

## CHAPTER IX

### FOREIGN COMPANIES AND DOCTRINE OF DISCLOSURE

#### AND

### DOCTRINE OF DISCLOSURE IN OTHER COUNTRIES

#### A. FOREIGN COMPANY

##### 1. FOREIGN COMPANY IN GENERAL :

The expression 'foreign company' has a special meaning assigned to it under the Companies Act, 1956. It does not fall within the definition of a company which according to section 3 must be a company which is either registered under the present Act or is an existing company, that is, a company registered under any of the previous Companies Act. It simply means company incorporated outside India. According to section 591m a foreign company is one which is incorporated outside India and

- (a) which established a place of business in India after the commencement of this Act, or
- (b) which had a place of business within India before the commencement of this Act and continues to have the same at the commencement of this Act. In this sense, it satisfies the condition of body incorporated under the Act, although it is special types of body corporate which is not only incorporated outside India but has to established a place of business in India.

In 1974 an important amendment was made in the Companies Act. A new sub-section (2) was added which provides that where not less than 50 percent of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, whether singly or in aggregate, such company shall 'Comply with such of the provisions of this act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.

The object of this new sub-section is to have more control over the foreign companies which though incorporated outside India have raised a major portion of their capital from citizens of India or bodies corporate and carry on a major portion of their business in India.

This new sub-section may be compared with section 43-A added by the Companies (Amendment) Act, 1960, according to which private company becomes a public company under certain circumstances, baptised (named) as 'deemed public company'. On the same analogy under this new Sub-section, a foreign company will be required to comply with the certain provisions of the Companies Act, 1956 as if it were a

company incorporated in India. It may be termed as "deemed Indian company".

As mentioned, section 591 lays down conditions to determine whether or not a company is a foreign company for the purpose of the Companies Act, 1956. The conditions are :

- (a) it must have been incorporated out side India,  
and
- (b) must have established a place of business in  
India.

In several cases questions arose in respect of second condition. In one Scottish case<sup>1</sup> it was held that 'a company incorporated outside U.K. which employs agents within U.K. but has no office here does not establish a place of business within the U.K.

In another case<sup>2</sup> it was held that where representatives of a foreign company were often coming and staying in a hotel in England for purchasing machinery, cotton etc. the foreign company had a place of business in England. Whereas in *Employer's Liability Assurance Corporation v. Sedgwick, Collins & Co.*<sup>3</sup> it was held that having a share transfer office or shares registration office will constitute 'establishing place of business'.

It may be stated that a company will be establishing a place of business in India, if it has a specified or identical place at which it carries on business, such as an office, store house, godown or other premises having some concrete connection between the locality and its business. It is rightly observed that the word 'Establish' indicates more than occasional connection.<sup>4</sup>

Disclosure of Name (Section 595 - English Act, Section 411)

A foreign company is required to exhibit on the outside of every office or place where it carries on business in India the name of the company, together with the name of the country where it is incorporated, in English and in one of the local language. Further, all bill heads, letter papers and all notices and other official publications of the company must also show the name of the company. It must also disclose whether liability of the members is limited.

2. DOCUMENTS REQUIRES TO BE DELIVERED TO REGISTER

FOR REGISTRATION : As per section 592, a foreign company is required to deliver, the following documents to the Registrar of companies for registration-within 30 days of establishing a place of business in India. They are :

- (a) a certified copy of its character, statute or memorandum and articles of the company or other instrument constituting or defining the constitution of the company, and if the instrument is not in the English language, certified translation thereof.
- (b) the full address of the registered or principal office of the company,
- (c) a list of directors and secretary containing their names, surname, address, nationality, occupation etc.,
- (d) the names and address of one or more persons resident in India authorised to accept service of notice and process; and
- (e) the full address of the office of the company in India, which is incidentally treated as principal place of business in India.

In order to have upto-date information, with the registrar, where any change occurs in the above particulars, the Registrar must be notified accordingly.

It may be submitted that though under the provisions of companies Act, 1956 no formality is required for a foreign company establishing a place of business in this

country, except the filling of the documents required by section 592. However, under section 29 of the Foreign Exchange Regulation Act, 1973 general or special permission of the Reserve Bank of India is required for a foreign company for carrying on in India any activity of a trading, commercial or industrial nature and establishing any branch, office or other place of business for carrying on such business, or acquirement of the whole or part of any undertaking in India of any person or company carrying on of the activity or purchasing the shares in India of any such company.

The object of this section is to regulate the entry of foreign investment in India in the form of branches, the expansion of companies engaged in non-manufacturing activities and acquiring control of other enterprises through purchases of shares or otherwise and also to regulate the increasing remittance by way of profits and dividends.

