

## CHAPTER - III

### THE COMPANIES ACT, 1956 AND ITS ADMINISTRATION

#### **Objectives and Policies of the Companies Act, 1956**

**3.1** Companies play very vital role in any economy. In our country, the Companies Act, 1956 primarily regulates the formation, financing, functioning and winding up of companies. The Act prescribes regulatory mechanism regarding all relevant aspects including organisational, financial and managerial aspects of companies. The winding up matters, presently are largely within jurisdiction of High Courts. Regulation of the financial and management aspects constitutes the main focus of the Act. In the functioning of corporate sector, although freedom of companies is important, protection of investors and shareholders is also equally important. The Companies Act plays the balancing role between these two competing factors, namely, management autonomy and investor protection. The main objects of the Act are as under.

- (a) To protect the interests of a large number of shareholders, as there exists separation of ownership from management in a company;
- (b) To safeguard the interests of creditors;
- (c) To help the development of companies in India on healthy lines, because corporate sector constitutes a very important segment of the economy;
- (d) To help the attainment of the ultimate ends of social and economic policy of the Government;
- (e) To equip the Government with adequate powers to intervene in the affairs of a company in public interest and as per procedure prescribed by law so that the interests of all stakeholders may be protected from unscrupulous management.

These objectives are achieved through measures as explained in the following paragraphs.

#### **Regulation of Companies**

**3.2.1** The Companies Act, 1956 empowers the Central Government to inspect the books of accounts of a company, to direct special audit, to order investigation into the affairs of a company and to launch prosecution for violation of the Companies Act, 1956. Books of accounts and other documents of the companies are inspected by the officers of the Directorate of Inspection and Investigation and the Registrars of

Companies. These inspections are designed to find out whether the companies conduct their affairs in accordance with the provisions of the Companies Act, 1956 to see whether any unfair practices prejudicial to public interest are being resorted to by any company or a group of companies and to examine whether there is any mismanagement which may adversely affect any interest of shareholders, creditors, employees and others. Wherever inspection reports disclose any information that may be of interest to other Departments or agencies like the Ministry of Commerce and Industry, Central Board of Direct Taxes, Enforcement Directorate, State Government or Provident Fund Authorities, such information is passed on to them. If an inspection discloses a *prima facie* case of fraud or cheating, action is initiated under provisions of the Companies Act, 1956 or the same is referred to the Central Bureau of Investigation.

**3.2.2** Sections 235 and 237 of the Companies Act empower the Central Government to order investigation into the affairs of a company under circumstances specified therein. The power to appoint inspectors, to conduct investigation and to act on report of investigation remains with the Central Government. The Company Law Board is also empowered to consider application of members for conducting investigation into the affairs of a company. The powers to order investigation arise in circumstances where the business of a company is being conducted with an intent to defraud its creditors, or for unlawful purposes, or in a manner oppressive to any of its members or that if the company was formed for any fraudulent or unlawful purposes.

**3.2.3** The companies are prosecuted for committing default in filing their documents or for contravening the provisions of the Act. The Companies (Amendment) Act, 1988, introduced a new Section 621A empowering the Company Law Board and the Regional Directors to compound offences of prosecution. The power to compound is not exercisable in relation to offences, which are punishable either with imprisonment only or with imprisonment and fine.

**3.2.4** To ensure better management of companies, the Central Government accords approval for the appointment and re-appointment of persons as Managing Directors, whole-time Directors or Managers of a public limited or private limited company which is a subsidiary of a public limited company, under Section 269 read with Section 388 of the Companies Act, 1956.

## **Investor Protection**

**3.3.1** Investor Protection Cell (IPC) of the Ministry of Company Affairs was set up in 1993 to deal with investors' grievances. It receives a large number of complaints from the aggrieved investors. The complaint relates to the following broad issues.

1. non receipt of annual report
2. non receipt of dividend amount
3. non refund of application money
4. non payment of matured deposits and interest thereon
5. non receipt of duplicate shares
6. non registration of transfer of shares
7. non issue of share certificates
8. non receipt of debenture certificates
9. non issue of right bonus shares
10. non issue of interest on late payment
11. non redemption of debentures and interest thereon
12. non receipt of share certificates on conversion.

**3.3.2** With a view to improving the processing of investors grievances, a new system for online lodging of complaints by investors and depositors has been jointly developed by the Ministry and the National Informatics Centre (NIC). The new system facilitates investors and depositors to electronically lodge their complaints with the IPC without the requirement of sending their grievances in writing through post. The system issues complaint number, as acknowledgement online for future reference.

**3.3.3** The new systems for lodging online complaints of investors and depositors was released on 11<sup>th</sup> January 2005 on the website of Ministry of Company Affairs (<http://dca.nic.in>) now (<http://mca.gov.in>).

**3.3.4** In order to actively associate the field offices in investor grievances redressal function, a nodal team headed by a designated officer has been set up in each office of Registrar of Companies/Regional Directors and their names have been given wide publicity through leading newspapers and on website so that public can approach them for redressal of their grievances.

**3.3.5** The IPC has received about 1380 complaints at Headquarters during the period from 1.04.2005 to 31.12.2005 from the investors/depositors , out of this 55 complaints have been settled and the complainants have been given the final letters of

settlement. For rest of the complaints, action has been initiated through the Registrar of Companies.

**3.3.6** The Ministry is proposing to put up the names of the companies which have not settled the grievances of the investors/depositors on its new website which is being launched under the MCA 21 Project. Since the business process of the Registrar of Companies will be carried out through this website such companies will get noticed by the public, potential investors/business partners of the defaulting companies. The Ministry is also proposing to contact each defaulting company directly for settlement of complaints of the investors/depositors.

#### **Vanishing Companies**

**3.4.1** The Capital Market had witnessed a boom period during 1993-94 and 1994-95 when many new companies tapped the capital market and collected funds from the public through public issue of shares/debentures. Some of these companies defaulted in their commitments made to the public while mobilising funds. SEBI had identified 229 companies by October 2000 which came out with IPOs during the period 1992-1998, as vanishing.

