# Social Sector Hotline

May 05, 2014

## ELECTORAL CONTRIBUTIONS BY CERTAIN CLASS OF COMPANIES UNDER THE JUDICIAL SCANNER

- Vedanta Plc. is a foreign company within the meaning of the Companies Act, 1956
- The subsidiaries of Vedanta are 'foreign source' under the Foreign Contribution Regulation Act, 1976
- Nationality of a company to be decided on the *situs* of its incorporation and not on nationality of its shareholders
- Contribution made by Sterlite and SESA towards political parties is violative of Foreign Contribution Regulation Act, 1976

The Delhi High Court ("**Delhi HC**") recently held, in the case of Association of Democratic Reforms ("**ADR/Petitioner**") v Union of India and Ors[1] that Vedanta Resource Plc. (**"Vedanta"**) is a 'foreign company' within the meaning of Companies Act, 1956 (**"Companies Act"**). The Delhi HC further held that its subsidiary companies incorporated in India i.e. Sterlite Industries (**"Sterlite"**) and Sesa Goa (**"SESA"**) are also a 'foreign source' for the purposes of Foreign Contribution Regulation Act, 1976 (**"FCRA"**). The Delhi HC also held that acceptance of political contributions from Indian subsidiary of a foreign company is violative of FCRA.

### BACKGROUND

The Petitioner, ADR, is a not-for-profit entity working in the field of political and electoral reforms in India. ADR had filed a Public Interest Litigation ("**PIL**") before the Delhi HC drawing attention of the court towards donations received by political parties for the period up to year 2009 and raised the legal position with respect to the nature of such donations. The petitioner contended that by taking political donations from Sterlite and SESA, the political parties have violated Section 29(b)[2] of the Representation of People Act, 1951 (**"RPA"**). The petitioner further contended that by accepting political contribution made by Sterlite and SESA, the political parties violated Section 4(1)(e) of FCRA.

The Petitioner relied upon the annual report of Vedanta a company incorporated under the Companies Act, 1985 with majority shares held by an Indian citizen and registered in England and Wales. The petitioner also relied upon the annual report of Sterlite and SESA evidencing donations made by them but controlling shareholding of both the companies was owned by Vedanta. Replying on the annual report of Vedanta, the Petitioner informed the Delhi HC that more than 50% of the issued share capital of Sterlite and SESA were held by Vedanta; and keeping in view the admitted fact that Sterlite and SESA were companies registered under the Companies Act, Sterlite and SESA would be considered as a 'foreign source' within the purview of FCRA and donation by them would be in contravention of FCRA.

### ISSUE

The issue mainly related to the interpretation of the definition of a 'foreign source' i.e. whether Sterlite and SESA or other similarly situated company or companies could be identified as a 'foreign source' within the meaning of Section 2(e) and be liable under FCRA.

### CONTENTION BY PETITIONER

The petitioner submitted that donations made by Sterlite and SESA to the political parties during the period when FCRA was in force[3] would be foreign contributions because Sterlite and SESA are "foreign source"[4] within the meaning of Section 2(e)(vi). The petitioner further contended that although the donors are companies registered in India under the Companies Act, however, significantly, more than one-half of their share capital is held by Vedanta – a company incorporated in the United Kingdom. Therefore, in view of the mandate of clause (vi) of Section 2(e), the donations in favor of the political parties are to be construed as emanating from a "foreign source" and would fall within the prohibition imposed by Section 4 of the FCRA, which does not permit acceptance of foreign contributions by political parties or their office-bearers.

### CONTENTION BY RESPONDENT

The respondents contended that the donations made by Sterlite and SESA in favor of political parties could not be construed as a 'foreign contribution' as they are not 'foreign source' within the meaning of section 2(e) of FCRA. It was argued that since Vedanta is not a 'foreign company' within the meaning of Section 591(2) of the Companies Act[5] as majority of its shares are held by an Indian citizen and therefore, its subsidiaries- Sterlite and SESA could not be construed as 'foreign source' to attract the rigor of FCRA.

### THE RULING

While arriving at the decision, the bench looked into the nature of the definition of 'foreign source' in detail. The Bench highlighted the legislative intent behind the wider definition of 'foreign source' and held that any escape from

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the applicability of Section 2(e)(vi) of FCRA by the subsidiary companies would not be possible. The Bench opined that the said definition is an inclusive one and allows remedial measures in case of any interpretational mischief or loophole that could be exploited in future with respect to the definition of 'foreign source'.

The Delhi HC held that the definition of 'foreign source' is being misinterpreted because of the conjoint reading of Section 2(e)(iii) of FCRA and Section 591(2) of the Companies Act. The Bench held that even though Vedanta is incorporated outside India and is *domiciled* within the territory of India, it will still be, unquestionably, a foreign company under the legislative interpretation of clause (1) of Section 591 as it is incorporated outside India.

The Delhi HC added that even when more than one half of the share-capital of a company [incorporated outside India] is held by one or more citizens of India, such companies shall comply with provisions of the Companies Act as if it were incorporated in India. Therefore, through section 591, a fiction of law operates which casts a greater burden of compliance on 'foreign companies' having its place of business in India which is essentially held by Indian citizens.