In addition to section 29, under section 26 the Central Government or Reserve Bank of India may by notice direct foreign company for furnishing additional information, such as particulars as to its assets and business as may be specified in the notice.

Effect of Registration of Documents :

The delivery of name and address for registration amounts to submission to the jurisdiction of the Court in this country.<sup>5</sup> As regards status, the law of the place of incorporation applies, as regards contractual and other obligations the law of the place of business alone will govern.

The declaration of nationality of directors may be helpful to the Court in determining the character i.e. enemy character of a company in case of war.<sup>7</sup>

It may be submitted that on registration with the Registrar, these documents assumes the character of public documents as they becomes accessible to any person i.e. any person may inspect the contents of these documents as per the provisions of the Act. As such this filing of documents may be regarded as valuable disclosure about the foreign company to the governmental agency, creditors, and other persons dealing with such company.

3. ACCOUNTS OF FOREIGN COMPANY (Section 594-English Act Section 410 ) :

The provisions of section 209 regarding books of accounts to be kept by a company also apply to foreign company, so far as its business in India is concerned. For

this purpose, section 594 lays down that every foreign company shall in every calender year :

(a) make out a balance sheet and profit and loss account in such a manner as if it is an Indian Company within the meaning of the Companies Act, 1956; and

(b) deliver thre copies of the same to the Registrar.

However, the Central Government has the <sup>discretion</sup> to exempt a foreign company from the provision by notification in the Official Gazette.

Now as per the Central Government notification

(a) A foreign company shall, in respect of its Indian business submit to the appropriate Registrar in triplicate ~~it~~ its balance sheet and profit and loss account in such form containing such particulars and including or having annexed or attached there to such documents as under the provisions of the Act, have been required to make out and lay before the company in general meeting:

(b) The working capital earmarked for its branch, if any, shall be shown in the balance-sheet.

(c) The profit and loss account in respect of its business shall disclose the net profit or loss for the year transferred to its principal office in the country of incorporation.



(d) The balance sheet and profit and loss account of the Indian business of the foreign company in terms of clause (i) shall be audited by such person or persons and in such manner as laid down in the Act. In regard to the said balance sheet and profit and loss account relating to a period on or before the 31st day of March, 1958 it shall be deemed to be sufficient compliance if such documents are audited by auditors of the foreign company in the country of its incorporation.

(e) This foreign company shall also submit to the appropriate Registrar three copies of the authenticated balance sheet and profit and loss account (including documents relating to every subsidiary of the foreign company) as submitted by it to the prescribed authority in the country of its incorporation under the provisions of the law in that country.

(f) the Government shall have authority when there is difficulty in reconciling the balance sheet and profit and loss account of a foreign company submitted in accordance with clause (a) with the balance sheet and profit and loss account filed in that country as far as practicable, in such form as it would, if it had been a company within the meaning of the Act, have been required to make out and lay before the company in a general meeting, and the

foreign company shall be bound to make such clarification or comply with such demand as the case may be.

(g) In regard to a foreign shipping or an airlines company, it shall be deemed to be sufficient compliance of the provisions of Part II of Schedule VI of the Act, if the profit and loss accounts of such companies prepared in terms of clause (a) disclose under broad heads the items of direct expenditure (relating to entire voyage or flight which cannot be directly charged against the Indian business of such companies) allocated on reasonable basis.

(h) It shall be sufficient compliance of the provisions of section 594, if the balance sheets in respect of the period ending on or before the 31st March, 1956 are filed in the manner laid down in sub-section (3) of section 277 of the previous Act.

(i) In the case of foreign company which if incorporated under the Act would have been deemed to be a private company within the meaning of clause (iii) of sub-section (1) of section 3 of the Act, no person other than a member of the company concerned shall be entitled to inspect or obtain copies of :

(i) the profit and loss account of its Indian business submitted to the appropriate Registrar in terms of clause (a),

(ii) the profit and loss account submitted to the appropriate Registrar in terms~~xx~~ of clause (d).<sup>9</sup>

4. PROVISIONS RELATING TO PROSPECTUS :

The prospectus issued in India by a foreign company must comply with the provisions of the Act relating to prospectus. Clause (a) of section 595 provides for disclosure of the name of the country of its incorporation. It enables the prospective investor to know the nationality of the company and also enables him to inquire and know about the fiscal policy of that country. Other particulars requires to be disclosed as per the provisions of the Act are :

- (a) Name of Company,
- (b) Date of its incorporation,
- (c) Whether the liability of the members is limited,
- (d) The address of its principal place of business in India,
- (e) The Instrument containing and defining the constitution of the company,
- (f) The provisions of law under which the company was incorporated.
- (g) Address in India where the said instrument, enactment or provisions or copies thereof, and if the same are not in English, a translation thereof, can be inspected and..