**3.4.2** Finance Minister in his Budget Speech on 27.2.1999, inter alia, stated that a joint mechanism between SEBI and Ministry of Company Affairs (MCA) would be set up for taking stringent action against unscrupulous promoters who raised moneys from investors and misused them. Accordingly, a Coordination and Monitoring Committee (CMC), co-chaired by Secretary, Ministry of Company Affairs (MCA) and Chairman, SEBI was set up in March, 1999 to settle the policy issues regarding the delinquent companies/promoters and to monitor the progress in regard to action against vanishing companies. The CMC is assisted by four Task Forces, one each corresponding to a Region, falling under the jurisdiction of four Regional Directors of Ministry of Company Affairs (MCA). Other members of these Task Forces are representatives of SEBI, Regional Stock Exchanges and concerned Registrars of Companies. The main responsibility of these Task Forces is to identify the companies which have disappeared, or which have misutilised funds mobilised from the investors, to suggest/take appropriate action in terms of the Companies Act or SEBI Act or any other law applicable, and monitor the action initiated in different cases.

**3.4.3** For identifying a company as vanished, the following criteria have been adopted:

- (i) Companies, which have not complied with listing requirements/filing requirements of Stock Exchange/ROC respectively for a period of 2 years;
- (ii) No correspondence has been received by the Exchange from the company for a long time;
- (iii) No office of the company is located at the mentioned registered office address at the time of Stock Exchange inspection.

All the conditions laid down have to be met for treating a company as vanishing and companies satisfying one or more but not all conditions are not to be considered as vanishing.

**3.4.4** Of the 229 companies earlier identified as vanished, CMC, in its meetings, held on 25.02.2003, 15.01.2004, 23.11.2004 and 18.03.2005 deleted the names of 44, 63, 7 and 1 companies respectively from the list of vanishing companies, as these companies were found to be regular in filing statutory returns, etc., resulting in the number of vanishing companies getting reduced to 114.

**3.4.5** Following steps have been taken/are being taken by the Ministry against the vanishing companies and its promoters/directors under the relevant provisions of the Companies Act, 1956 and under the Indian Penal Code:

- (i) Prosecutions have been filed under Sections 62/63, 68 and 628 of the Companies Act, 1956 against 107 vanishing companies for misstatement in prospectus/fraudulently inducing persons to invest money/ false statement made in the offer documents etc.
- (ii) Prosecutions filed under the Companies Act, 1956 for non-filing of statutory returns.
- (iii) FIRs have been filed/registered under the Indian Penal Code against 100/94 vanishing companies and their Promoters/Directors.
- (iv) A Monitoring Committee (MC) was set up in August, 2004 for closely monitoring all cases of prosecutions launched under the Companies Act, 1956 and FIRs filed/registered under the Indian Penal Code against vanishing companies and their Directors. This Committee is co-chaired by Secretary, Ministry of Company Affairs and Chairman, SEBI and includes senior officials of various State Governments and

the Commissioner of Police, Delhi or his representative. The Committee in its 2<sup>nd</sup> meeting held on 02.05.2005 decided to take steps to closely monitor the progress of action by regular exchange of information between the Police authorities and the Registrar of Companies at the State level. The concerned State authorities have nominated Nodal Officers for effective coordination with the Registrar of Companies.

- (v) The latest position regarding Region-wise cumulative action taken against vanishing companies, their Directors/Promoters, is given below:

	Northern Region	Western Region	Eastern Region	Southern Region	Total
Number of vanishing Companies	17	49	14	34	114
Number of companies against which prosecutions filed under Section 62/63, 68 & 628 of the Companies Act, 1956	17	48	11	31	107
Number of companies against which prosecutions filed for non-filing of statutory returns.	16	47	11	20	94
Number of companies where FIR filed.	16	42	14	28	100
Number of companies where FIRs registered	15	42	13	24	94

- (vi) Petitions have also been filed with the Company Law Board (CLB) under Sections 397/398/402/408 read with Section 406 of the Companies Act, 1956 in respect of two vanishing companies, which are (i) M/s Nuline Glassware (India) Ltd. and (ii) M/s AVI Industries Ltd., to disgorge the properties/moneys fraudulently

obtained by Promoters/Directors of these two vanishing companies. The first case has been recently dismissed by the CLB vide its order dated 30.9.2005. However, the concerned ROC, Gujarat has been advised to file an appeal before the Hon'ble High Court, Gujarat against this dismissal order and the same has been filed on 3.3.2006. The case of AVI Industries Ltd. is pending before the CLB.

- (vii) The recommendations of the Expert Committee set up by the Ministry to advise the Government on the new Company Law are being examined in the Ministry from the point of view of providing a legal framework for safeguarding investors' interests.
- (viii) Details of Vanishing Companies and their promoters/directors have been placed on the website of the Ministry (earlier [www.dca.nic.in](http://www.dca.nic.in), now [www.mca.gov.in](http://www.mca.gov.in)) for wider public information.
- (ix) A new website [www.watchoutinvestors.com](http://www.watchoutinvestors.com) has been created by Prime Investors Protection Association and League, with the financial assistance from the Investor Education and Protection Fund, to help the investors to protect themselves from unscrupulous promoters, companies and entities. This website is a national web-based registry covering entities including companies, intermediaries and, wherever available, persons associated with such entities, who have been indicted for an economic default and/or for non-compliance of laws/guidelines. It enables investors to do a free, fast and user-friendly search on such entities/persons before making any new investments and for continuously reviewing their existing portfolio vis-a vis such entities. This website also marks a step on the part of the Ministry in promoting investor protection through various means including investor awareness and education.
- (x) Public notice giving details of vanishing companies alongwith the names and addresses of their promoters/directors were issued in the newspapers requesting the public to forward their complaints to the concerned Registrar of Companies so as to strengthen the prosecution cases launched against these companies and their promoters/directors. In addition, it was decided that the complaints received directly from the affected investors would be forwarded to the state police authorities

to strengthen the prosecution cases launched by the Economic Offences Wing. So far 15 complaints were received in the Ministry which were forwarded to the concerned RDs with the advice to forward the same to the concerned police authorities. Although SEBI did not receive any complaints of vanishing companies directly, they had forwarded the details of directors/promoters of these companies published in newspapers to investor associations registered with it for inviting complaints, if any.

