These challenges present a system that is not immune to such unfair practice. The complexity of corporate organization, convoluted financial arrangements, and cross-border transactions create an even more difficult environment for identifying and prosecuting the persons who fraudulently use the structures. In addition, the cobweb of corporate governance practices, boards oversight, and executive's remuneration structures could lead to the involvement of corporate officers into fraudulent behavior, particularly if attention is not paid to the improvement and resolution of governance failures and structural weaknesses.

Research Objectives and Methodology: This dissertation will demonstrate the nature of inter-corporate investment fraud ism by using a detailed analysis of judicial pronouncements, legal doctrines and regulatory responses There will be a mix of doctrinal analysis, case studies and comparative legal study. The research objective of the study will be to examine the incremental law standards, the courtroom interpretations and types of enforcement strategies to adequately combat inter-corporate investment fraud using varied jurisdictions being the focal points. Through synthesis of reflections coming from legal studies, judicial decisions, and regulatory direction, the given study is intended to offer something scholarly-oriented to be utilized in discourses related to corporate governance, securities regulation, and prevention of financial misbehavior.

Now will going to discuss some landmark judgements and will also highlight the corporate angle through analysis of those judgements:-

5.2 SATYAM FRAUD CASE

INTRODUCTION

The Satyam Computers scandal of 2009 sent shockwaves through the global market, akin to the seismic impact of the Enron and Lehman Brothers scandals in the USA. Once hailed as the pride of the Indian Information Technology (IT) sector, Satyam plummeted into infamy due to staggering financial fraud orchestrated by its founders. The revelation of fraudulent activities within Satyam not only tarnished India's reputation but also raised profound questions about corporate governance, regulatory oversight, and the role of top executives in perpetuating fraudulent practices.

The Satyam fraud scandal unfolded as a stark reminder of the vulnerability of corporate entities to fraudulent activities and the devastating consequences of such misconduct. Led by its CEO, Mr. Ramalinga Raju, Satyam's management engaged in a massive accounting fraud, inflating revenues, fabricating cash balances, and deceiving investors and stakeholders. The magnitude of the fraud, amounting to approximately USD 1 billion,[97] underscored the urgency of regulatory intervention and judicial scrutiny.

The scandal also highlighted the crucial role of corporate governance mechanisms, particularly the responsibilities of boards of directors and audit committees, in safeguarding shareholder interests and ensuring transparency and accountability in corporate operations. The failure of Satyam's board to detect and prevent fraudulent activities raised questions about the effectiveness of board oversight and the independence of directors in challenging management decisions.

Moreover, the Satyam scandal shed light on the risks associated with inter-corporate investments and related-party transactions, where conflicts of interest and self-dealing may facilitate fraudulent practices. Mr. Raju's attempt to acquire Maytas Properties and Maytas Infra, companies owned by his family members, exemplified the potential for abuse of corporate resources and the need for enhanced regulatory scrutiny of such transactions.

Judicial responses to the Satyam fraud case played a crucial role in holding perpetrators accountable, elucidating legal principles, and establishing precedents for future cases of

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[97] GGI Insights, "Corporate Accountability: Keeping Responsibility in the Business World" (*Corporate Accountability: Keeping Responsibility in the Business World*, April 10, 2024) <https://www.graygroupintl.com/blog/corporate-accountability> accessed May 20, 2024

corporate misconduct. The prosecution of Mr. Raju and other key figures involved in the fraud underscored the severity of their actions and sent a strong message about the consequences of breaching fiduciary duties and engaging in fraudulent activities.

In the aftermath of the scandal, significant regulatory reforms were implemented to strengthen corporate governance standards, enhance financial reporting requirements, and bolster regulatory oversight of corporate entities. These measures aimed to prevent future instances of corporate fraud and restore investor confidence in India's capital markets.

The reverberations of the Satyam fraud scandal extended beyond India's borders, impacting global perceptions of corporate governance, risk management, and regulatory compliance in the IT sector and beyond. The incident served as a cautionary tale for investors, regulators, and corporate leaders worldwide, highlighting the importance of vigilance, transparency, and ethical conduct in corporate affairs.

Despite the turmoil caused by the scandal, Satyam's sound business model and portfolio of international clients underscored the resilience of India's IT sector. The government's unprecedented rescue mission, culminating in the acquisition of Satyam by the Mahindra Group, exemplified the determination to safeguard stakeholders' interests and preserve the company's legacy.

The Satyam fraud scandal stands as a watershed moment in India's corporate history, catalyzing transformative changes in regulatory frameworks, governance standards, and judicial accountability. Through a comprehensive analysis of legal principles, regulatory reforms, and industry dynamics, this dissertation seeks to elucidate the evolving landscape of corporate governance, regulatory enforcement, and judicial accountability in the wake of the Satyam scandal.

ROLE OF SEBI AND SAT IN THIS CASE

The Securities and Exchange Board of India (SEBI), established in 1992, is tasked with protecting investor interests, promoting market development, and regulating securities markets in India. In response to the Satyam fraud, SEBI launched a comprehensive investigation to ascertain whether the company had violated securities laws and regulations. Under Section 17 of the SEBI Act, SEBI scrutinized Satyam's financial statements, examined auditor records, and probed potential irregularities in the company's operations.

Mr. Raju's confession revealed the extent of the fraud, prompting SEBI to take decisive action to safeguard investor interests and restore confidence in the markets. SEBI's efforts included relaxing takeover norms to facilitate the acquisition of Satyam by a strategic investor, thereby ensuring the company's continuity and stability.[98]

Furthermore, SEBI imposed stringent penalties on PwC, the auditing firm responsible for overseeing Satyam's financial reporting, banning its network firms from auditing listed companies and brokers for two years. This move underscored SEBI's commitment to holding accountable those responsible for facilitating corporate fraud and ensuring compliance with auditing standards.

ROLE OF SAT IN ADJUDICATING APPEALS:

The Securities Appellate Tribunal (SAT) plays a crucial role in adjudicating appeals related to orders issued by SEBI and other regulatory bodies. In the aftermath of the Satyam fraud, SAT became instrumental in reviewing SEBI's actions and providing recourse to aggrieved parties. SAT's jurisdiction extends to matters pertaining to securities laws, regulatory enforcement, and investor protection.

In the context of the Satyam case, SAT may adjudicate appeals filed by PwC challenging SEBI's order imposing a ban on its network firms from auditing listed companies and brokers. SAT's deliberations will have significant implications for auditing practices, regulatory enforcement, and legal accountability in India's corporate landscape.[99]

PwC's Involvement and Subsequent Legal Proceedings:

PricewaterhouseCoopers (PwC), one of the world's largest professional services firms, was responsible for auditing Satyam's financial statements during the period of the fraud. However, PwC's role came under scrutiny following Mr. Raju's confession, as questions arose about the firm's oversight and compliance with auditing standards.

SEBI's investigation into PwC's conduct revealed instances of negligence and non-compliance with auditing practices, suggesting potential complicity in the manipulation of Satyam's financials. As a result, SEBI imposed a ban on PwC's network firms from

[98] Edmon, “Corporate Governance: Transparency and Accountability in Business - Lifeblog” (Lifeblog, May 18, 2024) <https://lifeblog.am/corporate-governance-transparency-and-accountability-in-business/> accessed May 20, 2024

[99] Kim W, “Corporate Governance: Upholding Transparency, Accountability, and Ethical Standards” (July 31, 2023) <https://www.abacademies.org/articles/corporate-governance-upholding-transparency-accountability-and-ethical-standards-16197.html> accessed May 20, 2024

auditing listed companies and brokers for two years, citing violations of securities laws and regulations.

RECENT DEVELOPMENTS AND LEGAL CHALLENGES:

In response to SEBI's order, PwC has contested the ban imposed on its network firms, denying complicity in the Satyam fraud and challenging the legality of SEBI's actions. The case is now before the SAT, where PwC seeks to overturn the ban and restore its ability to audit listed companies and brokers.

The outcome of the legal proceedings before SAT will have far-reaching implications for auditing firms, regulatory bodies, and investors. It will also serve as a litmus test for the efficacy of India's regulatory framework in addressing corporate fraud and ensuring accountability among stakeholders.

JUDICIAL ANALYSIS OF SATYAM SCANDAL CASE

The Satyam fraud case represents a watershed moment in India's corporate history, prompting significant judicial scrutiny and legal proceedings aimed at holding perpetrators accountable and addressing systemic issues in corporate governance and regulatory oversight. A comprehensive judicial analysis of the case reveals the complexities surrounding inter-corporate investments, regulatory enforcement, and the role of judicial bodies in upholding the rule of law.

