Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2024 – ISSN 2582-7820
Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

Public Interest in Flux: A Critique of Section 237 and Recommendations for Reform

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Received 19 December 2023; *Accepted* 11 January 2024; *Published* 15 January 2024

This paper examines and assesses the implications of Section 237 of the Companies Act 2013, shedding light on its historical evolution from its predecessor, Section 396 of the Companies Act 1956 for business mergers. Although the provision gives the Central Government discretionary flexibility for mergers in the public interest, concerns regarding arbitrary choices are raised by the nebulous definition of 'public interest' in the clause. The paper further draws attention to pivotal legal issues like the HDFC Bank and Centurion Bank of Punjab merger is used as an example to show how this provision has changed over time. The vague meaning of 'public interest' and the central government's extensive discretionary powers are the main points of contention. 63 Moons Technologies Ltd. v Union of India & Ors. is a prominent case that illustrates how government involvement, purportedly in the public interest, can be interpreted as favouring corporate interests over the larger welfare. An analysis of the judiciary's contribution to the definition of 'public interest' reveals enduring ambiguity in the term. To guarantee responsibility and openness, recommendations include the creation of more precise norms to govern the government's exercise of authority under Section 237 of the Companies Act; the creation of autonomous regulatory organisations to oversee the amalgamation process; and re-evaluating the government's intervention powers, restricting them to extraordinary situations. The proposed revisions are in line with the goals of the Companies Act, 2013, as they seek to strike a balance between company autonomy and government involvement.

Keywords: *section 237, public interest, amalgamations, central government, discretionary powers.*

INTRODUCTION

The modern business environment that we live in depends heavily on mergers and amalgamations. A merger can be defined as an agreement where two current businesses combine to form a single new or existing business. An amalgamation, on the other hand, involves joining two or more businesses to form a single new entity. The companies amalgamating tend to be operating in the same industry and amalgamation helps them in diversifying their business operations. Here, the weaker transferor company gets absorbed by the more powerful transferee company, creating an altogether new and larger corporation. A merger is distinct from amalgamation as under amalgamation, both companies combine to form a brand-new entity to hold their merged assets and obligations. Section 396 of the Companies Act, 1956 provided the Central Government with the authority to allow for the amalgamation of firms in the public interest. According to this section, the government may use this clause to compel the merger of two or more corporations if it believes that the merger is essential in the 'public interest'. If the government judges that it is in the public interest for two or more corporations to combine into a single entity with the same legal status, property rights, powers, interests, and liabilities, any combination allowed by a government order must be legal and advantageous to the public interest.[1] After the 2013 amendment to the Companies Act, this provision is now mentioned under Section 237[2]. An example of such an amalgamation done in the public interest under Section 237[3] is of the HDFC Bank and the Centurion Bank of Punjab (CBOP) in the year 2008. Both these banks had a stable financial performance and a customer base, but they faced healthy competition from other banks. The amalgamation of these two banks was successfully done in the public interest as it aimed to create the formation of a stronger bank with a broader geographical presence, improved technology, and a diversified portfolio. This shows that the provision of this section can be of great help to businesses as well as the general public, but we feel that there is a lot of ambiguity and arbitrariness in the provision of this section. So, this paper aims to talk about how the phrase 'public interest' used in this

[1] Companies Act 1956, s 396
[2] Companies Act 2013, s 237
[3] *Ibid*

section can go against the interest of the public and how the arbitrary powers of the central government can defeat the overall objective of the Companies Act and conclude with suggestions to handle this situation efficiently.

