
(1956) 10 BOM CK 0003
In the Bombay High Court
Case No : Suit No. 291 of 1956

Ramaben A. Thanawala

APPELLANT

Vs

Jyoti Ltd. and Others

RESPONDENT

Date of Decision : 10-10-1956

Acts Referred:

Companies Act, 1956 — Section 198, 198(1), 309(1), 309(2), 309(3)

Citation : AIR 1958 Bom 214 : (1957) 59 BOMLR 67

Hon'ble Judges : Chagla, C.J.;Desai, J

Bench : Division Bench

Advocate : Y.B. Rege and Bhagwati, for the Appellant; K.T. Desai, J.B. Kanga, D.M. Rege and Kishore K. Kolicha, for the Respondent

Judgement

Chagla, C.J.—This is a special case submitted to us u/s go of the CPC and it raises questions of construction of certain sections of the new Companies Act, 1956. Counsel have drawn our attention to the extremely unsatisfactory drafting of this Act and we must confess that many of its provisions do not suffer from lucidity. We have been told that the new Act has raised many problems for those who have anything to do with the management or running of companies, and the problems brought before us are only a few of those which have arisen in practice. It seems to us unfortunate that a law which is intended to help in the development of companies in our country and also to put down abuses- which were noticed in the working of companies and especially in the institution of the managing agency which is peculiar to our country, should not have been couched in clear and more precise language. That, however, is a matter for Parliament. Our concern is to take the law as we find it and do the best that we can.

2. The plaintiff in this case is a shareholder of the first defendant company and the second defendants are the managing agents. They were appointed managing agents by an agreement dated the 10th April 1951. The third defendant is a partner of the second defendant firm, the other partner being one Dinubhai Amin. The third defendant is also a Director of the first defendant company and

he was also appointed a Technical Adviser, he being qualified as an Electrical and Mechanical Engineer, on a salary of Rs. 3,000/- on the 1st January 1944. His appointment as Director came subsequently, he being appointed in April 1944, and the questions which call for a construction at our hands relate to the remuneration to be paid to the managing agents and the remuneration also to be paid to the third defendant. Under the agreement the managing agents were to receive 10 per cent of the annual net profits and under certain circumstances also a further one-third share in the balance of net profits after making certain deductions as provided in the managing agency agreement.

3. The first relevant section that we have to consider in this connection is Section 309. That section deals with the remuneration of directors and Sub-section (1) provides:

"(1) The remuneration payable to the directors of a company, including any managing or whole-time director, shall be determined, in accordance with and subject to the provisions of Section 198 and this section, either by the articles of the company, or by a Resolution or, if the articles so require by a special resolution, passed by the company in general meeting."

Therefore, Section 309 and Section 198 are overriding sections notwithstanding the articles or any resolution with regard to the remuneration to be paid to a director. Sub-section (2) provides for a director receiving remuneration either by way of a monthly payment, or by way of a fee for each meeting attended, or partly by the one way and partly by other. It is clear that as far as this remuneration is concerned the remuneration, is paid to a director as a director managing the affairs of the company. Then Sub-section (3) provides:

"(3) In lieu of or in addition to the remuneration specified in Sub-section (2), remuneration may be paid to a director who is either in the whole-time employment of the company or a managing director, at a specified percentage of the net profits of the company;

Provided that such percentage shall not exceed five for any one such director, or where there is more than one such director, ten for all of them together."

The controversy centres round this question as to whether the remuneration referred to in this Sub-section is confined to the remuneration paid to the director in his capacity as a director, or whether the Sub-section extends to the remuneration paid to a director in any capacity whatsoever. In other words, when Rs. 3,000/- are being paid to the third defendant as a technical adviser, is that amount to be considered in deciding whether the amount paid to him exceeds the 5 per cent of net profits referred to in the proviso? In the first place, it will be noticed that Sub-section (3) refers to remuneration in lieu of or in addition to the remuneration mentioned in Sub-section (2), and as we have just pointed out, the remuneration referred to in Sub-section (2) is clearly the remuneration paid to the director in his capacity as a director and in no other capacity. Further, Sub-section (3) speaks of a director in the whole-time employment of the company,