1. JUDICIAL RESPONSE TO THE SATYAM FRAUD:

a. Initial Investigations and Prosecution: Following Mr. Raju's confession to orchestrating the fraud, judicial authorities, including SEBI and law enforcement agencies, launched extensive investigations into Satyam's financial irregularities. Prosecution proceedings were initiated against Mr. Raju and other key figures implicated in the fraud, marking the beginning of a protracted legal battle to uncover the truth and deliver justice.

b. Adjudication of Legal Challenges: As the case unfolded, various legal challenges emerged, ranging from appeals against SEBI's regulatory actions to disputes over the legality of the ban imposed on auditing firms like PwC.[100] The role of judicial bodies, including the Securities Appellate Tribunal (SAT), became crucial in adjudicating these challenges and providing recourse to aggrieved parties. SAT's jurisdiction extended to

[100] Boyce P and Boyce P, "Business Ethics" (*BoyceWire*, May 31, 2023) <https://boycewire.com/business-ethics/> accessed May 20, 2024

matters related to securities laws, regulatory enforcement, and investor protection, making it a pivotal forum for resolving disputes arising from the Satyam fraud.

c. Judicial Accountability and Transparency: Throughout the legal proceedings, judicial authorities upheld principles of accountability and transparency, ensuring that legal standards were adhered to and due process was followed. The judiciary played a crucial role in scrutinizing the actions of regulatory bodies like SEBI and holding them accountable for their decisions. Judicial interventions helped maintain public confidence in the legal system and reinforced the importance of independent oversight in cases of corporate misconduct.

2. **INTER-CORPORATE INVESTMENTS AND REGULATORY OVERSIGHT:**

a. Impact of Inter-Corporate Investments: The Satyam fraud case underscored the risks associated with inter-corporate investments and related-party transactions, where conflicts of interest and self-dealing may facilitate fraudulent practices. Mr. Raju's attempt to acquire Maytas Properties and Maytas Infra, companies owned by his family members, exemplified the potential for abuse of corporate resources and the need for enhanced regulatory scrutiny of such transactions. Judicial scrutiny of these transactions highlighted the importance of transparency and disclosure in safeguarding shareholder interests and preventing corporate malfeasance.

b. Regulatory Response and Reform: In response to the Satyam fraud, regulatory bodies like SEBI enacted stringent reforms aimed at strengthening corporate governance standards, enhancing financial reporting requirements, and bolstering regulatory oversight of corporate entities. These reforms included measures to increase transparency in inter-corporate transactions, improve board oversight mechanisms, and enhance disclosure requirements for related-party transactions. Judicial review of these regulatory reforms ensured that they were consistent with legal principles and aligned with the objectives of investor protection and market integrity.

c. Judicial Oversight and Enforcement: Judicial oversight played a critical role in enforcing regulatory reforms and holding corporate entities accountable for compliance with legal and regulatory standards. Courts adjudicated disputes arising from regulatory actions, ensuring that due process was followed and legal rights were upheld. Judicial enforcement

mechanisms, including penalties and sanctions, deterred corporate wrongdoing and promoted a culture of compliance among market participants. The judiciary's proactive stance in monitoring regulatory enforcement efforts contributed to the restoration of investor confidence and the integrity of the capital markets.

3. CONCLUSION AND FUTURE IMPLICATIONS:

The Satyam fraud case represents a landmark in India's legal and regulatory landscape, highlighting the challenges and opportunities in addressing corporate misconduct and enhancing investor protection. Judicial analysis of the case reveals the interconnectedness of legal, regulatory, and judicial mechanisms in safeguarding market integrity and upholding the rule of law. Moving forward, sustained efforts are needed to strengthen regulatory frameworks, improve corporate governance practices, and enhance judicial accountability to prevent future instances of fraud and promote sustainable growth in India's corporate sector. Through collaborative efforts between regulators, law enforcement agencies, and the judiciary, India can emerge as a global leader in corporate governance and investor protection, setting new standards for transparency, accountability, and ethical conduct in the business environment.

5.3 SAHARA CASE

INTRODUCTION:

The Securities Exchange Board of India (SEBI) v Sahara India Real Estate Ltd. case stands as a landmark in India's legal landscape, particularly concerning the jurisdiction and powers of SEBI in regulating corporate fundraising activities. This case revolves around the issuance of Optionally Fully Convertible Debentures (OFCDs) by Sahara India Real Estate Corporation Limited (SIRECL) and Sahara Housing Investment Corporation Limited, which attracted investments from millions of individuals, primarily from rural and low-income backgrounds. SEBI, the regulatory authority tasked with overseeing securities markets, intervened in the matter, asserting its jurisdiction and alleging violations of securities laws by Sahara. The subsequent legal proceedings, culminating in a decision by the Supreme Court, shed light on key legal and regulatory issues surrounding corporate fundraising, investor protection, and the scope of SEBI's authority.

UNDERSTANDING OPTIONALLY FULLY CONVERTIBLE DEBENTURES:

Before delving into the specifics of the case, it is essential to grasp the concept of Optionally Fully Convertible Debentures (OFCDs). Debentures represent a form of corporate borrowing, where a company raises funds from investors by issuing debt instruments. OFCDs offer investors the option to convert their debentures into shares of the issuing company, typically based on predetermined terms and conditions. The timing of conversion depends on various factors, including the company's financial performance, market conditions, and shareholder approvals. While OFCDs provide flexibility for investors to participate in potential upside gains, they also entail risks associated with market volatility and corporate performance.

SAHARA'S FUNDRAISING STRATEGY:

Sahara's fundraising strategy in the case under scrutiny was characterized by the solicitation of investments from individuals belonging to economically disadvantaged backgrounds, such as cobblers, laborers, artisans, and peasants. The company claimed that the issuance of OFCDs constituted a private placement, targeting select clients with privileged access to investment opportunities. However, SEBI challenged Sahara's assertions, alleging that the fundraising scheme amounted to a public offer, attracting investments from millions of individuals across the country. The crux of the dispute revolved around the interpretation of securities laws and the regulatory framework governing corporate fundraising activities.

SEBI'S JURISDICTIONAL CLAIMS:

SEBI asserted its jurisdiction over the matter, invoking provisions of the Companies Act, 2013, and the SEBI Act, 1992, to regulate securities offerings and protect investor interests. Section 55A of the Companies Act, 2013, delineates SEBI's jurisdiction, confining it to listed public companies. However, SEBI argued that Sahara's fundraising activities fell within the purview of securities laws, regardless of the company's listing status. Moreover, SEBI contended that Sahara's purported private placement exceeded regulatory limits, as evidenced by the substantial number of investors and the prolonged duration of the fundraising campaign. The regulatory body maintained that OFCDs constituted securities under the SEBI Act, 1992, thereby subjecting Sahara to regulatory oversight and enforcement actions.

CHALLENGES AND LEGAL PROCEEDINGS:

The legal proceedings in the SEBI v Sahara case witnessed a series of challenges and counterarguments from both parties. Sahara vehemently opposed SEBI's jurisdictional claims, arguing that its fundraising activities did not fall within the ambit of securities laws. The company contended that OFCDs did not qualify as securities and, therefore, were not subject to SEBI's regulatory authority. Additionally, Sahara disputed the characterization of its fundraising campaign as a public offer, citing its purported status as a private placement targeting specific clients. However, SEBI refuted Sahara's arguments, citing regulatory provisions and legal precedents supporting its jurisdictional authority over corporate fundraising activities.

SUPREME COURT'S OBSERVATIONS AND DECISION:

In its landmark decision, the Supreme Court of India meticulously analyzed the facts and legal arguments presented by both parties. The Court noted that Sahara's OFCD scheme, despite claims of being a private placement, exhibited characteristics of a public offer, attracting investments from millions of individuals across diverse socio-economic backgrounds.[101] The Court emphasized the importance of transparency and compliance with regulatory norms in securities offerings, particularly concerning investor protection and market integrity. Moreover, the Court rejected Sahara's assertions regarding the private placement nature of its fundraising campaign, citing the absence of evidence supporting such claims.

The Supreme Court ultimately ruled in favor of SEBI, ordering Sahara to refund the entire deposits collected through its OFCD scheme. The Court mandated Sahara to repay investors at an interest rate of 15% until the date of refund, underscoring the significance of investor restitution and accountability for regulatory violations. Furthermore, the Court empowered SEBI to initiate legal proceedings against Sahara in the event of non-compliance with the refund directive, signaling its commitment to upholding regulatory enforcement and investor rights.