INCONSISTENCIES OF S. 237 OF THE COMPANIES ACT

Ambiguity Surrounding the concept of 'Public Interest': Firstly. the wording of this section is not very clear as to the meaning of the 'public interest'. As per Black's Law Dictionary, '**Public Interest** - Something in which the **public**, the community at large, has some pecuniary **interest**, or some **interest** by which their legal rights or liabilities are affected. It does not mean anything so narrow as a mere curiosity or as the **interests** of the particular localities, which may be affected by the matters in question. **Interest** shared by citizens generally in affairs of local, state, or national government....'[4] This definition shows that the expression 'public interest' used in this section is too wide an amplitude for a provision like section 237, and its operation can result in great civil consequences. Even Justice Felix Frankfurter of the US Supreme Court has once remarked that 'the idea of public interest is a vague, impalpable, but all controlling consideration'. It was submitted that such a broad conceptualisation of ground to 'regulate' companies is not in line with ensuring certainty and precision in legal standards.[5] In lieu of public interest, the government sometimes tends to compel a healthy business to combine with an unsustainable business just to help the latter. *63 Moons Technologies Ltd. (formerly known as Financial Technologies India Ltd.) v Union of India & Ors.*[6] is one such example of one such amalgamation. In this case, Section 396[7] (now Section 237[8]) was introduced for the first time. Here, 63 Moons Tech. Ltd. (formerly known as Financial Technologies India Limited) (FTIL) was compelled to merge with its subsidiary company National Spot Exchange Limited (NSEL) by the Central Government under Section 396[9]. NSEL was experiencing a serious financial catastrophe in 2013 because of illegal transactions carried out by its officers and this

[4] *State of Uttaranchal v Balwant Singh Chaufal & Ors* (2010) SCC OnLine SC 196
[5] *Ibid*
[6] *63 Moons Technologies Ltd v Union of India & Ors.* (2019) 18 SCC 401
[7] Companies Act 1956, s 397
[8] Companies Act 2013, s 237
[9] Companies Act 1956, s 396

amalgamation was done to assist NSEL in recouping debts of INR 5,600 crores from defaulters. Supreme Court held this amalgamation as ultra vires Section 396 of the Act and violative of Article 14 of the Constitution. The court said that the central government's sole intent behind passing this order of amalgamation was to take care of the priv*ate interest of NSEL in recovering dues as opposed to the interest of the general public. It went on to say that the Central Government should have focussed on the provision of Section 396 of the Companies Act, 1956 carefully as per which a compulsory amalgamation is done not only when it is public interest but also when it is indispensably necessary and important in the highest degree.* While deciding upon this case, the Supreme Court undertook the exercise of elucidating what constitutes 'public interest' under Section 396. The court said that the expression 'public interest' is wide and amorphous and takes colour from the context in which it is used. However, when it came to deciding upon what can be considered to be in the public interest, the court merely said that the expression 'public interest' is the general interest of the community, as distinguished from the private interest of an individual. It said that an amalgamation by a combination of resources of two companies is in the public interest if it positively impacts the production and consumption of goods and services, and employment of persons, for the general benefit of the community. Conversely, any amalgamation which obstructs or impedes the promotion of industry and growth, will not be in the public interest under Section 396.[10] This shows that though the court has tried to describe public interest, there is still a lot of ambiguity in it. In another instance, the Mumbai Bench of NCLT said that *"It is pertinent to mention that to invoke section 396 of Companies Act, 1956 (analogous to sec. 237 of new Act), it has to first establish that Central Govt. is satisfied that the Scheme agreed in between two Companies is in relation to the public interest. Unless such satisfaction is not shown, it cannot be said that this Scheme has to be considered within the ambit of section 237 of the Companies Act 2013."*[11] Here also NCLT talks about public interest just as a pre-condition for amalgamating the companies but fails to define the ambit of such public interest. This lack of a proper and precise

[10] Ishaan Chhaya and Srijata Majumdar, 'India: 'Public Interest'- The Sine Qua Non For Mandatory Amalgamation' (*Mondaq*, 29 May 2019 <https://www.mondaq.com/india/corporate-and-company-law/810000/public-interest--the-sine-qua-non-for-mandatory-amalgamation> accessed 21 November 2023

[11] *Subrata Sarkar v KND Engineering Technologies Limited* (2017) SCC OnLine NCLT 743

conceptualisation of public interest gives the government enormous power to misuse this provision and arbitrarily amalgamate the companies even if it isn't in the public interest.