(h) Matters requires to be included in a prospectus issued by a company incorporated under the Companies Act, 1956. A copy of the prospectus is also required to be filled with the Registrar of companies. So far as liability for mis-statement in the prospectus is concerned, is the same as in case of Indian company.

The object of all these provisions is to bring to the notice of public and particularly those persons dealing with the company that the company is a foreign company and also to bring to their notice about the state of affairs of the company concerned.

#### B DOCTRINE OF DISCLOSURE IN OTHER COUNTRIES :

1 ENGLAND : In England the arguments on disclosure were set out by Professor Harold Rose<sup>10</sup> in which he argues that disclosure should not be limited to the prevention of abuse and to the exercise of shareholders control. The wider interest of the society demands disclosure because free economy operates through the spontaneous attraction of resources to points of highest productivity, using the mechanism of the markets and price, and to this process the provision of finances is crucial. The other arguments in favour of disclosure usually advanced are that it provides for traders the information which they

requires in deciding whether to grant credit to a company, and for trade unions the information which they need is to enable them to assess the justice of wage rate offered by employer.

The usual arguments advanced against disclosure is that it gives competitors an unfair advantage, it informs competitors favourable areas for exploitation if the other company's accounts reveals a high rate of return on its local operations or on certain types of good. However, the Cohen Committee stated "we do not believe that publication would have so completely one sided consequences. In any event, in the public interest, stimulation or elimination of the inefficient, whether small or large, is desirable. Moreover, if the disclosure be made general by making it obligatory, the objection is overcome".

According to Professor Rose, the traditional method of setting out company accounts is unhelpful to investment analyst and the financial press. The balance sheet as an historical record and little else is a concept that has been weakened by rising prices caused by full employment and the consequently increasing problem of asset valuation. The insurance value of assets should be published as well as their nominal book value. Section 16 and Schedule 2

part I of Companies Act, 1967 have now made it compulsory for firms to reveal, when assets have been revalued, by whom, and in what manner. Professor Rose approves of the American disclosure rules and concludes that 'there is not much doubt that disclosure plays a material part in keeping American Management at full stretch.

The section 3 to 23 of 1967 Act greatly extended the information which must be disclosed in the accounts and the directors report. It is now necessary to disclose details of shareholdings in other companies, the turn over, the relative profitability of each part of the company's business where more than one trade is carried on, details of any significant changes in the companies undertaking and fixed assets ~~in~~ during the year. Greater details of remuneration of directors and highly paid employees are required as are details of political and charitable contribution exceeding in aggregate of £ 50. Where more than 100 people are employed, the directors report must state the average number employed each week during the year and their aggregate emolument. These rules provide for more information for shareholders and general public, and the Board of Trade is empowered to investigate where it appears that the members are not receiving all the informations which they might reasonably expect. As company accounts are difficult for layman to understand,

this additional disclosure is perhaps useful in that it provides more information for the press to use as the basis of comment.

## 2. BELGIAM :

The Belgian Code of Commercial Companies contains various disclosures requirements. The charter of a Societe anonyma and any amendments, must be published in the supplements of the Official Gazette.<sup>11</sup> Disclosure about election and resignation of directors, auditors and liquidators and in the liquidator case, the instrument stating the manner of liquidation<sup>12</sup>. The balance sheet and profit and loss account, as approved by the shareholders, must also be published in the supplements, together with a list of directors and auditors in office and the allocation of the annual profit<sup>13</sup> and well as any transfer of the location of the company's head office.<sup>14</sup> As per article 81 all documents emanating from the company must bear the name of the company, its legal form and head office address. So far as shares are concerned, special disclosure requirements apply in the case of public issue of shares or bonds.<sup>15</sup> In addition to publication in the supplements of the Official Gazette, registration of the company in the Trade Register is required.

In Belgium also, various demands have been made for an extension of disclosure requirements, both in the interests of shareholders and third parties such as creditors and also for the benefit of company's employees, these demands directed mainly to accounting documents.

### 3. FRANCE :

Information on the situation and activities of firm is of general interest to the overall national economy and of more particular interest to shareholders, creditors, customers, and suppliers, on the one hand, and on the other, to employees, such information is still scanty in France, for the following reasons :

The business secrete is a notion which has remained dear to French businessman, who does not feel that information need to be passed on and tend to consider even quite ordinary piece of information as confidential, even if everyone knows about them from another source. The fact that there is little delegation of director's responsibilities help to reinforce the wall of silence.