IMPLICATIONS AND FUTURE CONSIDERATIONS:

The SEBI v Sahara case has far-reaching implications for corporate fundraising practices,

[101] Staff S, “[Economy] SEBI-Sahara OFCD Case: Optionally Fully-Convertible Debentures- Meaning Explained » Mrunal” (*Mrunal*, January 26, 2015) <https://mrunal.org/2013/01/economy-sebi-sahara-ofcd-case-optionally-fully-convertible-debentures-meaning-explained.html> accessed May 20, 2024

regulatory oversight, and investor protection in India's capital markets. The Supreme Court's decision reaffirms the authority of SEBI to regulate securities offerings, irrespective of the listing status of the issuing company. It also underscores the importance of transparency, disclosure, and compliance with regulatory norms in safeguarding investor interests and market integrity. Moving forward, the case sets a precedent for enhanced scrutiny of fundraising activities, particularly those targeting vulnerable investors, and underscores the need for robust regulatory enforcement mechanisms to deter misconduct and promote investor confidence. By upholding the principles of investor protection and market regulation, the SEBI v Sahara case contributes to the resilience and integrity of India's financial markets, paving the way for sustainable growth and development in the corporate sector.

JUDICIAL ANALYSIS OF THE SAHARA JUDGEMENT

JUDICIAL ANALYSIS OF SEBI V SAHARA INDIA REAL ESTATE LTD. CASE

INTRODUCTION:

The SEBI v Sahara India Real Estate Ltd. case is a significant milestone in India's legal landscape, particularly regarding SEBI's jurisdiction over corporate fundraising. The case revolves around the issuance of Optionally Fully Convertible Debentures (OFCDs) by Sahara India Real Estate Corporation Limited (SIRECL) and Sahara Housing Investment Corporation Limited, attracting investments from millions, mainly from rural and low-income backgrounds. SEBI intervened, alleging violations of securities laws by Sahara, leading to legal proceedings and a landmark decision by the Supreme Court.

UNDERSTANDING OPTIONALLY FULLY CONVERTIBLE DEBENTURES:

OFCDs represent debt instruments offering investors the option to convert them into shares based on predetermined terms. While providing flexibility, they entail risks linked to market volatility and corporate performance.

SAHARA'S FUNDRAISING STRATEGY:

Sahara targeted economically disadvantaged individuals, claiming the OFCD issuance as a private placement. SEBI disputed this, alleging a public offer due to widespread investments, sparking a jurisdictional dispute.

SEBI'S JURISDICTIONAL CLAIMS:

SEBI asserted jurisdiction invoking the Companies Act, 2013, and SEBI Act, 1992, despite Sahara's unlisted status. It argued that OFCDs fell under securities laws and Sahara's actions exceeded regulatory limits.

CHALLENGES AND LEGAL PROCEEDINGS:

Sahara challenged SEBI's jurisdiction, arguing OFCDs were not securities and the issuance was not a public offer. SEBI countered with regulatory provisions supporting its authority.

SUPREME COURT'S OBSERVATIONS AND DECISION:

The Supreme Court analyzed Sahara's OFCD scheme, deeming it a public offer due to widespread investments. It emphasized transparency, ruling in SEBI's favor and ordering Sahara to refund deposits with interest.

IMPLICATIONS AND FUTURE CONSIDERATIONS:

The case sets precedents for regulatory oversight, investor protection, and market integrity. It underscores the importance of compliance and transparency in fundraising, signaling the need for robust regulatory enforcement and promoting investor confidence.

CONNECTION WITH INTER-CORPORATE INVESTMENT:

The SEBI v Sahara case indirectly highlights issues related to inter-corporate investments, where companies engage in financial transactions with other entities. In this case, Sahara's fundraising strategy targeted individuals, but the principles of transparency, compliance, and investor protection remain relevant to inter-corporate investments. Regulatory oversight ensures that such transactions adhere to legal and ethical standards, preventing potential misuse of funds or fraudulent activities.

CONCLUSION:

The SEBI v Sahara case exemplifies the judiciary's role in upholding regulatory enforcement, investor protection, and market integrity. By ruling in favor of SEBI, the Supreme Court reaffirmed the importance of transparency and compliance in corporate fundraising. This landmark decision sets a precedent for future cases, emphasizing the need for robust regulatory mechanisms and ethical conduct in India's financial markets.

5.4 KINGFISHER AIRLINES CASE

INTRODUCTION:

The Kingfisher Airlines case serves as a sobering reminder of the pitfalls of unchecked corporate ambitions and the consequences of regulatory oversight lapses. Spanning a decade from 2007 to 2017,[102] this saga encapsulates the rise and fall of Vijay Mallya's aviation empire, marred by financial mismanagement, loan defaults, and allegations of corporate fraud. As we delve deeper into the intricacies of this case, we uncover a tale of ambition, hubris, and the human cost of corporate failures.

BACKGROUND:

In 2007, Vijay Mallya, renowned for his flamboyant persona and entrepreneurial zeal, acquired Air Deccan, a struggling low-cost carrier, with aspirations to revolutionize India's aviation industry under the banner of Kingfisher Airlines. However, the merger proved ill-fated as Air Deccan continued to hemorrhage losses amidst skyrocketing oil prices, plunging Kingfisher Airlines into a precarious financial position. To prop up his ailing venture, Mallya resorted to securing substantial loans from multiple banks, amassing debts totaling a staggering 9,900 crores by 2013.

CORPORATE FRAUD ALLEGATIONS:

The Serious Fraud Investigation Office (SFIO) unearthed alarming irregularities within Kingfisher Airlines' operations, particularly during its merger with Air Deccan. Investigations revealed a pattern of financial malfeasance, with Mallya allegedly diverting loan funds to offshore accounts in tax havens, utilizing dormant companies and fictitious directors to obfuscate the illicit transactions. These funds, purportedly intended for the airline's operations, were instead funneled into Mallya's personal ventures, including his IPL cricket team, Royal Challengers Bangalore, and Formula 1 racing team, Force India.

HUMAN COST AND EMPLOYEE HARDSHIPS:

As Kingfisher Airlines teetered on the brink of insolvency, its employees bore the brunt of

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[102] Gandhi M, “Fall of Kingfisher Airlines: A Cautionary Tale of Corporate Governance” (*TaxGuru*, February 18, 2023) <https://taxguru.in/company-law/fall-kingfisher-airlines-cautionary-tale-corporate-governance.html> accessed May 20, 2024

Mallya's mismanagement, enduring months of unpaid salaries and statutory dues. The plight of these workers, deprived of their livelihoods for over 15 months,[103] serves as a stark reminder of the human toll exacted by corporate negligence and greed. Families faced financial distress, uncertainty, and upheaval as they grappled with the fallout of Kingfisher Airlines' collapse.

LEGAL PROCEEDINGS AND EXTRADITION BATTLE:

In a dramatic turn of events, Vijay Mallya fled to the United Kingdom in March 2016, evading imminent legal consequences in India and triggering extradition proceedings initiated by Indian authorities. In February 2017, India issued an extradition request to the UK, seeking Mallya's return to face trial for alleged financial misconduct and loan defaults. Despite concerted efforts and extradition warrants, Mallya remains ensconced in the UK, contesting his repatriation to India through protracted legal battles.[104]

JUDICIAL RESPONSE AND ACCOUNTABILITY:

The Supreme Court of India, in a landmark judgment in 2022, delivered a decisive blow to Mallya's impunity, sentencing him to four months in prison for his role in the bank loan default case. The court imposed a nominal fine of ₹2000, symbolic of the judiciary's uncompromising stance on corporate accountability. However, Mallya's extradition remains shrouded in uncertainty, as legal entanglements persist in British courts. The judicial response to the Kingfisher Airlines case underscores the imperative of holding corporate offenders accountable for their actions and upholding the sanctity of the rule of law.

ANALYSIS OF THE KINGFISHER JUDGEMENT

Analysis of the Judgment with Relation to Intercorporate Investment Abuse:

1. IDENTIFICATION OF INTERCORPORATE INVESTMENT ABUSE:

The judgment in the Kingfisher Airlines case indirectly highlighted the abuse of intercorporate investments as a means to conceal financial irregularities and perpetrate

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[103] Anna, "Kingfisher Airlines Essay" (October 11, 2019) <https://internationalstudiesresearchtopics.blogspot.com/2019/10/kingfisher-airlines-essay.html> accessed May 20, 2024

[104] "Corporate Scandal: Enron's Downfall: A Lesson in Ethical Failure" (*Corporate Scandal: Enron's Downfall: A Lesson in Ethical Failure*, April 18, 2024) <https://fastercapital.com/content/Corporate-Scandal--Enron-s-Downfall--A-Lesson-in-Ethical-Failure.html> accessed May 20, 2024

corporate fraud. Through the diversion of loan funds to offshore accounts and the utilization of dormant companies, Vijay Mallya effectively exploited intercorporate investment structures to obfuscate illicit transactions and evade regulatory scrutiny.

2. **REGULATORY OVERSIGHT LAPSES IN INTERCORPORATE INVESTMENTS:**

The case underscored the regulatory oversight lapses concerning intercorporate investments, as regulatory authorities failed to detect and prevent the misuse of such structures by Kingfisher Airlines. Despite indications of financial distress and irregularities in the company's operations, regulators overlooked the intricate web of intercorporate investments orchestrated by Mallya, allowing the fraudulent activities to continue unchecked.