Sweeping Powers of the Central Government: Secondly, Section 237 of the Companies Act, 2013 provides wide discretionary power in the hands of the Central Government. The wording of the provision itself indicates that the power is meant to be flexible and broad. It is clearly mentioned in sub-clause 1 of Section 237 of the Companies Act, 2013 that, '*Where the* ***Central Government*** *is* ***satisfied*** *that it is essential in the public interest that two or more companies should amalgamate….*' A mere reading of this sub-section shows that the statute leaves the amalgamation of two companies upon the satisfaction of the Central Government. The Hon'ble Supreme Court has also substantiated this point by stating that the first and foremost requirement under section 396 of the Companies Act, 1956 is that the Central Government should be 'satisfied', meaning thereby, that it must, on certain objective facts, be of the view that amalgamation between two or more companies is 'essential' in nature.[12] The court has pointed out that the Central Government's mind has to be applied to whether a compulsory amalgamation under Section 396 is indispensably necessary or not. As per Abhijeet Singh Rawaley, Section 396 (now S. 237 in the Companies Act, 2013) can be cited as a clause that goes beyond simple regulation and takes on the characteristics of intrusive governmental control over the very existence and structuring of corporations. Even an expert committee on company law, 2005 under the chairmanship of Jamshed J. Irani Committee) felt the need to take some power from the hands of the Central Government and distribute it among the Courts and tribunals. It was mentioned in the report submitted by this committee that the *"Existing Section 396 empowers Central Government to order amalgamation of two or more companies in the public interest. It has been suggested that these provisions should be reviewed. It is felt - that amalgamation should be allowed only through a process overseen by the Courts/Tribunals. Therefore, instead of existing provisions of Section 396, provision should be made to empower the Central Government to approach the Court/Tribunal for approval for amalgamation of two or more companies."*[13] Had the government implemented this strategy suggested by the committee, the amalgamation of companies would

[12] *Moons Technologies Ltd. v Union of India & Ors* (2019) 18 SCC 401
[13] Ministry of Company Affairs, *Report of Expert Committee on Company Law 2005* (2005)

have taken place on just and valid grounds and with proper procedure. This step would have taken away the arbitrary nature of the power allotted to the Central Government under this section. But these suggestions weren't followed, and no change was made to this section as a result, the government still enjoys enormous powers under this section. This broad and arbitrary exercise of power under Section 237 goes against the very objective of the Companies Act, 2013. The objective of the Companies Act of 2013, as per the Institute of Company Secretaries of India, is to offer business-friendly corporate regulation and pro-business initiatives, as well as e-governance Initiatives, good corporate governance and CSR, enhanced disclosure norms, enhanced management accountability, stricter legal enforcement, audit accountability, protection for minority shareholders, investor protection and shareholder activism, a robust framework for insolvency regulation, and institutional structure.[14] The government has been launching a lot of policy reforms for the ease of doing business in India.[15] The government has constantly been trying to promote foreign direct investment in the nation and for this reason, it has also been investing in Special Economic Zones. However, the government failed to take into consideration that providing such a broad and arbitrary exercise of power in the hands of the central government under Section 396 can negatively impact the ease of doing business in India. If companies believe that the government's authority to force amalgamation or winding up poses a threat to their operations, they may be reluctant to invest in India. This can result in a loss of investments and employment. Therefore, it is essential to keep in check the powers of the Central Government.

SUGGESTIONS

Enhancing Clarity by Establishing Guidelines for the Government Authorities: Rather than just focusing on the public interest, the central government can provide some clear guidelines for the exercise of authority described in section 237 of the Companies Act of 2013. For example, the way Companies act provides various grounds to allow the lifting of the corporate veil, viz.