- (xi) Ministry is also examining the feasibility of taking appropriate action against the Chartered Accountants (CAs) associated with the public issue of securities made by 9 Vanishing Companies, which had larger issue size (Rs. 10 crores or above). Out of nine, the Ministry has accorded sanction to the Registrar of Companies (RoC) on 5.10.05 for prosecution of Auditors of M/s. Western India Industries Ltd., M/s. Vini Metaspin Steels Ltd., and M/s Kiev Finance Ltd. for contravention of provisions of the Companies Act, 1956. The cases of the remaining six companies are still under examination.
- (xii) The concerned Task Forces are reviewing the working of Vanishing Companies, which had been deleted from the list, very closely with a view to keep a close watch so that such companies do not indulge in fraudulent activities again.
- (xiii) The Task Forces have been instructed to scrutinize the list of companies, which had come out with IPOs during 1998-2001 sent by SEBI and another list of companies forwarded by one of the Investors' Association namely Midas Touch Investor Association.
- (xiv) SEBI has invoked powers granted to it under Section 11/Section 11B of the SEBI Act, 1992 and has issued orders against the vanishing companies and their Promoters/Directors prohibiting them from associating in any way with the capital market activities. This order also prohibits them from dealing in securities and from accessing the capital market for a period of 5 years, which is the maximum, permissible under SEBI regulation. SEBI has debarred 100 companies and 378 Directors.

### **Acceptance of Deposits**

**3.5.1** Section 58A of the Companies Act, 1956, introduced by the Companies (Amendment) Act, 1974, came into force on 1.2.1975. It regulates the invitation and acceptance of deposits by non-banking non-financial companies.

**3.5.2** The Companies (Acceptance of Deposits) Rules, 1975 framed in pursuance of sub-section (1) of Section 58A of the Companies Act, 1956 prescribe the limits up to which, the manner in which, and the conditions subject to which deposits may be invited and/or accepted by these companies either from the public or from their members. These Rules, inter-alia, require every company to advertise at the time of inviting deposits a summarized financial position of the company as in the two audited balance sheets immediately preceding the date of advertisement. The Rules lay down ceiling limits with reference to the company's net worth for acceptance of deposits and prescribe the maximum rate of interest and the maximum period of 36 months for which the deposits can be accepted. The Rules also lay down the maximum rate of brokerage, which can be paid by the company to brokers through whom the deposits are collected. In order to safeguard the interests of depositors, the Rules also provide for maintenance of liquid assets to the extent of 15% of deposits maturing during the year invested in specified securities with effect from 1.4.1992 as per Gazette Notification No. GSR 393(E) dated 10.1.1992. Similarly the maximum rate of interest payable on deposits by non-Banking, Non-Financial Companies has been fixed at the maximum rate of interest prescribed by the Reserve Bank of India that the Non-Banking Financial Companies can pay on their public deposits vide Notification GSR 774(E), dated 29.9.2003.

**3.5.3** Sub-section 7 of Section 58A empowers the Government to keep any company outside the purview of these provisions after consultation with the Reserve Bank of India. In exercise of this power, small scale units which conform to certain parameters have been kept outside the purview of the provisions of Section 58A.

**3.5.4** Sub-section (8) of Section 58A empowers the Central Government, if it considers necessary, for avoiding any hardship or for any other just and sufficient reason, to grant extension of time to a company or class of companies to comply with or exempt any company or class of companies from all or any of the provisions of Section 58A either generally or for a specified period, subject to such conditions as may be specified, either prospectively or retrospectively from a date not earlier than the commencement of the Companies (Amendment) Act, 1974. In case, exemption is

to be granted for a class of companies, it is to be done after consultation with the Reserve Bank of India.

**3.5.5** Sub-sections (9) and (10) of Section 58A were inserted by the Companies (Amendment) Act, 1988 as a measure of protecting the interests of depositors. It provides for compulsory repayment of deposits, unless renewed in accordance with the prescribed rules. The amended provisions of sub-section (9) of the Companies Act empower the Company Law Board to take cognisance of any case of non-repayment of such deposits within such time and subject to such conditions, as may be specified in the order. Non-compliance of the order of the Company Law Board would attract penalty by way of imprisonment, which may extend to three years and shall also be liable to a fine of not less than Rs. 500/- for every day till such non-compliance continues.

**3.5.6** Under the provision of sub-section (7) of Section 58A, the Government is empowered to exempt a class of companies from all or any of the provisions of Section 58A. The Ministry has granted exemption vide Notification GSR No. 1075 (E) dated 29.12.1989 from the provisions of sub-Section (1) to (6) of Section 58A in respect of acceptance of deposits by issue of commercial paper by companies which satisfy the eligibility criteria laid down by Reserve Bank of India in the Non-Banking Companies (Acceptance of Deposits through Commercial Paper) Directions 1989. The said Notification has come into force from 1.1.1990.

**3.5.7** Eight applications for exemption/extension of time were received under Section 58A(8) of the Companies Act, 1956 during the period 1.4.2005 to 31.12.2005 and 24 applications were brought forward from the previous year. Out of the total of 32 applications, 15 applications were disposed of and 17 applications were at various stages of consideration as on 31.12.2005

#### **Protection of Interests of Shareholders/Consumers**

**3.6.1** In order to afford greater protection to shareholders, Section 205A has been incorporated in the Companies Act, whereby unpaid or unclaimed dividends are to be kept in a separate account for three years by the company concerned. Thereafter, if these dividends still remain unpaid or unclaimed, these are to be transferred to the account of the Central Government, which will make necessary payments to the shareholders concerned upon an application duly made by them.