3. **IMPACT ON STAKEHOLDERS AND INVESTORS:**

The abuse of intercorporate investments in the Kingfisher Airlines case had far-reaching consequences for stakeholders and investors, who suffered significant financial losses due to the company's collapse. By misappropriating loan funds and diverting them to personal ventures, Mallya not only jeopardized the financial viability of Kingfisher Airlines but also undermined investor confidence in the aviation sector.

4. **LEGAL FRAMEWORKS AND ENFORCEMENT MECHANISMS:**

The judgment underscored the need for robust legal frameworks and enforcement mechanisms to address intercorporate investment abuse effectively.[105] Regulatory authorities must enhance their oversight of intercorporate transactions, conduct thorough due diligence, and impose stringent penalties on entities found guilty of abusing such structures for illicit purposes.

5. **RECOMMENDATIONS FOR REFORM:**

To mitigate the risks associated with intercorporate investment abuse, regulatory reforms are imperative. Enhanced transparency and disclosure requirements for intercorporate transactions, coupled with stricter enforcement measures, can serve as deterrents against fraudulent activities. Additionally, regulators should collaborate with law enforcement agencies to investigate and prosecute cases of intercorporate investment abuse vigorously.

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[105] "Kingfisher Airlines Nosedives: Can It Soar Again or Will It Remain Grounded? [10 Steps] Case Study Analysis & Solution" (*Fern Fort University*) <http://fernfortuniversity.com/hbr/case-solutions/10002-kingfisher-airlines-nosedives--can.php> accessed May 20, 2024

In conclusion, the Kingfisher Airlines case underscores the need for heightened vigilance and regulatory scrutiny concerning intercorporate investments to prevent abuse and safeguard the interests of stakeholders and investors. By addressing the loopholes and challenges inherent in intercorporate investment structures, regulatory authorities can foster greater transparency, accountability, and integrity in corporate operations, thereby restoring trust in the financial markets.

5.5 Chidambaram v Directorate of Enforcement (2019):

INTRODUCTION:

The Chidambaram v Directorate of Enforcement (2019) case, commonly known as the INX Media case, is a significant legal saga involving allegations of money laundering and economic irregularities. This case revolves around the approval of foreign direct investment (FDI) to INX Media Group by the Foreign Investment Promotion Board (FIPB) in 2007,[106] leading to subsequent allegations of financial misconduct and criminal conspiracy. The involvement of prominent political figures, including P. Chidambaram and Karti Chidambaram, adds complexity to the legal proceedings, making it a matter of national interest and debate. This analysis delves into the background, facts, issues, and the judgment rendered by the Supreme Court in this landmark case.

BACKGROUND:

In March 2007, INX Media, a media conglomerate founded by Indrani Mukherjee and Peter Mukherjee, sought FIPB approval for FDI from non-resident investors in Mauritius. The proposal included the issuance of convertible debentures for television channel operations and downstream investment in INX News Private Limited. While one proposal was approved, the other was denied. However, INX Media allegedly executed the denied proposal fraudulently, attracting scrutiny from the income tax department in 2008. Karti Chidambaram, son of P. Chidambaram, was accused of intervening to evade penalties, leading to accusations of criminal conspiracy. The Enforcement Directorate (ED) initiated proceedings under the Prevention of Money Laundering Act (PMLA), resulting in P.

[106] Advtanmoy, "P. Chidambaram vs Directorate of Enforcement – 4/12/2019" (*Advocatetanmoy Law Library*, December 21, 2019) <https://advocatetanmoy.com/2019/12/05/p-chidambaram-vs-directorate-of-enforcement/> accessed May 20, 2024

Chidambaram's arrest and subsequent bail application.[107]

FACTS OF THE CASE:

The core issue in the INX Media case revolves around allegations of economic irregularities and money laundering related to INX Media's FDI approval. The ED filed a case under the PMLA, accusing P. Chidambaram of involvement in money laundering activities. P. Chidambaram's arrest prompted a bail application, necessitating judicial review of the merits of the case and the grant of bail.

JUDGMENT:

After overturning the Delhi High Court's order, the Supreme Court granted bail to P. Chidambaram, subject to certain conditions. The court considered various factors, including the gravity of the allegations, the likelihood of tampering with evidence, and the appellant's health condition. Ultimately, the Supreme Court concluded that P. Chidambaram was entitled to bail, albeit subject to stringent conditions.

CONCLUSION:

The judgment in the Chidambaram v Directorate of Enforcement case reflects a balanced approach to the grant of bail in high-profile money laundering cases.[108] While acknowledging the seriousness of the allegations, the Supreme Court upheld the principles of due process and individual rights. As the legal proceedings continue, the case remains emblematic of the challenges and complexities inherent in combating financial crimes and upholding the rule of law in India.

ANALYSIS OF THE CHIDAMBRAM JUDGEMENT

1. BALANCED APPROACH TO BAIL GRANT:

The Supreme Court's decision to grant bail to P. Chidambaram reflects a balanced approach to the administration of justice. Despite the gravity of the allegations and the potential impact on national security and financial integrity, the court carefully weighed the appellant's right to liberty against the need for judicial scrutiny. This demonstrates the judiciary's commitment to upholding individual rights while ensuring accountability for

[107] Mehta V, "P. Chidambaram vs. Directorate of Enforcement" (*Law Times Journal*, June 28, 2021) <https://lawtimesjournal.in/p-chidambaram-vs-directorate-of-enforcement/> accessed May 20, 2024

[108] "Enforcement Directorate: 10 High Profile Cases in India" (*Finology*, August 8, 2022) <https://blog.finology.in/Legal-news/enforcement-directorate> accessed May 20, 2024

financial misconduct.

2. **EXAMINATION OF MERITS**:

The court's decision to examine the merits of the case before granting bail underscores the importance of due process and judicial scrutiny. By considering the evidence presented by both the prosecution and the defense, the court ensured a fair and impartial assessment of the allegations. This approach enhances the credibility of the judicial process and reinforces public trust in the legal system.

3. **STRINGENT BAIL CONDITIONS:**

While granting bail to P. Chidambaram, the Supreme Court imposed stringent conditions to mitigate the risk of tampering with evidence and obstruction of justice. By requiring the appellant to furnish a surety bond and provide securities, the court sought to address concerns regarding flight risk and the preservation of evidence. These conditions serve as a deterrent against potential misconduct and underscore the court's commitment to upholding the rule of law.[109]

4**. INTERPLAY WITH INTERCORPORATE ABUSE:**

The INX Media case highlights the potential nexus between political influence, corporate interests, and financial misconduct. The alleged involvement of prominent political figures in facilitating economic irregularities underscores the need for robust regulatory oversight and transparency in intercorporate transactions. The case serves as a cautionary tale against the abuse of corporate structures for illicit purposes and emphasizes the importance of accountability and integrity in corporate governance.

5. **SUGGESTIONS FOR LEGAL REFORM:**

The judgment in the Chidambaram case provides an opportunity to reflect on the efficacy of existing legal frameworks in addressing complex financial crimes. To enhance regulatory enforcement and prevent intercorporate abuse, policymakers may consider strengthening anti-money laundering laws, enhancing transparency in corporate transactions, and bolstering regulatory oversight mechanisms. Additionally, initiatives to promote whistleblower protection and strengthen corporate governance standards could help mitigate the risk of financial misconduct and enhance investor confidence.

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[109] India AL, “All You Need to Know about the INX Media Case” (*Lexlife India*, October 6, 2019) <https://lexlife.in/2019/08/24/all-you-need-to-know-about-inx-media-case/> accessed May 20, 2024

Overall, the Supreme Court's judgment in the Chidambaram case underscores the judiciary's role in upholding the rule of law, ensuring accountability, and safeguarding individual rights in the face of complex legal challenges. While the case raises concerns about intercorporate abuse and financial misconduct, it also presents an opportunity for legal reform and regulatory enhancement to prevent similar incidents in the future.

Some of the cases related to banking sector related to corporate abuse will going to discuss now:-

5.6 PUNJAB NATIONAL BANK FRAUD CASE

INTRODUCTION:

The Punjab National Bank (PNB) scam, orchestrated by diamantaires Mehul Choksi and Nirav Modi, stands as one of the most infamous instances of financial fraud in India's history. Spanning from 2007 to 2017, this scandal involved the fraudulent issuance of Letters of Undertaking (Lou's) worth billions of rupees[110], implicating over 50 employees of the PNB's Brady House branch in Mumbai. With the aid of fake bank guarantees, Choksi and Modi managed to deceive PNB and other banks, resulting in a staggering loss estimated between 11,400 to 13,500 crores. This paper delves into the intricate details of the PNB scam, exploring the modus operandi of the fraudsters, the regulatory oversights that facilitated the wrongdoing, the legal proceedings that ensued, and the implications for India's banking sector.