The Delhi HC further added that the nationality of a company is determined exclusively on the touchstone of the *situs* of its incorporation and the nationality of its shareholders or directors have no bearing upon the nationality of a company, the company being a distinct jural entity having an existence independent of its constituents. The Delhi HC ultimately held that Vedanta is a 'foreign company' within the meaning of Section 591 of the Companies Act and therefore, Vedanta and its subsidiaries- Sterlite and SESA are 'foreign source' as contemplated under Section 2(e)(iii) of FCRA.

## ANALYSIS

With this judgment the Delhi HC seems to have plugged the interpretational inconsistency imported to the meaning of 'foreign companies' in cases where the majority shareholding is held by Indian citizens. By disallowing Vedanta to be treated as an Indian company under the Companies Act, the Delhi HC has re-enforced the legislatures' xenophobic notion of political and economic subjugation of India by foreign organizations and companies. Although the present Foreign Contribution Regulation Act, 2010 (**"FCRA, 2010"**) has introduced certain changes, the legislative intent behind it still does not seem to have diluted much from the earlier legislation. The FCRA, 2010 remains highly regulated and appear to be a linear extension of the previous legislation. Through this judgment, the Delhi HC seems to have over-scrutinized the role of Sterlite and SESA regarding donations made to political parties. The act of impugning subsidiary companies of a foreign corporation is a [symptom of the] desire to create asymmetry between different classes of Indian companies for the selective interpretation of the term 'foreign source'. The implications of such an approach could bring impulsive and undesired outcomes as the primary role of ensuring transparency and accountability of foreign funds, for which FCRA was enacted in the first place, seems to have retreated. Moreover, the radical simplicity of the 'neo-colonial' debate cited by the Delhi HC i.e. foreign power versus unprivileged nations- continues to be highly contentious.

An act of making donations to political parties by Sterlite and SESA should not be seen as a site of threat to electoral reforms. The hallmark of globalization is that it countenances the possibility of seamless flow of money across borders. Thus, in such a globalized economy and polity, judicial disagreements over the nature of political contributions by Indian subsidiaries present a risk by attributing motives on such companies. The problem is not foreign funding but the diminished understanding of FCRA which allows for impugning of corporate instrumentalities in the name of political sovereignty.

– Rahul Rishi & Dr. Milind Antani
You can direct your queries or comments to the authors

[1] Association of Democratic Rights and Anr. v Union of India and Ors: W.P.(C) 131/2013 (Delhi High Court)

[2] **29B**. Political parties entitled to accept contribution.—Subject to the provisions of the Companies Act, 1956 (1 of 1956), every political party may accept any amount of contribution voluntarily offered to it by any person or company other than a Government company: Provided that no political party shall be eligible to accept any contribution from any foreign source defined under clause (e) of section 2 of the Foreign Contribution (Regulation) Act, 1976 (49 of 1976).
(b) "Government company" means a company within the meaning of section 617; and
(c) "contribution" has the meaning assigned to it under section 293A,
of the Companies Act, 1956 (1 of 1956) and includes any donation or subscription offered by any person to a political party; and
(d) "person" has the meaning assigned to it under clause (31) of section 2 of the Income-tax Act, 1961 (43 of 1961), but does not include Government company, local authority and every artificial juridical person wholly or partially funded by the Government.

[3] The Foreign Contribution Regulation Act of 1976 is replaced with a new law enacted in the year 2010. Currently, the new Act is Foreign Contribution Regulation Act, 2010.

[4] 2(e) "**foreign source**" includes-
(i) the government of any foreign country or territory and any agency of such government,
(ii) any international agency, not being the United Nations or any of its specialized agencies, the World Bank, International Monetary Fund or such other agency as the Central Government may, by notification in the Official Gazette, specify in this behalf,
(iii) a foreign company within the meaning of section 591 of the Companies Act, 1956 (1 of 1956), and also includes-
(a) a company which is a subsidiary of a foreign company, and
(b) a multi-national corporation within the meaning of this Act.
(iv) a corporation, not being a foreign company, incorporated in a foreign country or territory,
(v) a multi-national corporation within the meaning of this Act,
(vi) a company within the meaning of the Companies Act, 1956 (1 of 1956), if more than one-half of the nominal value of its share capital is held, either singly or in the aggregate, by one or more of the following, namely,-
(a) government of a foreign country or territory,
(b) citizens of a foreign country or territory,
(c) corporations incorporated in a foreign country or territory,
(d) trusts, societies or other associations of individuals (whether incorporated or not), formed or registered in a foreign country or territory,
(vii) a trade union in any foreign country or territory, whether or not registered in such foreign country or territory,
(viii) a foreign trust by whatever name called, or a foreign foundation which is either in the nature of trust or is mainly financed by a foreign country or territory,
(ix) a society, club or other association of individuals formed or registers outside India,
(x) a citizen of a foreign country,
but does not include any foreign institution which has been permitted by the Central Government, by notification in the Official Gazette, to carry on its activities in India;

[5] 591. Application of sections 592 to 602 to foreign companies.
(1) Sections 592 to 602, both inclusive, shall apply to all foreign companies, that is to say, companies falling under the following two classes, namely:-
(a) companies incorporated outside India which, after the commencement of this Act, establish a place of business within India; and
(b) companies incorporated outside India which have, before the commencement of this Act, established a place of business within India and continue to have an established place of business within India at the commencement of this Act.
(2) Notwithstanding anything contained in sub- section (1), where not less than fifty per cent. 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, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply

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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.]

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