**3.6.2** The interests of consumers are also sought to be taken care of under the provisions of the Companies Act. Approval of the Central Government is required to

be obtained under Section 294AA in regard to the sole selling agency agreements, which may be entered into by companies having paid up capital of Rs. 50 lakh or more. This is to ensure that the cost of commodities sold to the consumers through these agreements is not inflated by avoidable additional expenditure on the part of the companies concerned.

**3.6.3** Cost Accounting Records Rules are prescribed under Section 209(1)(d) of the Companies Act, for companies engaged in production, processing, manufacturing and mining activities. These are designed to bring cost consciousness among the companies to ensure the best use of resources by them with a view to reduce the cost of production and in turn to provide cheaper goods to the consumer.

**3.6.4** The interest of the public in general in the matter of keeping deposits with the companies has also been taken care of in the Companies Act. Under section 58A of the Companies Act, 1956, the Ministry has framed the Companies (Acceptance of Deposits) Rules, 1975. Under these Rules, companies are required to advertise and publish their financial accounts for information and guidance of the public at the time of inviting deposits. If a company fails to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board may, if it is satisfied that it is necessary to do so to safeguard the interests of the company, the depositors, or in the public interest, direct the company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the order.

#### **Protection of Interests of Workers**

**3.7** Sections 529 and 530 of the Companies Act provide that the dues of workers would rank pari passu with those of secured creditors in the event of closure of a company. This is intended to protect the interest of the workers of a sick company, who, in the event of closure of the company, have in the past generally lost their dues in the absence of funds after payment to the secured creditors.

#### **Company Law Board:**

**3.8.1** As per the powers vested in it under Section 10E of the Companies Act, 1956, the Central Government has constituted an independent Company Law Board with quasi-judicial powers with effect from 31.5.1991. The Company Law Board has framed Company Law Board Regulations. The Central Government has also prescribed the fees for making applications/petitions before the Company Law Board under the Company Law Board (Fees on Applications and Petitions) Rules 1991.

**3.8.2** The Board has its Regional Benches at Mumbai, Kolkata, Chennai and New Delhi, besides the Principal Bench at New Delhi and the Additional Principal Bench at Chennai. The matters falling under Sections 235, 237(b), 247, 248, 250, 388B, 408 and 409 and matters falling under Chapter VI of Part VI of the Companies Act, 1956 and under Section 2A of the M.R.T.P. Act are dealt with by the Principal Bench at New Delhi. The matters falling under Sections 235 and 237 of the Act and matters falling under Chapter VI of Part VI of the Act, in so far as they relate to the Southern Region, are dealt with by the Additional Principal Bench at Chennai. In order to reduce pendency, Single Member Bench has been entrusted to hear all types of cases from September, 2002 onwards. The Regional Benches are mainly concerned with petitions/applications under Sections 17, 18, 19, 58A, 58AA, 79/80A, 111/111A, 113/ 113(3), 117, 117B, 117C, 118, 141, 144, 163, 167, 186, 196, 219, 269, 284, 304, 307, 614, 621A and 643A of the Companies Act, 1956 and Section 45QA of the Reserve Bank of India Act, 1934, filed before them. During the period from 1.4.2005 to 31.12.2005, 1527 applications were considered under Section 58A(9) of the Companies Act, 1956 and 45QA of the RBI Act, 1934 of which 510 were disposed of. Under other Sections of the Companies Act, 1956, 4749 petitions were considered out of which 3657 petitions were disposed of during this period. This includes 569 cases compounded under Section 621A of the Companies Act, 1956.

**3.8.3** As against the sanctioned strength of nine Members including Chairman and Vice Chairman, the constitution of the CLB as on 31.12.2005 is as follows:-

1. Shri S. Balasubramanian, Chairman
2. Shri K.K. Balu, Vice-Chairman
3. Shri C.D. Paik, Member
4. Shri V.S. Wahi, Member (Since resigned)

#### **Company Petitions before Company Law Board**

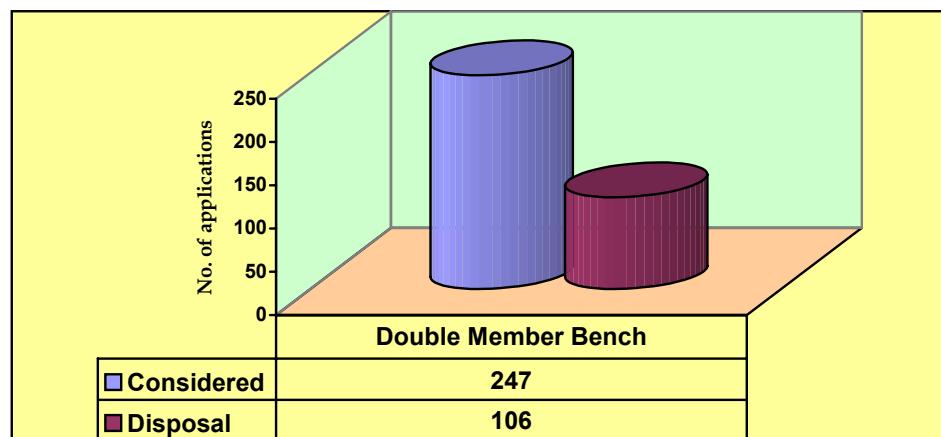
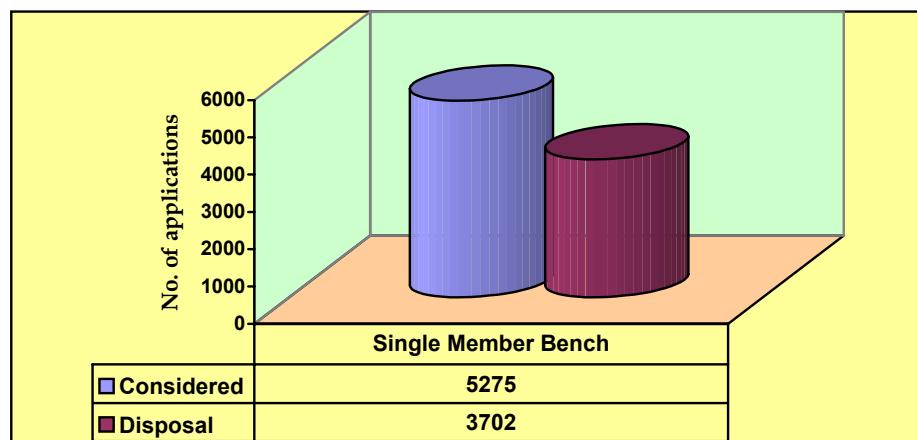
**3.9** Particulars of petitions/applications received and disposed of by various Benches including Principal Bench for the year 2005-2006 are given in Table 3.1.