BACKGROUND:

The PNB scam unfolded against the backdrop of India's burgeoning diamond industry, with Nirav Modi and Mehul Choksi emerging as prominent figures in the sector. Leveraging their business acumen and social connections, Modi and Choksi cultivated an aura of success and prosperity, concealing their fraudulent activities behind a facade of legitimacy. Their companies, including Gitanjali Gems, operated both domestically and internationally, with retail chains spanning across India and renowned global destinations. However, behind the glittering facade lay a web of deceit and financial malfeasance, as Choksi and Modi orchestrated a sophisticated scheme to defraud PNB and other banks.

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[110] india today group, "Mehul Choksi News, Mehul Choksi Dominica High Court, Mehul Choksi PNB Scam Case" (*Intoday*) <https://www.indiatoday.in/interactive/immersive/mehul-choksi-pnb-scam/> accessed May 20, 2024

MODUS OPERANDI:

At the heart of the PNB scam were the fraudulent issuance of Letters of Undertaking (Lou’s) and the exploitation of systemic deficiencies within the banking sector. Beginning in 2011, Choksi and Modi, in collusion with PNB employees, obtained fake Lou’s worth over 10,000 crores to facilitate the import of pearls. These Lou’s were issued without the requisite collateral and were used to secure foreign credit, with the banks bearing the liability in case of default. Over the course of 74 months, Choksi and Modi procured approximately 1200 fraudulent guarantees, exploiting loopholes in PNB's IT systems and reconciliation processes. The scam went undetected for years, allowing the perpetrators to siphon off billions of rupees with impunity.[111]

REGULATORY OVERSIGHT LAPSES:

The PNB scam revealed glaring deficiencies in regulatory oversight and risk management within India's banking sector. Despite red flags and warning signs, including periodic inspection reports from the Reserve Bank of India (RBI), banks and regulators failed to take adequate action to prevent the fraud. The absence of robust reconciliation mechanisms and the non-compliance with RTGS requirements allowed the fraudulent Lou’s to go unnoticed, highlighting systemic vulnerabilities that were exploited by fraudsters. Moreover, the failure of banks' management to heed RBI's directives and address deficiencies in their IT systems contributed to the perpetuation of the scam.

LEGAL PROCEEDINGS AND JUDGMENT:

In the aftermath of the PNB scam, legal proceedings were initiated against Mehul Choksi, Nirav Modi, and other implicated individuals. Charges were filed under various sections of the Indian Penal Code, Prevention of Money Laundering Act (PMLA), and other relevant statutes. In a landmark judgment, Mehul Choksi and Nirav Modi were declared fugitives, and extradition requests were issued to the countries where they had sought refuge. Despite ongoing legal battles and diplomatic efforts, their extradition remains pending, underscoring the challenges of prosecuting transnational financial crimes and bringing perpetrators to justice.

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[111] “Financial Development Analysis: How to Support and Enhance the Growth and Development of the Financial Sector and Economy - FasterCapital” (*FasterCapital*, April 23, 2024) <https://fastercapital.com/content/Financial-Development-Analysis--How-to-Support-and-Enhance-the-Growth-and-Development-of-the-Financial-Sector-and-Economy.html> accessed May 20, 2024

IMPLICATIONS AND REPERCUSSIONS:

The fallout from the PNB scam reverberated throughout India's financial landscape, tarnishing the reputation of the banking sector and eroding public trust in financial institutions. The massive financial losses incurred by PNB and other banks underscored the need for enhanced risk management practices and regulatory oversight to prevent future frauds. Moreover, the escape of Nirav Modi and Mehul Choksi from India raised questions about the effectiveness of extradition mechanisms and international cooperation in combating financial crimes. The PNB scam served as a wake-up call for policymakers, regulators, and stakeholders, prompting calls for reforms to strengthen governance, transparency, and accountability in the banking sector.

CONCLUSION:

The PNB scam represents a watershed moment in India's banking history, exposing systemic vulnerabilities and regulatory lapses that allowed fraudsters to perpetrate one of the largest financial frauds in the country's history. The case underscores the imperative of robust risk management practices, regulatory oversight, and transparency to safeguard the integrity of the financial system. As India grapples with the aftermath of the PNB scam, concerted efforts are needed to enact reforms, strengthen governance frameworks, and restore public confidence in the banking sector. Only through proactive measures and collective action can the lessons learned from the PNB scam be translated into meaningful reforms to prevent future financial misconduct and protect the interests of stakeholders.

JUDICIAL ANALYSIS OF THE PNB CASE

ANALYSIS OF THE JUDGMENT:

The judgment in the PNB scam case represents a critical milestone in India's legal and regulatory landscape, shedding light on the intricate web of financial misconduct, regulatory oversights, and systemic deficiencies within the banking sector. Here is an analysis of the judgment, focusing on its relationship with intercorporate abuse, highlighting the loopholes, and offering suggestions for future developments:

1. INTERCORPORATE ABUSE:

The PNB scam exemplifies the phenomenon of intercorporate abuse, wherein fraudulent actors exploit complex corporate structures and relationships to perpetrate financial crimes.

Nirav Modi and Mehul Choksi leveraged their corporate entities, including Gitanjali Gems, to orchestrate a sophisticated scheme of deception and misrepresentation. By establishing a network of interconnected companies and subsidiaries, they obfuscated the flow of funds and concealed the true nature of their transactions, thereby facilitating the fraudulent issuance of Letters of Undertaking (LOUs). This case underscores the need for heightened scrutiny of intercorporate transactions and structures to prevent abuse and ensure transparency in corporate dealings.

2. <u>REGULATORY OVERSIGHTS:</u>

One of the key loopholes exposed by the judgment is the regulatory oversights that enabled the perpetuation of the PNB scam.[112] Despite periodic inspection reports and red flags raised by the Reserve Bank of India (RBI), banks and regulators failed to implement adequate measures to prevent fraudulent activities. The absence of robust reconciliation mechanisms and the non-compliance with RTGS requirements allowed the fraudulent Lou's to go undetected for years, highlighting systemic deficiencies in risk management and regulatory oversight.[113] This underscores the imperative of strengthening regulatory frameworks, enhancing surveillance mechanisms, and fostering greater collaboration between banks and regulators to detect and prevent financial crimes.

3. <u>SUGGESTIONS FOR FUTURE DEVELOPMENTS:</u>

In light of the PNB scam judgment, several recommendations can be made to address the loopholes and shortcomings identified in the banking sector:

a. Strengthen Risk Management: Banks must implement robust risk management practices, including stringent due diligence procedures, real-time monitoring systems, and comprehensive internal controls to mitigate the risk of fraud and misconduct.

b. Enhance Regulatory Oversight: Regulators such as the RBI should enhance supervisory mechanisms, conduct regular audits, and impose stricter penalties for non-compliance with regulatory norms. Additionally, regulators should prioritize the implementation of advanced technology solutions, such as blockchain and artificial

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[112] "Biggest Money Laundering Cases in India - iPleaders" (*iPleaders*, April 17, 2023) <https://blog.ipleaders.in/biggest-money-laundering-cases-in-india/> accessed May 20, 2024

[113] Fu C, Lu L and Pirabi M, "Advancing Green Finance: A Review of Sustainable Development" (2023) 1 Digital Economy and Sustainable Development <https://doi.org/10.1007/s44265-023-00020-3>

intelligence, to enhance surveillance and risk assessment capabilities.

c. Promote Transparency and Accountability: There is a need for greater transparency and accountability in corporate governance practices, including disclosure requirements, board oversight, and whistleblower protections. Companies should adopt best practices in corporate governance and adhere to ethical standards to foster investor confidence and trust.

d. Strengthen Legal Framework: The legal framework governing financial crimes should be strengthened to ensure swift and effective prosecution of perpetrators. This includes streamlining investigation procedures, expediting trial processes, and imposing stringent penalties on those found guilty of financial misconduct.

e. Enhance International Cooperation: Given the transnational nature of financial crimes, there is a need for enhanced international cooperation and collaboration among law enforcement agencies, regulatory authorities, and financial institutions. Mutual legal assistance treaties (MLATs) should be leveraged to facilitate the extradition and prosecution of fugitives involved in financial frauds.

By implementing these recommendations and addressing the loopholes identified in the PNB scam judgment, India can strengthen its financial system, enhance investor confidence, and mitigate the risk of future financial frauds. It is imperative for stakeholders, including policymakers, regulators, banks, and corporate entities, to work collaboratively towards building a resilient and transparent financial ecosystem that fosters sustainable growth and development.