[14] 'Reforms under Companies Act, 2013 for Ease of Doing Business' (*Student Company Secretary*, April 2020) <https://www.icsi.edu/media/webmodules/Reforms_under_CompaniesAct2013_Ease_of_Doing_Business.pdf > accessed 21 November 2023

[15] *Ibid*

fraud, evasion of obligations, etc., similarly, it can also include some requirements that the government needs to consider before amalgamating companies. These requirements for the government may include improving operational effectiveness, reducing costs, and raising the profitability of newly created companies. The formation of such legislation and regulatory frameworks will help in catering to the interests of the business owners as well as the general public. The small-scale industrialists will now be willing to amalgamate their industries as per the direction of the government as it would help their companies to expand at a minimalistic cost. Also, the government would benefit from the revenue generated by such companies. Moreover, prior to the amalgamation, the government should hold public consultations and consider input from stakeholders, including industry groups and consumer advocates.

Establishment of Independent Regulatory Agencies: Also, all the power should not be given in the hands of the government and there should be a proper check upon the exercise of such powers. As mentioned above, the company law committee under the leadership of Jamshed J. Irani also wanted the central government's powers to be regulated and that's why suggested that the amalgamation processes should be looked at by the courts and tribunals instead of the central government. But there is already very high pressure of work upon the courts and a large number of cases are still pending before them. In this situation, if we put the responsibility of approving amalgamations, it would put additional pressure upon them and will unnecessarily increase their workload. Also, it would delay the process of amalgamation. That's why, instead of giving this power to the court, we can establish independent regulatory agencies to deal with this issue. Such agencies shall be responsible for handling the merger and amalgamation part of the companies just like SEBI is responsible for handling the stock market process in India. This agency would have the authority to oversee government intervention in the private sector and will help ensure that government decisions are subject to appropriate oversight and accountability. These agencies will help establish a transparent decision-making process by serving as a check on the government's exercise of power, helping to ensure that interventions are consistent with legal and regulatory frameworks and are not arbitrary or capricious.

Balancing Government Oversight by Government's Limited Intervention: Establishing a particular agency for the purpose of amalgamation doesn't mean that government shouldn't have any say in the process of amalgamation. The government's power to intervene in the private sector should be limited to exceptional circumstances where there is a clear and compelling public interest at stake such as in matters of competition, national security, or the protection of public health and safety. However, the government's intervention powers should be limited to reviewing and potentially blocking proposed mergers or acquisitions and referring the matter to the agency established to regulate the amalgamations for further investigation. The agency can then conduct an assessment and decide whether the merger or acquisition should be blocked, approved with conditions, or cleared. Ultimately, the decision to merge or amalgamate should rest with the companies involved, subject to compliance with the legal requirements and procedures. This will take away the arbitrary power of the central government to force companies to merge or amalgamate as the government won't be able to directly initiate a merger or amalgamation.

CONCLUSION

Therefore, it can be validly said that Section 237 of the Companies Act, 2013 (erstwhile Section 396) is not properly framed and needs to be amended. Even after several amendments and changes to the Companies Act, the provisions under this section remain unamended. The term 'public interest' in this section has a broad meaning which results in a lot of ambiguity. Moreover, this section provides enormous powers in the hands of the central government which can compel the companies to amalgamate in the name of public interest. If the term public interest had an accurate meaning or definition under this section, it would have put control over the central government's power to a certain extent as the government could not have gone beyond that power. But the lack of a proper definition of public interest gives the government the opportunity and power to mould the definition of public interest as per its own will and use its unquestionable discretion in amalgamating the companies for the so-called public interest. This highlights the need to bring amendments to this section and put control over the power of the central government. This can be done by limiting the scope of public interest and taking into

account other criteria for amalgamation. Also, setting up independent agencies to look after the amalgamations of companies in India is necessary to take control from the hands of the central government. The government should just be left with the power to intervene if it thinks that some amalgamation is not good for the country. Here also the government should report it to the agency which will look into the matter. This will distribute the government's power and the amalgamation of companies then done would be a just and reasonable amalgamation that will be in the best interest of society as a whole.