**TABLE - 3.1**  
**Consolidated Statement of Petitions/Applications received, disposed of and**  
**pending for the period 1.4.2005 to 31.12.2005**

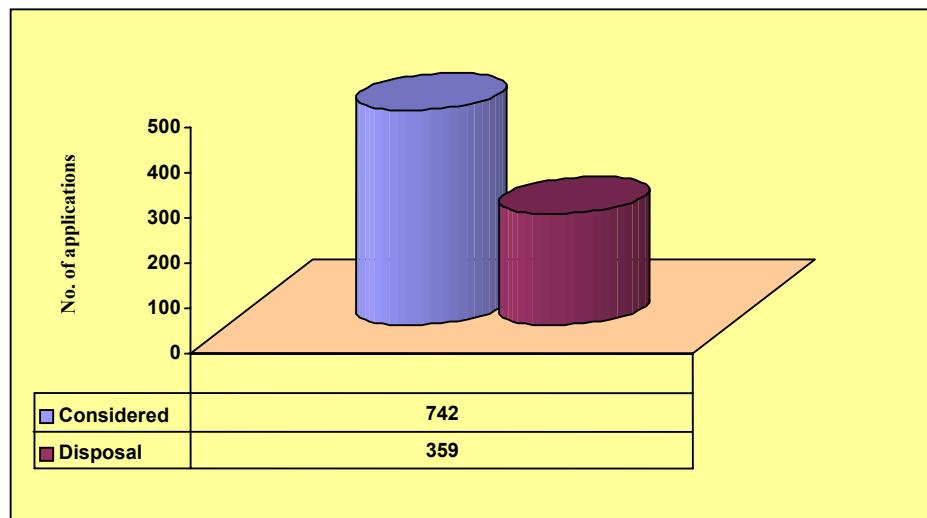
Composition of Bench and Sections	Opening Balance as on 1.4.2005	Receipt	Total (Col. Nos. 2 & 3)	Disposal	Pending as on 31.12.2005
1	2	3	4	5	6
<b>1. Single Member Bench:</b>					
Section 17	56	512	568	518	50
Section 18/19	0	12	12	11	1
Section 45QA of RBI Act	378	290	668	217	451
Section 58A(9)	588	271	859	293	566
Section 58AA(1)	8	17	25	10	15
Section 79	1	3	4	3	1
Section 80A	3	0	3	2	1
Section 113/113 (3)	20	40	60	44	16
Section 117	0	0	0	0	0
Section 117C	205	143	348	137	211
Section 118	0	0	0	0	0
Section 141	27	1721	1748	1704	44
Section 144	0	0	0	0	0
<b>Misc. Applications</b>	25	96	121	105	16
Section 163	4	6	10	3	7
Section 167	12	6	18	6	12
Section 186	0	2	2	2	0
Section 196	2	2	4	2	2
Section 219	0	2	2	0	2
Section 284	4	2	6	5	1
Section 304	0	1	1	1	0
Section 307	0	0	0	0	0
Section 614	1	7	8	6	2
Section 621A	91	630	721	569	152
Section 634A	33	54	87	64	23
<b>Total (a)</b>	<b>1458</b>	<b>3,817</b>	<b>5,275</b>	<b>3,702</b>	<b>1,573</b>
<b>2. Double Member Bench:</b>					
Section 111	178	63	241	103	138
Section 269(7)	0	0	0	0	0
Section 634 A	5	1	6	3	3
<b>Total (b)</b>	<b>183</b>	<b>64</b>	<b>247</b>	<b>106</b>	<b>141</b>
<b>Total (a)+(b)</b>	<b>1641</b>	<b>3881</b>	<b>5522</b>	<b>3808</b>	<b>1714</b>
<b>3. Principal Bench &amp; Additional Principal Bench:</b>					
Cases under Sections 235,237 247,250, 388b, 397/398,408,409 and interlocutory applications and interlocutory applications	329	425	754	359	395
<b>Grand Total</b>	<b>1,970</b>	<b>4,306</b>	<b>6,276</b>	<b>4,167</b>	<b>2,109</b>

## Petitions/Applications considered and disposed of by the Company

Law Board for the period 1.4.2005 to 31.12.2005



Principal Bench and Additional Principal worktable



### **Petitions before the Company Law Board under Section 408/402/406 of the Companies Act**

**3.10** Section 397/398 of the Companies Act, 1956 provides for filing of application before the Company Law Board for relief in cases of oppression, mismanagement or apprehension of mismanagement of the affairs of the Company. Section 408 of the Act empowers the Central Government to appoint such number of persons on the Board of the company as directed by Company Law Board on the reference/application made by the Government to safeguard the interests of the company or its shareholders or the general public. In addition, the Central government can also file petitions under Section 402 read with Section 406 of the Act for disgorgement of assets against the Directors of the Company when they indulged in misappropriation/misfeasance. During the period 1.4.2005 to 31.12.2005, the Government has filed petitions/applications before the Company Law Board under Sections 408 and 402 read with section 406 of the Act in respect of 3 companies. During this period, the Company Law Board has disposed of cases in respect of 7 companies. A total of 6 petitions/applications under Sections 397/398/408/402/406/388 of the Act are pending before the Company Law Board for adjudication/decision.