The economic and financial press remains weak in France in compared to with that in other countries, it is less read and consequently has insufficient means at its disposal. It is symptomatic that when a group of big industrial and banking firms gained control of a



considerable financial press group no reaction was apparent. As noted by Andre Flagno, Chairman of the Institute for Research and Financial Studies that the number of pages devoted to company news in the important French dailies was only a quarter of those in the British Daily Telegrape.

The number of companies quoted on the stock exchange is small and they are the only ones to get publicity or to be interested in it. Companies whose stock are quoted on the stock exchange, and their subsidiaries, are however, obliged to disclose certain information to the shareholders and to the public. The decree of 29th November 1965 brought in a number of innovations which remain valid in the framework of the new Company Law of 1966.

Quoted companies whose capital exceeds Fr. 10 million must publish the following documents in the Bulletin of Obligatory Legal Announcements :

(i) Within month following the Annual General Meeting, balance sheet, information relative to extra balance sheet liabilities, distribution and allocation of profits, information on subsidiaries and holding in other companies, general accounts, profit and loss account, inventory of moveble securities.

(ii) Within month following each financial quarter-day:

the amount of turn over, with the figure for the proceeding quarter and the corresponding quarter of the previous year for comparison. (In the case of companies which are involved in different sectors of industry the turnover must be broken down sector to sector)

(iii) Within three months following each quarter pf the financial year the provisional balance sheet taken at the end of the previous quarter.

Quoted companies whose capital does not exceed Fr. 10 million are exempted from the above obligation, but they are required to send certain items of information to any shareholder who ask for them, within fifteen days of the request.

#### Disclosure for Shareholders and Creditors :

At the time of its formation a company is bound by certain disclosure obligation which vary according to its juridical form. In addition, certain items of information are required for the benefit of third parties when the company appeals to the public for investment of capital or when assets of a particular kind accrue to the company (commercial funds, patents, real estate etc.) Most important of all every company must be registered at the registry of commerce. This is the first disclosure measure and the most significant because commercial

companies have neither the status of a corporate body nor legal existence until their date of registration.

In order to ensure that every company regularly constituted, the government had envisaged instituting a system of judicial checking (Control) that would precede registration.

Dissolution of a company also requires various disclosure formalities. It does not take effect as far as third parties are concerned until the date is published in the Registry of Commerce. The same goes for the nomination, dismissal or registering and directing the company, who cannot be declared by the company to be acting Ultra Vires in dealing with third parties until facts concerning them have been duly published.

Shareholders have certain rights of access to a number of documents, either at any time or at the time of ~~next~~ general meeting or of an extra-ordinary meeting.

#### Shareholders Rights :

At any time in the year, shareholders have a right of access to certain documents concerning the last three financial years. These documents are : The inventory, The business accounts, The profit and loss account, the balance sheet and the reports of the administration board (or of the directory and the supervisory board) and of the auditor. Further, any shareholder of a quoted company whose capital does not exceed Fr. 10 Million may receive

within 15 days on request, the balance sheet and its appendices, the general business amount, the profit and loss account and the inventory of moveable assets held in portfolio. Within fifteen days which preceded the Annual General Meeting, shareholders have right of access to a list of all directors, information concerning candidates for the administrative or supervisory boards, the text and the summarised objectives of resolution to be proposed, and the total sum, certified by the auditor, of the emoluments paid to the highest paid persons etc.

In case of extra-ordinary meeting within fifteen days which precede an extra ordinary meeting, shareholders must be provided with the text of proposed resolutions, the report of the board, and if relevant, the auditor's report and any merger plan.

Within fifteen days before the general meeting the list of shareholders must be put at the disposal of the shareholders. The list must show the surname, first name and address of registered securities entered on that date, in the company's register and of every holder of bearer stocks who had at that date made a permanent deposit at the head office, together with the number of shares which each holds. Failure to honour these disclosure obligation can incur a fine varying from Fr. 2000 to Fr. 40.000.

A Commission des Operations des Bourse, modelled on the American Securities Exchange Commission, has recently been set up, primarily to check the truth and completeness of information provided.

Disclosure for Employees :

The law on works councils has specified a company's disclosure obligations towards its employees, represented by the council. In joint stock companies (Societies Anonymes), the managements obliged to send to the works council (before their presentation to the shareholder's general meeting) the profit and loss account, the balance sheet, the auditor's report and the other documents submitted to the meeting. The Council members enjoy the same rights of communication and copying as shareholders. In all companies, whatever their form, the head must give the works council information on (i) future plan likely to effect manpower structure, hours of work, conditions of employment and redundancy, (ii) Quarterly production and order levels and operating and plan projects; (iii) a general report, at least once a year, on the activities of the firm and in development of wage structure and levels over the past financial year and plans for the coming year. As a counterpart of these wider rights of information, the law has bound works council members to secrecy in matter

concerning information given as confidential by the head of the firm and, as in the part, in all questions relating to manufacturing process.