and that expression is put in juxtaposition to the alternative case of a managing director. If the remuneration was with reference to the managing director, then it is clear that the remuneration of a managing director is with reference to the work done by the director as a director for the purpose of managing the company. The expression "whole-time director" also occurs in Section 310 and Section 311. u/s 310 in order to increase the remuneration the sanction of the Government is required, and Section 311 also deals with increase in remuneration of managing director or a whole-time director appointed after the Act and such increase requires the sanction of Government. In the context it seems to us that the expression "whole-time director" must refer to a director who spends his whole time in the management of the company in the same sense as a managing director does. It will also be noticed that if it was intended by the Legislature that the remuneration referred to in Sub-section (3) should include not only the remuneration paid to the director as a director, but also remuneration paid to him in any capacity whatsoever, appropriate language could have been used for that purpose, and, as We shall presently point out in other sections where the Legislature wanted to convey that meaning proper language has been used. For instance, in Section 318 which deals with compensation for loss of office of a director or a whole-time director, Sub-section (5) provides :

"(5) Nothing in this section shall be deemed to prohibit the payment to a managing director, or a director holding the office of manager, of any remuneration for services rendered by him to the company in any other capacity."

Therefore, the Legislature clearly indicates that a director may receive remuneration as a director and he may also get it in a capacity other than that of a director. But the position is made even clearer when we come to Section 348 which deals with the remuneration of managing agent, and that section clearly provides that the remuneration to be paid to the managing agent must not exceed the remuneration laid down in that section, whether the remuneration is in respect of the managing agent's services as managing agent or in any other capacity. We will deal with that section at greater length when we deal with the question of the remuneration of managing agents, but, the contrast between the language of Sub-section (3) of Section 309 and Section 348 is apparent. The other sub-sections of this section to which reference might be made is Sub-section (8) and that provides :

"(8) The provisions of this section shall come into force immediately on the commencement of this Act or, where such commencement does not coincide with the end of a financial year of the company, with effect from the expiry of the financial year immediately succeeding such commencement."

The financial year of this company is the calendar year and therefore by reason of the provisions of this sub-section, this section would apply to this company only from the 1st of January 1957, the new Act having come into force on the 1st April 1956.

4. Now, Section 309(1) also refers to Section 198 and the remuneration payable to a director is not only subject to Section 309 but also to Section 198, and when we turn to that section it deals with, as the head-note indicates, managerial remuneration, and Sub-section (1) provides:

"(1) Save as otherwise expressly provided in this Act. in the case of a public company or a private company which is a subsidiary of a public company, the total remuneration payable by the company to its directors, its managing agent or secretaries and treasurers, if any, and its manager, if any, shall not exceed eleven per cent of the net profits of the company, computed in the manner laid down in Sections 349, 350 and 351, except that the remuneration of the directors shall not be deducted from the gross profits."

The question that is raised is whether the amount of Rs. 3,000/- paid to the third defendant as a technical adviser and not as a director is included in the limit of 11 per cent fixed by Section 198. One possible view of Section 198 is that we must calculate the total amount which the company pays to its directors, managing agent or secretaries and treasurers and the manager and such total amount must not exceed 11 per cent of the net profits of the company, and it may be suggested that what the Legislature intended was that there should be some limit put upon the company paying out sums to the various authorities mentioned in this Section, and from that point of view it may be said that inasmuch as Rs. 3,000/- a month is being paid to the director, the third defendant, that sum should be included for the purpose of computing the 11 per cent mentioned in Section 198. But in our opinion, although the heading of a section or a marginal note cannot control the clear language of the section, in this case we must consider the heading and the marginal note for the purpose of arriving at a conclusion as to what according to the Legislature was the purpose of enacting this section, and in our opinion the marginal note correctly indicates what the Legislature aimed at in enacting this section. What was sought to be controlled was the cost of management and if what was sought to be controlled was the cost of management, then what had to be considered was managerial remuneration and not remuneration paid for any other purpose. Even on principle this seems to be the correct view because it is difficult to understand why a company could employ a technical expert and pay him whatever amount it thinks proper and there should be no control with regard to it, and yet the company should be prohibited from making use of the technical knowledge of a director and pay him a proper remuneration. It may be said that if this view were to be accepted, large amounts may be paid to a director in the guise of these amounts being remuneration for the technical or expert knowledge of the director. Now, the Legislature has provided a safeguard and that safeguard is to be found in Section 314 and that section debars a director from holding any office or place of profit except with the previous consent of the company accorded by a special resolution, and in the case of the third defendant a special resolution was necessary in order to enable him to hold this place of profit. In the absence of any such resolution a director would have vacated his office as a