### **Petitions under Section 237 (b) of the Companies Act**

**3.11.1** As per section 237(b) of the Companies Act, the Central Government may file petition before Company Law Board seeking order for investigation of the cases. As on 31.3.2005, 1 petition was pending before Company Law Board. During the period 1.4.2005 to 31.12.2005, the Government has filed petition in one case. During the period, one case has been disposed of by the Company Law Board. As on 31.12.2005 one case is pending before Company Law Board.

**3.11.2** During the period from 1.4.2005 to 31.12.2005, 24 cases were filed/contested before the Hon'ble High Courts out of which 18 cases have been disposed of while six cases are still pending with for section 397/398 R/w 406/408 & 237(b) of the Act. During the period 1.4.2005 to 31.12.2005, seventeen cases u/s 237(b) of the Companies Act, were contested before the Supreme Court and all the seventeen cases were disposed of.

### **Appointment of Managerial Personnel**

**3.12.1** The Ministry of Company Affairs deals with statutory applications relating to the appointment of and payment of remuneration to Managing Directors, whole-time Directors and managers of public limited companies and of private limited companies

which are subsidiaries of public limited companies under Sections 269, 198/309, 310 and 388 of the Companies Act, 1956 in accordance with provisions of Schedule XIII to the said Act, as amended from time to time.

**3.12.2** To bring greater transparency in processing of various statutory applications, the status reports of these applications have already been made available on the website of the Ministry of Company Affairs, which has been appreciated by the applicant companies. Further, to bring about quicker disposal of cases and ushering in an era of e-governance, the prescribed application forms are being revised and simplified.

**3.12.3** It has been observed that applications received are generally deficient in several respects. In order to have complete information at the initial stage itself, Form Nos. 25A and 26 have been revised and are proposed to be made effective along with MCA-21 project implementation. The details of receipt and disposal of statutory applications for the period from 01.04.2005 to 31.12.2005 are given in Table 3.2 below.

**Table 3.2**  
**Applications on Managerial Appointment received and disposed of by  
the Central Government during 1.4.2005 to 31.12.2005**

Sections of the Companies Act	Nature of Applications	Brought Forward	Received during the year	Total	Disposed of during the year	Pending as on 31.12.2005
259	Increase in number of Directors	3	15	18	14	4
268	Amendment of provisions relating to Managing or Whole time Directors	1	5	6	5	1
269	Appointment/reappointment of Managing or Whole time Directors	199	425	624	334	290
309(1B)	Remuneration of Directors for rendering professional	6	23	29	23	6

	services.					
309(4)(5B)	Waiver of recovery of sums refundable by Directors	2	20	22	19	3
310	Increase in remuneration of Directors	8	110	118	110	8
314(1B)	Appointment/continuance of Director/relative of a Director to hold any office or place of profit in company which carries remuneration of not less than Rs. 20,000 per month	17	90	107	81	26
	<b>Total</b>	<b>236</b>	<b>688</b>	<b>924</b>	<b>586</b>	<b>338</b>

### **Investigation**

**3.13.1** Section 235 and 237 of the Companies Act, 1956 empower the Central government for ordering investigation of the affairs of companies. The cases for investigation under section 235/237 of the Act are handed over to the SFIO on the following grounds:-

- (i) Where the size of the alleged fraud is estimated to be at least Rs. 50 crore or more, or;
- (ii) Such companies which are listed or where the paid up capital of the company is more than Rs. five crore, and 20% or more capital is subscribed by the public; or
- (iii) When the alleged fraud involves widespread public concern estimated to affect at least more than 5000 persons; or
- (iv) Where investigation requires specialized skills and multidisciplinary approach.

**3.13.2** During the current year, 5 investigations under section 235/237 of the Companies Act, 1956 have been ordered by the Serious Fraud Investigation Office (SFIO). In addition, no investigations have been ordered to be carried out by agencies other than the SFIO. During the year, one investigation was stayed by the High Court.

### **Inspections**

**3.14.1** Section 209A of the Companies Act, 1956 empowers the Registrar of Companies or the officers, duly authorised by the Central Government, to undertake inspection of the books of accounts and other records of companies. Several officers of the Ministry have been authorised under this section from time to time to undertake inspections.

**3.14.2** Broadly, inspections are undertaken to serve one or more of the following objects:

- (i) to verify compliance by companies of various provisions of the Companies Act, 1956;
- (ii) to verify whether the company accounts represent a true and fair picture of the company's finances and whether the same have been disclosed in a manner consistent with the Companies Act;
- (iii) whether the company's funds have been siphoned off, applied or diverted in a manner violative of the provisions of the Act and whether the company management has misused its fiduciary position for any personal advantage in violation of the Act;
- (iv) whether there are acts of mis-management or oppression which adversely affect the interest of company stakeholders, or which may adversely prejudice such interests, which may merit the company to be wound up on just and equitable grounds under the Act.
- (v) whether statutory auditors have carried out their duties properly while certifying true and fair view of the state of affairs of the company;
- (vi) to examine legal action under the Companies Act if the company has made a default in filing its balance sheet and profit and loss account or annual return for any five consecutive financial years with the Registrar.

**3.14.3** Inspection under section 209 A of the Companies Act, 1956, of the books of accounts of the company are generally ordered on the basis of:-

- (i) complaints received in the Ministry or in its field offices about mis-management in respect of maintenance of books of accounts as prescribed under Section 209 of the Act, delay in transfer of shares/debentures, delay in payment of dividend, non-payment of deposits or interest thereon etc.
- (ii) Violations/irregularities noticed on scrutiny of documents including auditors remarks filed in the office of the Registrar of Companies.