4. GERMANY :

The disclosure of the affairs of the company for the protection of present and future shareholders should, in place of State supervision, make it possible for individual shareholder to protect themselves from deception and fraud. The history of company law, has certainly shown how difficult it is to prevent the public being misled and, especially creditors being deceived as to the state of the company's assets. The development of company law has therefore always been marked by sharpening and refinement of provisions for disclosure, especially with regard to creditors.

The crucial point of the legal duty of disclosure lies in additions to the annual report, in the principle of clarity in the annual accounts, the value of which the Act of 1965 has increased by making more ~~more~~ stringent demands of them. Section 177 and 178 of the 1956 Act, lays down the requirements of disclosure. The new wording of section 177 is intended to make it even more certain that the annual statement of accounts (i.e. the balance sheet and profit and loss account) as entered in the

HANDELSR REGISTER corresponds truly with the certified accounts. Further more, the REGISTERGERICHT (Court of register) now has a formal and material duty of verification with regard to the annual statement. Such a duty was not included in the old Act (i.e. the Act 1937). Another important difference between the new Act and old Act is the distinction now made between obligatory and optional disclosure. Many companies used to publish their annual statement of accounts in abbreviated form and accompanies by the auditor's certification notice (such as newspapers) other than those laid down by law and thus may have given the impression that this was the full statement of accounts. Para 2 of section 178 deals with this possible misunderstanding by requiring that if the statement of accounts is not reproduced in full, this fact must be explicitly declared in a heading, an auditor's certificate must not be attached and the number of the BUNDASANEIGER (the official gazett) in which the full statement is published must be given. Certain new provisions on the annual report on the otherhand, are likely to have only a small effect in practice, since publication of report is not required in any way by the Act and only in rare cases by Articles of Association. The new section 178 does not include the requirements of section 144, para 2 of the 1937 Act, that the sum total

of assets, liabilities, expenditure and income be set out as separate items in each case, since this is self-evident and follows from the principles of proper accounting procedure.

Para 1(3) of section 178 prescribes that the resolution of the annual general meeting concerning the application of the profit is to be disclosed (because of its significance for economic position of the company). Before the Act of 1965 it was possible to bring down the profit by undervaluing the assets and by building up hidden reserve to conceal the true yield. The new Act has sought a more accurate revelation of real assets in the balance sheet by strict provisions for valuation aimed especially at the prevention of undisclosed reserves, furthermore, the method of evaluation any essential alteration in them are to be stated in the report.

## 5. ITALY

Under Italian law the balance sheet, prescribed by the board must be certified by the SINDASI and approved by the annual shareholder's meeting and thereafter filed in the registry of companies. Its contents and the valuation criteria for individual item are strictly laid down in Articles 2424 ~~of~~ of the Civil Code but as the law seems



mainly concerned with the danger of over valuation, direction are given much room for manoeuvre. Further more detailed specification of individual item in the balance sheet or in the director's report, separate director's report for any proposal for a merger, etc. are required to be made and disclosed.

6. NETHERLAND :

The traditional view was that any shareholder had a right to be informed of the contents of company's annual accounts. In 1928, however, a provision was included in the Dutch Commercial Code (Arts. 42c) which made it obligatory for the management of the companies ('open' limited companies to publish the contents of the annual accounts on depositing them at the HANDELSREGISTER (Registry of commerce). Close limited companies are under no such obligation. Apart from the obligation to publish annual accounts, the Dutch Commercial Code (Art. 36f and 42e) also requires managements to publish articles of association and amendments thereto in the Official Gazette (Netherlands Staatscourant). The management is also required to keep register (open to general inspection at the office of the company) containing the name of all owners of shares that have not been fully paid up.

Finally it should be mentioned that the (private) Stock Exchange Committee requires its members, in the case of an issue of shares, to publish a company prospectus giving specified data concerning the issuing company and particulars of the issue if the shares are to be traded on the stock exchange.

7. SWEDEN :

Requirements on disclosure are laid down in detail by the Swedish Companies Act, which at the time it was passed was rather radical compared with similar legislation in other European Countries. Parliament considered disclosure primarily as an instrument for the protection of shareholders and creditors. By the Act of 1950 disclosure's provisions are more stringent.

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