director.

5. The other interesting question that arises with regard to the construction of Section 198 is as to when that section comes into force. As in. Section 309 there is no indication as to when the Legislature intended that this particular section would become operative, and therefore it was urged that the section must come into force when the Act came into force and the managerial remuneration paid by a company should be considered for the purpose of Section 198 from the 1st April 1956. and therefore it is said that this section would apply to this company with regard to the net profits made by it and the amount expended by it for management for the financial year 1956. Now, that contention cannot be accepted because Section 193 provides that the net profits have to be computed in the manner laid down in Sections 349, 350 and 351, and when we turn to Section 349 the net profits of the company have to be computed in any financial year. It is a truism well known to taxing law that net profits of a business cannot be ascertained till the end of the year of account or a financial year of the business, and therefore in the case of the second defendant company the net profits could not be ascertained till the 31st December 1956. But in ascertaining those profits the period from the 1st January 1956 to the 31st March 1956 would have to be taken into consideration because what has to be ascertained is the net profits of the whole financial year, and if that were done then a period antecedent to the coming into force of the Act would have to be taken into consideration. That, as was rightly pointed out, would be giving to the section a retrospective effect and that would require the working of the company to be considered before the Act came into force. Now, section 198 does not purport to be retrospective, and therefore the better view with regard to the operation of Section 198 seems to be that as far as this company is concerned it would come into operation from the 1st of January 1957.

6. Turning to Section 348, which deals with the remuneration of managing agents, it is not open to a managing agent after the Act comes into force to receive by way of remuneration, whether in respect of his services as managing agent or in any other capacity, any sum in excess of ten per cent of the net profits of the company for the financial year, and Mr. Desai appearing for the defendants concedes that as far as the second defendants are concerned they cannot receive as remuneration anything more than 10 per cent of the net profits, but he strongly contests the position that the amount of Rs. 3,000/- paid to the third defendant as a technical adviser should be included in the computation of 10 per cent. What is argued is that the managing agent is the firm and the third defendant is a separate entity from the firm, and when Rs. 3,000/- are paid to the third defendant they are not paid to the managing agent but they are paid to the third defendant who may be a director but certainly not the managing agent. The argument when analysed has a curious ring because what is seriously urged is that although the company cannot Pay to the firm of managing agents more than a certain amount it could pay one of the partners of that firm an amount exceeding that certain sum. Now, a firm has no legal

existence; it is not a legal entity; it is merely a compendious manner of describing partners carrying on a business. Therefore, the argument of Mr. Desai comes to this that although the company in law could not pay A and B Jointly, it could pay A and B separately and individually. In our opinion, full effect must be given to the clear and emphatic language used by the Legislature in Section 348 that a managing agent cannot receive more than 10 per cent of net profits either in his capacity as managing agent or in any other capacity. The whole object of the Legislature would be defeated and the mischief aimed at would not be overcome if we were to take the view that although the company had paid up to 10 per cent of the net profits to the managing agents, it could further pay extra amounts to each one of the partners of the managing agents if the managing agency happened to be a firm. That would put a firm in an infinitely more advantageous position than an individual. If the managing agent was an individual, he would have to content himself with the remuneration fixed u/s 348, but if he shower the wisdom and the foresight of having a partner and starting a partnership firm, then he and his partner individually could get out of the limitation placed in Section 348 and each separately and individually could receive from the company any amount without any limit whatsoever. It is said by Mr. Desai that although in the managing agency commission which the second defendant firm receive, the third defendant has a share and interest, the firm has no share or interest in the sum of Rs. 3,000/- paid to the third defendant as a director. In our opinion, that is not the correct way to look at the matter. The correct way is that the third defendant not only receives a share in the managing agency commission as a partner in the second defendant firm, but over and above the commission he received a sum of Rs. 3,000/- and the Law says that he cannot receive in any capacity a sum exceeding the sum mentioned in Section 348.