5.7 ABG Shipyard case

ABG Shipyard Ltd., a Gujarat-based firm, found itself embroiled in one of the largest banking fraud cases in India's history. Spanning from 2012 to 2017, this scandal involved a staggering amount of 22,842 crores, impacting around 28 banks, including major players like the State Bank of India (SBI) and ICICI Bank. The case revealed a complex web of financial irregularities, including fund diversion, money laundering, and criminal breach of trust. Here is a detailed overview of the ABG Shipyard case:

BACKGROUND:

ABG Shipyard Ltd., a prominent player in the shipbuilding industry, availed substantial

loans from multiple banks for its business operations. However, it soon became apparent that the funds borrowed were not utilized for the intended purposes. Instead, ABG Shipyard engaged in a systematic scheme to divert funds, invest in overseas subsidiaries, and transfer money to related parties. This fraudulent activity continued unchecked for five years, resulting in significant losses for the defrauded banks.

INVESTIGATION AND ALLEGATIONS:

The Central Bureau of Investigation (CBI) conducted a thorough investigation into the ABG Shipyard case, unearthing evidence of financial misconduct and criminal wrongdoing. The investigation revealed instances of fund diversion, misappropriation, and criminal breach of trust, all aimed at unlawfully enriching the company at the expense of the banks' funds. The forensic audit conducted by the State Bank of India (SBI), with assistance from Ernst and Young, provided crucial insights into the extent and nature of the fraud perpetrated by ABG Shipyard.

CHARGE SHEET AND LEGAL PROCEEDINGS:

In 2022, the CBI filed a charge sheet against Rishi Agarwal, the former promoter of ABG Shipyard Ltd., and five other accused individuals, along with 19 companies, including three based in Singapore. The charge sheet detailed the amounts owed to various banks, including ICICI Bank, SBI, IDBI Bank, Bank of Baroda, Punjab National Bank, Exim Bank, Indian Overseas Bank, and Bank of India, among others. Rishi Agarwal was subsequently arrested by the CBI, although he was granted bail due to the incomplete nature of the charge sheet.

IMPACT AND FALLOUT:

The ABG Shipyard scandal sent shockwaves through India's banking sector, exposing vulnerabilities in risk management, regulatory oversight, and corporate governance. The massive scale of the fraud and its implications for financial stability underscored the urgent need for reforms and stricter enforcement measures. The case also highlighted the challenges faced by banks in detecting and preventing fraudulent activities, particularly in cases involving complex corporate structures and intercorporate transactions.

CONCLUSION:

The ABG Shipyard case serves as a stark reminder of the perils of financial misconduct and

the importance of robust risk management and regulatory compliance in safeguarding the integrity of the banking system. The investigation and legal proceedings surrounding this scandal underscore the commitment of law enforcement agencies and regulatory authorities to hold perpetrators of financial crimes accountable and restore trust in the financial system. Moving forward, it is essential for stakeholders to collaborate closely to implement reforms, enhance transparency, and strengthen governance mechanisms to prevent similar incidents in the future.

ANALYSIS OF ABG SHIPYARD CASE

The ABG Shipyard case presents a significant instance of corporate fraud and financial misconduct, highlighting various loopholes in the banking system and underscoring the need for enhanced regulatory oversight and risk management practices. Here is an analysis of the judgment, focusing on the relationship with intercorporate abuse, loopholes, suggestions, and developments:

1. INTERCORPORATE ABUSE:

The case of ABG Shipyard demonstrates how interconnected entities within a corporate structure can be exploited to perpetrate fraud and misuse funds. ABG Shipyard Ltd. allegedly diverted funds, invested in overseas subsidiaries, and transferred money to related parties, thereby engaging in intercorporate abuse to conceal illicit activities. This highlights the importance of scrutinizing intercorporate transactions and enforcing transparency and accountability measures to prevent such abuse.

2. LOOPHOLES IN THE BANKING SYSTEM:

The ABG Shipyard case exposed several loopholes in the banking system, allowing fraudulent activities to go undetected for an extended period. One significant loophole was the lack of robust risk management mechanisms to identify suspicious transactions and irregularities in fund utilization. Additionally, deficiencies in internal controls and oversight facilitated the diversion of funds, highlighting the need for stricter compliance measures and regular audits to mitigate risks.

3. SUGGESTIONS FOR IMPROVEMENT:

To address the loopholes exposed by the ABG Shipyard case and prevent similar incidents in the future, several suggestions can be considered:

a. Strengthen Risk Management: Banks should enhance their risk management frameworks to detect and mitigate fraud risks effectively. This includes implementing advanced analytics and monitoring tools to identify anomalies in transactions and behavior patterns.

b. Improve Due Diligence: Financial institutions should conduct thorough due diligence on borrowers and closely monitor their financial activities to ensure compliance with loan agreements and prevent misuse of funds.

c. Enhance Regulatory Oversight: Regulators should strengthen oversight of the banking sector, including stricter enforcement of compliance requirements and regular audits to identify systemic weaknesses and address them promptly.

d. Promote Transparency: Greater transparency in intercorporate transactions and financial reporting can help uncover potential abuses and prevent fraudulent activities. Companies should disclose related-party transactions and adhere to accounting standards to ensure transparency and accountability.

e. Foster Collaboration: Collaboration between banks, regulators, law enforcement agencies, and industry stakeholders is essential to combat financial crimes effectively. Information sharing and cooperation can facilitate early detection and investigation of fraudulent activities.

4. DEVELOPMENTS IN ENFORCEMENT AND LEGAL PROCEEDINGS:

The legal proceedings in the ABG Shipyard case, including the filing of a charge sheet against the accused individuals and companies, mark a significant step towards holding perpetrators accountable for their actions. However, the case also highlights challenges in prosecuting complex financial crimes and securing convictions. Going forward, there is a need for swift and effective enforcement of laws, along with reforms to streamline legal procedures and expedite trials.

5. CONCLUSION:

The ABG Shipyard case serves as a wake-up call for the banking sector and regulatory authorities, prompting a reevaluation of existing practices and the implementation of reforms to strengthen the financial system's resilience against fraud and misconduct. By addressing loopholes, enhancing oversight, promoting transparency, and fostering

collaboration, stakeholders can mitigate risks and safeguard the integrity of the banking sector. The lessons learned from this case should inform future efforts to combat financial crimes and protect the interests of stakeholders.

5.8 Yes Bank- DHFL case

The Yes Bank-DHFL case, revolving around the alleged financial irregularities and criminal conspiracy involving Rana Kapoor, the founder of Yes Bank, and the promoters of Dewan Housing Finance Limited (DHFL), Kapil Wadhawan and Dheeraj Wadhawan, is a significant episode in India's banking sector. This case spans a decade from 2007 to 2017 and involves an estimated amount of 5,050 crores. Here's an in-depth examination of the case:

BACKGROUND:

The scandal emerged from the credit facilities provided by Yes Bank, under the leadership of Rana Kapoor, to DHFL during Kapoor's tenure. Kapoor allegedly used his position to grant multiple credit facilities to DHFL for personal economic gain. These benefits included receiving bribes, purchasing undervalued properties, and facilitating dubious transactions between Yes Bank and DHFL.

ALLEGATIONS AND INVESTIGATIONS:

The Enforcement Directorate (ED) conducted a thorough investigation into the transactions between Yes Bank and DHFL. They discovered several abnormalities in the loans sanctioned by Kapoor to DHFL, including the purchase of debentures worth 3,700 crores and the sanctioning of a loan of 600 crores to a company owned by Kapoor and his family without adequate collateral. It was alleged that Kapoor and the Wadhawan’s colluded to receive credit by pledging overvalued assets.

LEGAL PROCEEDINGS:

In 2020, the ED attached properties worth 2,203 crores belonging to Rana Kapoor, including personal assets of the Kapoor family. Kapoor and his family were arrested multiple times for further investigation. The accused were charged under various sections of the Prevention of Money Laundering Act (PMLA).

TRIAL AND BAIL:

In 2022, Rana Kapoor and his wife were granted bail, along with Gautam Thapar , the promoter of Avantha Group. Additionally, two builders, Avinash Bhosale and Sanjay Chhabria, were taken into police custody, and their assets worth 415 crores were attached in the bank-loan fraud case. They are presently in judicial custody.

THE SIGNIFICANCE OF THE CASE:

The Yes Bank-DHFL case underscores the vulnerabilities in the banking sector, highlighting the risks associated with corporate governance lapses, insider trading, and conflicts of interest. It exposes the challenges faced by regulators in monitoring and regulating financial institutions effectively.

LESSONS LEARNED:

This case serves as a lesson for the banking industry and regulatory authorities, emphasizing the importance of robust risk management practices, transparency, and accountability. It calls for stricter enforcement of regulatory norms and closer scrutiny of intercorporate transactions to prevent fraudulent activities.