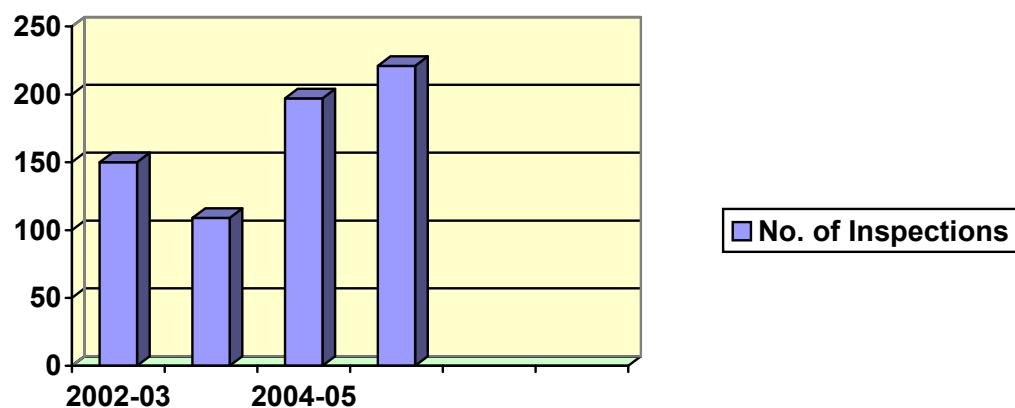
- (iii) Reference received from other Government Departments/Agencies pointing out violations of the provisions of the Companies Act, 1956 or other irregularities.

**Number of inspections conducted by this Ministry during last four financial years are as under:**

**Table no. 3.4**

Year	No. of Inspections
2002-2003	150
2003-2004	109
2004-2005	197
1.4.2005- 31.12.2005	221

**No. of inspections conducted by the Ministry during the last four Financial Years\***



\*The last bar in the chart above relates to the period 1.4.2005 to 31.12.2005.

### **Cost Audit**

**3.15.1** In exercise of the powers conferred by sub section (l) of the Section 642 read with clause (d) of sub Section (l) of Section 209 of the Companies Act, 1956, the Central Government notifies Cost Accounting Records Rules from time to time with respect to various industries requiring every company covered under these Rules to

maintain Cost Accounting Records from the financial year on or after the publication of these Rules.

**3.15.2** The Cost Accounting Records Rules (CARRs) prescribe the manner in which cost records are to be maintained so as to have cost data base to be utilized by the industries to improve upon their performance while facing competitive environment, and by various Government agencies like revenue authorities, regulatory bodies and other institutions for meeting their respective objectives. Cost Accounting Records Rules in respect of 44 industries have been notified so far as indicated in Table 3.3.

**3.15.3** An exercise for framing Cost Accounting Records Rules on Shipbuilding and Aircraft have been undertaken in consultation with the Ministry of Defence and PSUs.

**3.15.4** To simplify/ rationalize the existing Cost Accounting Records Rules and synchronize them with the likely technological changes in the manufacturing process and perceptual shift in the accounting methods and policies, the existing rules are reviewed periodically from time to time and necessary amendments are notified accordingly. During the year 2005-06, the Cost Accounting Records (Electricity Industry) Rules, 2001 have been amended and published on 7<sup>th</sup> December, 2005 vide GSR No. 709(E). An exercise has also been made to review and amend the existing Cost Accounting Records Rules relating to Bulk Drugs and Formulations in consultation with the National Pharmaceuticals Pricing Authority (NPPA), Department of Chemical & Petrochemicals.

**3.15.5** Subsequent to review of Cost Audit Reports received from cement companies, a limited inspection has been carried out under section 209A of the Companies Act, 1956, in respect of the three major cement companies to find out the reason for incurring losses on trading activity and establish the existence of cartel in some regions that led to sudden increase in prices. The reports revealed certain irregularities and prima-facie evidence of cartel in some regions.

**3.15.6** The Committee on Sub-ordinate Legislation (14<sup>th</sup> Lok Sabha) in its 1<sup>st</sup> Report, presented to the Lok Sabha on 2<sup>nd</sup> December, 2004, has recommended to extend Cost Accounting Records Rules to service sector and lay down clear, coherent and unambiguous policy guidelines in regard to Cost Accounting Records Rules in consultation with Ministries and Regulators concerned. On the basis of views/comments offered by the various Ministries/Departments/Regulators and Industry Associations, the draft policy guidelines on CARRs are under consideration.

**3.15.7** Under section 233B(1) of the Companies Act, 1956 cost audit orders are issued on eligible companies from time to time to get their cost records audited by a practicing Cost Accountant. On the basis of recommendations received from Central Electricity Regulatory Committee and various State Electricity Regulatory Commissions, cost audit orders have been issued in the current year for 65 electricity companies engaged in the generation, transmission and distribution of power.

**3.15.8** In compliance with Section 233B(2) of the Companies Act, 1956, 1207 applications were received for approval of appointment of cost auditors and exemption from cost audit during April 2005 to December 2005 as against 1380 applications received during the corresponding period of previous year and 1619 applications received during the full year 2004-2005. The amount of fees collected on these applications aggregated to Rs. 22.49 lakh during April to December 2005 as against Rs. 24.48 lakh received during the corresponding period of the previous year and Rs. 27.55 lakh of fees collected during the full year 2004-05.

**3.15.9** The number of Cost Audit Reports received during April to December, 2005 was 1025 as against 1228 during the corresponding period of the previous year i.e., from April 2004 to December 2004 (1619 during full year 2004-05).

**TABLE- 3.3**  
**Industries in which Cost Accounting Records Rules were notified under Section 209(1)(d) of the Companies Act, 1956**

S.No.	Name of the Industry
1.	Aluminium
2.	Batteries other than dry cell batteries
3.	Bearings
4.	Bulk Drugs
5.	Cement
6.	Chemicals
7.	Cosmetic & Toiletries
8.	Cycle
9.	Dry Cell batteries
10.	Dyes
11.	Electric Cables and Conductors
12.	Electric fans
13.	Electricity Industry
14.	Electric Lamps

S.No.	Name of the Industry
15.	Electric Motors
16.	Electronic Products
17.	Engineering Industries
18.	Fertilizers
19.	Footwear
20.	Formulations
21.	Industrial Alcohol
22.	Industrial Gases
23.	Insecticides
24.	Jute goods
25.	Milk food
26.	Mining and metallurgy
27.	Motor vehicles
28.	Nylon
29.	Paper
30.	Petroleum Industry
31.	Plantation products
32.	Polyester
33.	Rayon
34.	Refrigerators
35.	Room Air conditioners
36.	Shaving Systems
37.	Soaps and Detergents
38.	Steel Plants
39.	Steel tubes & pipes
40.	Sugar
41.	Telecommunications
42.	Textiles
43.	Tyres and Tubes
44.	Vanaspati

### Application under Section 108A

**3.16.1** Under this Section, prior approval of the Central Government is required to be obtained for acquisition/transfer of shares by or to an individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management in relation to dominant undertaking, provided, there is any increase in dominance as a result of such an acquisition or transfer of shares. During the period from 1.4.2005 to 31.12.2005 no application was received under this Section.