7. It is then said that if the intention of the Legislature was to prohibit not only the managing agency firm as such but every partner of that firm from receiving anything more than the remuneration fixed u/s 348, the Legislature could have used appropriate language as it has done in Sections 366, 357, 359 and 360. Now, in those sections the prohibition contained in those sections not only apply to a managing agent but also to an associate of a managing agent, and undoubtedly an associate as defined includes a partner. But what is overlooked in advancing this argument is that "associate" covers many more relationships according to the definition than the mere relationship of a partner, and the intention of the Legislature was to make the prohibition in these sections much more stringent than the prohibition in Section 348. Therefore, the expression "associate" could not have been used in Section 348 because it would have covered not merely a partner as just said, but persons holding other relationships according to the definition of the expression "associate" in the Act. It is therefore not a valid argument to suggest that the absence of the expression "associate" in Section 348 should lead the Court to the inference that a partner of a managing agent was permitted to receive a remuneration

exceeding the remuneration mentioned in Section 348.

8. Therefore, in our opinion, although the third defendant is permitted to receive Rs. 3,000/- as a technical expert and although that amount may not fall within the mischief of Section 309 and even though that amount may not be taken into consideration for the purpose of Section 198, that amount must be taken into consideration for the purpose of limiting the remuneration of the managing agents, the second "defendants, to the 10 per cent mentioned in Section 348. Section 348, as Section 309, lays down the time when the section should come into operation and that is in respect of any financial year beginning at or after the commencement of the Act. and therefore as far as this company is concerned the section would come into force from the 1st of January 1957.

9. Mr. Rege has drawn our attention to a rather curious anomaly in the Act by pointing out Section 331 which says:

"All provisions of this Act, other than those relating to the term for which the office can be held, shall apply to every managing agent holding office at the commencement of this Act, with effect from such commencement."

Mr. Rege says that there seems to be a clear inconsistency between Sections 331 and 348 as to when the provisions of Section 348 should come into operation. Section 331 applies the various provisions of the Act with effect from the commencement of the Act, but we have to turn to the provisions themselves to find out what they are, and although Section 348 may apply to the managing agent from the commencement of the Act, the provisions of the section make it clear in respect of what remuneration and from when the limitation is to apply. It may be that the Legislature overlooked Section 331 when it enacted Section 348 or it overlooked the fact when it enacted Section 331 that it was going to enact Section 348. But the language of Section 348 is clear and that language cannot be controlled by the language of Section 331.

10. Therefore we answer the questions as follows:

- (1) In the negative.
- (2) Does not arise.
- (3) Does not arise.
- (4) In the negative, after deleting Sections 349 and 350.
- (5) Unnecessary.
- (6) In the negative. The question to stop at the words "..... referred to in Section 198(1) of the said Act." The further question "Whether in any event the said overall limit applies for the year 1956 or any part thereof and if so which?" does not apply to the year 1956.
- (7) In the negative.

11. We will frame another question in the light of the Judgment, viz.,

12. Whether the remuneration of Rs. 3,000/-paid to the third defendant as technical adviser is to be included in the limit of 10 per cent laid down in Section 348?

and answer it in the affirmative. The further question "If so from when? the answer is" From and after the 1st of January 1957. No order as to costs.

13. Answers accordingly.