CONCLUSION:

The Yes Bank-DHFL case exemplifies the complexities and pitfalls inherent in the financial system. It underscores the need for heightened vigilance, stricter enforcement of laws, and continuous efforts to strengthen the integrity and stability of the banking sector. By learning from past mistakes and implementing reforms, stakeholders can mitigate risks and safeguard the interests of depositors and investors.

ANALYSIS OF YES BANK CASE

In analyzing the judgment of the Yes Bank-DHFL case, it's crucial to examine the relationship with intercorporate abuse, identify the loopholes in the system, and offer suggestions for preventing such incidents in the future. Let's delve deeper into these aspects:

1. INTERCORPORATE ABUSE:

The Yes Bank-DHFL case exemplifies intercorporate abuse through collusion between Rana Kapoor, the founder of Yes Bank, and the promoters of DHFL, Kapil Wadhawan and Dheeraj Wadhawan. Kapoor allegedly misused his position to provide undue credit

facilities to DHFL in exchange for personal economic gain, thereby abusing the trust and resources of Yes Bank. This case highlights how interconnected entities can exploit their relationships for illicit purposes, undermining the integrity of the financial system.

2. **LOOPHOLES IN THE SYSTEM:**

Several loopholes in the banking system facilitated the perpetration of the Yes Bank-DHFL fraud:

a. Weak Corporate Governance: The lack of stringent oversight and accountability mechanisms within Yes Bank allowed Kapoor to exploit his authority for personal enrichment.

b. Inadequate Regulatory Scrutiny: Regulatory authorities failed to detect and prevent the fraudulent transactions between Yes Bank and DHFL, indicating shortcomings in monitoring and compliance enforcement.

c. Lack of Transparency: The opacity surrounding intercorporate transactions enabled Kapoor and the Wadhawan’s to conceal their illicit activities, highlighting the need for greater transparency and disclosure requirements.

d. Insider Trading: Kapoor's insider knowledge and influence within Yes Bank gave him an unfair advantage, enabling him to orchestrate fraudulent schemes without detection.

3. **SUGGESTIONS FOR IMPROVEMENT:**

To prevent similar incidents in the future, the following measures are recommended:

a. Strengthen Corporate Governance: Banks must enhance internal controls, risk management frameworks, and board oversight to prevent conflicts of interest and abuse of power.

b. Enhance Regulatory Oversight: Regulators should implement stricter monitoring mechanisms, conduct regular audits, and impose severe penalties for non-compliance to deter fraudulent activities.

c. Improve Transparency: Banks should enhance transparency in intercorporate transactions, disclose related-party transactions, and adhere to stringent reporting standards to foster greater accountability.

d. Promote Whistleblower Protection: Encouraging whistleblowers to report unethical

conduct and providing legal safeguards against retaliation can help uncover fraudulent activities at an early stage.

e. Foster Ethical Culture: Banks should cultivate a culture of integrity, ethics, and compliance at all levels of the organization to deter misconduct and promote responsible banking practices.

4. DEVELOPMENTS:

The Yes Bank-DHFL case has prompted regulatory reforms and legal interventions to address systemic weaknesses and enhance the resilience of the banking sector. These developments include:

a. Regulatory Reforms: Regulatory authorities have introduced stricter regulations, enhanced supervision, and imposed stringent penalties to deter financial misconduct and safeguard depositor interests.

b. Legal Proceedings: The prosecution of individuals involved in the Yes Bank-DHFL fraud has led to legal proceedings, asset seizures, and bail hearings, underscoring the judiciary's commitment to upholding the rule of law and ensuring accountability.

c. Public Awareness: The high-profile nature of the case has raised public awareness about the risks of corporate malfeasance, prompting stakeholders to demand greater transparency, accountability, and ethical conduct in the financial sector.

In conclusion, the Yes Bank-DHFL case serves as a cautionary tale of intercorporate abuse, highlighting the need for comprehensive reforms, stronger oversight, and ethical leadership to safeguard the integrity of the banking system. By addressing loopholes, implementing robust measures, and fostering a culture of compliance, stakeholders can mitigate risks and restore trust in the financial ecosystem.

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CHAPTER -6

CONCLUSIONS AND SUGGESTIONS

6.1 CONCLUSIONS, PREDICAMENT AND SUGGESTIONS

To accept private enterprise as socially beneficial implies the acceptance of inter-corporate loans and investments and a corollary. Thus, the growth of inter-corporate investments is a logical and integral part of corporate growth. It is not possible to have one without the other. If private enterprise is to be regulated in the public interest, inter-corporation investments logically have e to be regulated. The purpose of the regulations can be three-folds

i) To protect the interest of shareholders o of the investing company;

(ii) To prevent anti-social uses of the opportunity available, and

(iii) To direct or redirect investment in accordance with the priorities laid down under the planned economy.

Even though Indian Company Law is more than a century old, the provisions directly relating to inter-corporate investments are of comparatively recent origin. It can be said that the practice of making inter-company investment was stated by managing agents to assist other companies under their management since they had very wide powers over the finance of managed companies; and all times abused for their personal gains. This led to the need for regulations. It was the companies (Amendment) Act, 1936 which brought for the first time certain regulatory framework to deal with this practice. Accordingly, two new sections were introduced by the Amending Act of 1936. It was 87F (inter-corporate investments). Under section 87F. a company other than an investment company, was appointed from purchasing shares unless such purchase had been approved unanimously by the board of directors of the purchasing company. Therefore, it is clear that the law on this aspect was at first enacted in order to aid the board of directors so as s to control the absolute power to make investment, being exercised by the managing agents the companies. However, the efficiency of the sections was considerably affected by the limitations put by the phrase "under management of the same managing agent"

At present the Companies Act, 1956 has a number of provisions to regulate intercompany

investments. Similarly, section 372 provided that no company shall invest more than prescribe limit (i.e. subscribed equity capital or aggregate of the paid-up equity and preference share capital in the shares of the other companies). Further, if such investments should I not exceed 30% of the subscribed capital off the investing company. For investment in excess of the above limits, sanctions of the company and further approval of the Central Government are essential. Thus, the board of directors of a company are free to use Company funds for making investments which may total up to a maximum of

60% of the company's Subscribed capital. There are, however, certain inbuilt exceptions provided by the sections where either the provisions are not attracted or certain concessions is provided.

It is considered that section 372 is more rigorous as the percentage limits laid down therein bear no relations to the capacity to invest. Section 372 relates it only to subscribed capital of the investor company irrespective limits to investments to subscribed it is pointed out that there is no rational in linking limits to investments to subscribed capital while limits to loan are to capitals and reserves. The Sachar Panel, in its report, had suggested that the rapacity of a firm to invest in shares or by way of loans, including deposits, should be related to the free reserves and not to the subscribed capital or net worth as at present. It is thought this would completely retard the growth of investment in private sector. Further, all the limitations are correlated to subscribe capital and not to equity capital which is the main factor for controlling a company. To control a company, paid up equity share capital is relevant rather than total subscribed capital. Section 372-A has come with several disadvantages relating to removes inter-corporate investments. It is only removes the drawbacks of the prior provisions are included with a view that better observance of the regulations relating to the inter-corporate investments will be achieved. Section 372A concludes as:

INTER-CORPORATE LOANS AND INVESTMENTS (372A]

By an amendment introduced by the Companies (Amendment) Act, 1999 the provisions of section 370 relating to inter-corporate loans and those of section 372 relating to inter-corporate investments have been abrogated them first and then substituting them by a single section, namely section 272-A. the amendment has the effect of saying that the provisions, of section 370 and 272 shall not apply and those of section 372-A will take over the matter of such loans and investments. The main and most primary change is that the

requirement of the Central Government approval has been dispensed with. Companies are form the shackles of control on inter-corporate loans and investments. The only control mechanism is wholly internal.

The board of directors can invest or advance up to 60% of their own decision and beyond that Mith the special resolution of the shareholders.

THE PROVISIONS UNDER SECTION 372-A ARE AS FOLLOWS:

A Company can advance loan t other company or invest in the securities of other companies up to 60% or up to 100% of the free reserves, which is more. The transactions covered under the sections are:

(a) loans to anybody corporate.

b) guarantee or security for any loan a given or taken a body corporate;

c) acquiring, by way of subscription, purchase or otherwise the securities of anybody corporate.

The notice of meeting of shareholder called for the purpose of giving previous approval of loans and investments beyond 60% must disclose clearly the specific limits, the particulars of body corporate in which the investment, etc. specific limits, the particulars of body corporate in which the investment is purposed to the made or loans or security or guarantee to be given, the purpose of the investment, etc. specific sources of funding and other allied details.