### **Declaration of Dividends**

**3.17** Section 205A(3) of the Companies Act, 1956 makes it obligatory for a company to seek prior approval of the Central Government where owing to inadequacy or absence of profits in the year, it proposes to declare dividend out of the accumulated profits earned by it in the previous years and transferred to the reserves and where declaration of dividend is not in accordance with the Rules, namely, the Companies (Declaration of Dividends out of Reserves) Rules, 1975. During the period from 1.4.2005 to 31.12.2005, one application was received while no application was brought forward from the previous year under Section 205A(3) of the Companies Act, 1956, which was pending as on 31.12.2005.

### **Payment of Dividend**

**3.18** Section 205(1)(c) of the Companies Act empowers the Central Government to allow any company, in public interest, to declare or pay dividend without providing for depreciation. Two such applications brought forward were considered during the period from April, 2005 to December 2005. Both the applications were disposed of during the year.

### **Accounts of Subsidiaries**

**3.19.1** Section 212 of the Companies Act provides that the Balance Sheet of a holding company should include certain documents of its subsidiaries. However, sub-section (8) thereof empowers the Central Government to exempt a holding company from the requirements of including in Balance Sheet the said particulars of subsidiary companies.

**3.19.2** One hundred eighty three (183) applications including 78 brought forward from the previous year were considered during April 2005 - December 2005. Of these, 164 applications were disposed of and 19 applications were pending as on 31<sup>st</sup> December 2005.

### **Appointment of Sole Selling Agents:**

**3.20.1** Sub-Section 294AA(1) of the Companies Act, 1956 requires that where the Central Government is of the opinion that the demand for goods of any category is substantially in excess of the production or supply of such goods and that the services of the Sole Selling Agents will not be necessary to create a market for such goods, the Central Government may, by notification in the Official Gazette, declare that Sole Selling Agent shall not be appointed by a company for the sale of such goods for such period as may be specified in the declaration. At present, the said prohibition on appointment of Sole Selling Agents exists only in respect of bulk drugs, drugs and

formulations, which has been extended for a period of three years w.e.f. 23.2.2004 vide Notification No. GSR 130(E) dated 23.2.2004.

**3.20.2** Sub-sections (2) and (3) of Section 294AA of the Companies Act, 1956 require the companies to obtain approval of the Central Government for appointment of Sole Selling/ Buying Agents. Sub-section (2) applies to those companies in which Sole Selling/ Buying Agents either by themselves or through their relatives hold paid-up capital of Rs. 5 lakh or 5 per cent of the paid-up capital of the company whichever is less. Sub-section (3) of Section 294AA of the Companies Act applies to those companies whose paid-up capital is Rs. 50 lakh or more.

**3.20.3** Six applications were received under sub-sections (2) and (3) of Section 294AA of the Companies Act seeking approval of the Central Government for appointment of Sole Selling Agents during the period 1.4.2005 to 31.12.2005, while 14 applications were brought forward from the previous year. Out of these, 12 applications were disposed of and 8 applications were pending at various stages of consideration as on 31.12.2005.

#### **Loans to Directors and Relatives:**

**3.21.1** Section 295 of the Companies Act, 1956 requires all public companies or their subsidiaries to obtain the previous approval of the Central Government before making any loan to, or giving any guarantee or providing any security in connection with a loan made by any other person to, or to any other person by their directors, relatives of such directors, firms or private companies in which such directors are common/interested and to other body corporate falling within the ambit of clauses (d) and (e) of sub-section (1) of the said Section.

**3.21.2** Seventy nine such applications, including 40 applications brought forward from the previous year, were considered during the period April 2005 to December 2005. Of these, 46 applications were disposed of and 33 remained pending as on 31st December 2005.

#### **Amalgamation of Government Companies**

**3.22** During period under report, 9 cases including 5 brought forward from the previous year were considered under Section 396 of the Companies Act, 1956. All the 9 cases were pending as on 31.12.2005.

#### **Power to Declare Companies as Nidhi**

**3.23.1** Under the Section 620A, the Central Government is empowered to declare by notification in the official gazette certain special type of Non-Banking Financial Companies as Nidhi companies or Mutual Benefit Societies as the case may be and

direct that certain provisions of the Companies Act, 1956 shall not apply and/or, as the case may be, shall apply with certain exceptions, modifications and adaptations to the said Nidhis. Since the period 1.4.2005 to 31.12.2005, the Central Govt. declared 13 companies as Nidhi Companies vide notification GSR 450 (E) dated 1.7.2005, bringing the total no. of companies notified as Nidhi companies to 257.

**3.23.2** During the period under review, the Central Government received 19 applications under Section 620A of the Companies Act, 1956 and 66 cases were brought forward from the previous year. Out of these 85 applications, 8 were disposed of and 77 applications were pending consideration of the Central Government as on 31.12.2005.

**3.23.3** The Government had set up an expert group by an order No. 4/6/2004-CL VI dated 3.6.2005 under the chairmanship of Shri V.S. Rao to review the existing regulatory framework for Nidhis with a view to ensure their orderly functioning and growth and provide the highest degree of safety to the depositors with them. The group has submitted its report in the 1<sup>st</sup> week of November, 2005 and the same is under the consideration of the Government.