The board of directors can give a guarantee without the authority of a special resolution:

a) if the board is so authorized by its own resolution to give the guarantee in accordance with the provision of section;

b) If some exceptional circumstances are preventing the process of obtaining a special resolution

c) If the resolution of the board in confirmed at a general meeting with in 12 months or at the annual general meeting held after the guarantee whichever is earlier,

The requirements of sub-section (1) & (2) are not to apply to any loan made by a holding to its wholly owned subsidiary; any guarantee given on any security provided by # holding

company in respect of loans made to its wholly owned subsidiary; or acquisition by a holding company; by way of subscription, purchase or otherwise, the securities of its wholly owned |subsidiary; resolution;

The rate of interest to ne charged on loans must not be less than the prevailing bank rate of interest which shall mean the standard rate made public under section 49 of the RBI Act, 1934.

The decisions of the Board of directors must be at a meeting sanctioning the transaction by a resolution passed with the consent of all the directors resent at the meeting and also prior approval of any such public financial institute must be taken whose term loan with the company is subsisting. Prior approval of a financial institution is not required where the 60% limit is not to be exceeded and there are no defaults in the payments towards the institution.

REGISTER OF INVESTMENTS-LOANS [S. 372-A (5)]-

The Company has to keep a register showing the particulars about investments, loans, guarantee and securities;

1) the name of the body corporate

2) the amount, terms, and purpose of the investments and loans or loans or securities or guarantee;

3.) the date on which the loan or investment has been made; *.

4)the date on which the guarantee or security has been provided in the connection with a loan.

The particulars should be entered in the register chronologically with in seven days of the making of loans and investment, etc.

The register has to kept at the register office of the company. It should be available for inspection to members who may also take extracts and may demand copies on a similar fee able in respect of the register of members.

RULE-MAKING POWER:

The Central Government may prescribe regulations for the purposes of this section .

Exceptions: The provisions of the section do not apply in respect of the following transactions.,

1). a banking company, insurance company or a housing finance company for transactions made in the ordinary course of business, a company established with the sole object of financing industrial enterprises or for providing infrastructure transactions: facilities;

2.) a company whose principal business i is the acquisition of shares, stock debentures or other securities.

3.) A private company, unless s it is subsidiary of a public company. Sub-section 81 (1) (a) (further issue of capital) from companies with the provisions:

Penalty Provisions [S. 372-A (9)]- Two kinds of default have been identified and given different treatment, one is the violations of the main provision and the second is default is default in maintaining the register a very high penalty is provided in matter of the register. The company and every officers of the company who is in default in punishable with fine extending of Rs. 5000 and also with a further fine up to Rs. 500 for every day during which the default continues. \

For failure to comply with the main provisions of the section the company and every officer of the company who is in default liable to be punished with fine extending to fifty thousand rupees of imprisonment when may extend to two years. Where any loan or investment made in violation of the section has been recovered, the punishment by way of imprisonment when may extend to two years. Where any loan or investment made in violation of the section has been recovered, the punishment by way of imprisonment is not be inflicted and where recovery is only partial, the term of imprisonment is not be inflicted and where recovery is only partial, the term of imprisonment is to be appropriately reduced where the Company suffers any loss because of the contravention, as for example, loans have become irrecoverable, the investment has lost, or the security has been attached by

he security holder or payment under guarantee has been enforced, all the persons who knowingly a party to the contravention would be jointly as well as severally liable do the company's loss.

6.2 PROBLEMS AND PREDICAMENT

Corporate sector continues to be perturbed over the possibility of a restriction on a Pyramidal structure creeping into the corporate statuettes of the country. Corporate sector s been pitching against the possibility of the enactment of such provisions in law books.

Thought the Companies (Amendment) Bill, 2003 which had proposal restrictions on PROBLEMS AND PREDICAMENT holding subsidiary company structure withdrawn by the Government for a thorough review, these issues continue to haunt the corporate sector. In fact, they have been arguing that this would make the Indian Corporate sector uncompetitive, federation of and inter-corporate investments/loans has been

Commenting on whether there should be any such restrictions under law, an Indian Chambers of well-known fact that Commerce and Industry (FICCI) official said, "it is an India is a capital starved country. In India, if we want capital formation to take place and are looking for entrepreneurship in a major way, it is important that restrictions should not be imposed on holding subsidiary company structure.

Stressing further, FICCI official pointed out, "Nobody can doubt that governance issue need to be looked into, but governance is not the only issue that the legislation of a country de of address. The laws have to address the issues on a larger plane and that is from where the capital will come from especially in a risk averse country like India."

Capital formation in India currently is not commensurate to the growth objectives of the Indian economy and imposition of any restrictions would make capital even more scarce he said. "it is a well-established practice in the international business that resources, assets including manufacturing assets) are being ring framed or ring faced in separate entities or companies. This may be required for various reasons to create the most efficient and practical environment/structure for doing business including to achieve the operational objective, tax issue, strategic purposes, and retaining control over business, "FICCI said.

On the issue regarding whether there should be any restrictions for inter-corporate investments after loans, a FICCI official said, Any restriction of this sort would limit the ability of f companies to grow 'laterally and horizontally."

FICCI would also be advocating for a separate law for small and private companies , so that such companies are subjected to minimal compliance.

IMPROVING SECTION 186 OF THE COMPANIES ACT, 2013, TO ADDRESS THE HIGHLIGHTED CHALLENGES AND STREAMLINE CORPORATE FINANCIAL

TRANSACTIONS CAN ENHANCE EASE OF DOING BUSINESS AND ALIGN REGULATIONS WITH PRACTICAL BUSINESS NEEDS. HERE ARE SOME SUGGESTIONS:

1. Clarification on Calculation of Limits: Clarification on Calculation of Limits

- Numerator and Denominator Calculation:- Numerator and Denominator Calculation:

  - The reader may recall that the MCA should issue a detailed guidance note or circular clarifying various aspects of the computation methodology of the 60 percent and 100 percent thresholds of indirect exposure, such as whether provisions should be included or excluded, whether written off investments must be included or not, whether partially repaid guarantees should be included or not and so on.

  - The position of paid-up share capital and securities premium account: These are two components of share capital which should be determined at the last balance sheet date alone though they can be revised mid-year if there is any recent issue of capital.

2. Definition and Scope of Free Reserves: Definition and Scope of Free Reserves:

- Explicit Definition:

  - To support your answer and enhance the structure of the regulatory language, we suggest clarifying the meaning of the phrase "free reserves" by answering the following questions: Are the total amounts of the general reserves or retained earnings to be included in full into the calculation of free reserves or are they allowed to include only up to 10% of such amounts into these computations?

  - This means that: There should be harmonization of the definition and meaning of free reserves when used in different sections of the Act to minimize confusion.

3. Interest Rate Requirement for Loans: Interest Rate Requirement for Loans:

- Alignment with International Norms:- Alignment with International Norms:

  - Modify the existing provisions of Section 186 (7) to permit a degree of flexibility with regards to the interest rate to be used in the loans provided to foreign subsidiaries and such rate may have to be set comparable to the corresponding rates in the subsidiary's operating country.

- Such discretion should not include the interest rate cap to cross-border loans because this would be a conflict with the local regulations of other countries we operate in as well as transfer pricing and fiduciary responsibilities.

4. Exemption for Cross-Border Transactions:

- Streamline Regulations:

- As the provisions of Section 186 are already inhibited under FEMA for the cross-border inter-corporate loans, guarantees, and investments, it is proposed for same should be exempted as per stringent norms.

- Extend a notification under section 462 of the Companies Act to legitimize this exception; to eliminate superfluous loopholes and overlapping authorities.

5. Simplified Compliance for Wholly Owned Subsidiaries (WOS):Simplified Compliance for Wholly Owned Subsidiaries (WOS):

- Relaxed Provisions for WOS:- Relaxed Provisions for WOS:

- Inter-corporate loans and guarantees given to wholly-owned subsidiaries: Here, one needs to provide certain exemptions or simplified compliance requirements because it is very important for a parent-company to extend financial assistance to the subsidiary.

- set up a minimum level of the transaction size below which they do not need to adhere to such strict ties and cut down on paperwork for holding companies.

6. Regular Updates and Clarifications:

- Continuous Guidance:

-Check that the MCA provides frequent releases containing interpretations of often troublesome sections which may be compared with the realities observed in business.

- A toll-free/ directory enquiry number should be set up to personally assist corporate lawyers and companies to provide consultation on some particular sections or provisions of Section 186.

7. Stakeholder Consultation:

- Engagement with Industry:

- Engage with corporate lawyers who use online technologies, financial advisors and

corporate corporates' representatives to discuss and capture the practical issues existing in the field.

- Delight on these consultations to give policies directions and guarantee the regulations are current with business CSI and global benchmark.

In sum, by adopting the above-stated recommendations, it would be possible for the MCA to successfully tackle the issues of interpretation as well as practical application of Section 186, which in turn will improve the ease of corporate financial transactions in India and thus, the country's competitiveness as a favourable business location.

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