Legal Update

Companies Bill 2011- Highlights

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Background:

The Companies Act, 1956 regulates the range of activities, from birth to death of companies. Various regulations of Corporate Governance, responsibility and obligations towards stakeholders emerge from the Act. It acts as a statutory platform for functioning of the companies with transparency to protect the interest of the shareholders and also industry friendly regulations. However, in the light of expansion of Indian economy increasing the avenues for international business opportunities, need was felt to bring about some changes in the old reforms and regulations to keep it at par with other nationals. Aiding to such need, Mr. Salman Khurshid had introduced Companies Bill 2009 in Lok Sabha on 3rd August, 2009. Key objective of the bill was:

- To make the existing Companies Act, 1956 compact by deleting such provisions which have become redundant over a period of time, due to various changes in the regulatory norms both nationally and internationally.

However, the bill remained due for quite some time and thereafter large number of recommendations was received from various stakeholders. It was then decided to have a fresh legislation to be put in place. The Bill has lot of provisions which are welcomes open heartedly and is sure to bring about a change in the Indian Corporate Governance scenario. The said Bill promises greater shareholder democracy. Also, by deleting the redundant provisions, the Act surely becomes much more meaningful. The Bill aims at modernization of corporate regulation. Thereafter, the Bill was placed in the Lok Sabha on December 14, 2011 as Companies Bill, 2011 ("**the Bill**"). The Bill was cleared by the Cabinet on November 24 this year but the disruption protesting FDI in multi-brand retail led to the inordinate delay.

Highlights:

- Rearrangement of sections, chapters making the Act much more reader friendly and compacting the existing Act; however, Rules yet to be prescribed;
- Regulatory framework on compromises and arrangements;
- It proposes to introduce the concept of class action suits for the first time in India. That would empower investors to sue a company for 'oppression and mismanagement' and claim damages;
- Introduction of One Person Company concept;
- Many new definitions have been introduced and existing ones been amended such as- accounting standards, auditing standards, associate company, charge, company limited by shares, control, CEO, CFO, books of accounts, deposit, promoter, postal ballot, related party, small company etc. Change in the definition of Company, employee stock option etc.;
- Periodic rotation of Auditors after every 4 years;
- Shareholders' approval a must for inter-corporate loans;
- Introduction to Revival and Rehabilitation of sick companies in Chapter XIX- SICA to be repealed
- Concept of Registered Valuer introduced;
- Dissenting shareholders to be given exit option at the time of decision making of the company such as change in object clause, any new business proposal etc.;
- Among other things, it also proposes to tighten the laws for raising money from the public;

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- The Bill also seeks to prohibit insider trading by company directors or key managerial personnel by treating such activities as a criminal offence;

- The Bill proposes that companies should earmark 2 per cent of the average profit of the preceding three years for corporate social responsibility (CSR) activities, and make a disclosure to shareholders about the policy adopted in the process; the same is not a mandatory requirement;

- Defining "Independent Directors" and "Interested Directors";

- Definition of "Associate companies' fixed at control of 20% share capital or business decisions under an agreement;

- Company Secretary included in definition of Key Managerial Personnel;

- The requirements of drawing the object clause of a company into main, ancillary and others are done away with;

- Provisions regarding the name approval now not in a separate section but clubbed together under incorporation;

- Additional documents to be filed by a public/private company in case of commencement of business;

- Share Transfer Agents, Registrars to an issue, CFO also included within the meaning of officer in default;

- Annual return of companies now to include addition data pertaining to:
  - Change in the promoters and KMPs alongwith directors
  - Meetings of members, Board along with attendance details
  - Remuneration of KMPs to be disclosed
  - Penalty or punishment imposed on the company, directors and/or officers and details of compounding and appeals (slight change from Companies Bill 2009)
    - Therefore, we expect change in the format of annual returns as well
  - Annual return to be signed by a director and a company secretary in whole time employment/practice
  - In case of non-filing within due time, penalty is strict in comparison to the Act and now also includes imprisonment;

- Companies having money idle which is raised from public through prospectus in the form of deposits are not suppose to change their object clause unless resolved by a special resolution or an exit option is given to the dissenting shareholders; this clause is certainly a investor friendly clause

- Concept of video conferencing in case of board and general meetings

- Mandatory rotation of independent directors

- More Powers to Serious Fraud Investigation Office (SFIOs)

Few of the above highlights being dealt in details below:

Regulations on Mergers and Acquisitions- Chapter XV- Section 230

- The existing heading reads as "Arbitrations, Compromises, Arrangements and Reconstructions" whereas, the chapter in the Bill reads as "Compromises, Arrangements and Amalgamation";

- The existing section 390 applies to companies liable to be wound up. The existing section 390 being excluded and part of it becomes part of explanation to section 230;

- Reduction of capital and corporate debt restructuring are also part of compromise and arrangements and are to be (consented by atleast 75% of the unsecured creditors) to be disclosed by the applicant(s) vide an affidavit at the time of making the application;

- Consolidation of provisions of section 393 into sub-section (3) of section 230. Thus, much more reader friendly and easy to understand at one go;

- Sub-section (4) imposes restrictions on objections to be raised by creditor. It says that a creditor not holding less than 10% of the shareholding or 5% of the total outstanding debt as per last audited financial statements shall not be liable to raise any objection to the arrangement. It is the same as in Companies Bill 2009. This does sound a little absurd. Surely it could have been framed in a phased manner;

- Compromise or arrangement now also includes buy back subject to fulfillment of conditions specified. Compromise or arrangement now also to include takeover offers;

- Clause (f) of sub-section (3) of section 232 deals with investment of NRIs and treatment thereof in case of an mergers/amalgamations. Where the share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order of the Tribunal;

- Under the existing Act, all the powers in relation to a scheme of arrangement lies with the High Court which shall now vest with the Tribunal.

Introduction of class action under Oppression and Mismanagement- Chapter XVI- section 245

- First, rearrangements of provisions of existing sections 397, 398, 402 as 241 onwards in relation to oppression and mismanagement and also consolidation of the sections/sub-sections therein.

- Companies Bill 2009 drew the minimum number of member/creditor to be one in case of a class action. This was certainly a threat to the Indian Companies where even a single shareholder could affect the day to day affairs of the company as at times undue harassment is caused by such shareholders in the practical scenario. The Bill amends such minimum number from 1 to minimum of 100 members and/or depositors or such percentage of paid up capital/no. of depositors as may be prescribed, whichever is less, in case of a company having share capital whereas in case of a company not having share capital, one fifth of its total no. of members; it excludes the term creditors and instead includes depositors.

- Conditions precedent to consideration of an application under class action are set out (earlier missing in Companies Bill 2009):

    - whether the member or depositor is acting in good faith in making the application for seeking an order;

  - any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of subsection (1);
  - whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;
  - any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;
  - where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—
    (i) authorised by the company before it occurs; or
    (ii) ratified by the company after it occurs;
  - where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company

- Two class action applications for the same cause of action shall not be allowed; inserted newly and is sensible enough

- The cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act; inserted newly.

- Provisions for also safeguarding the interests of the Company in case the application is found to be frivolous and vexatious in nature, then the Tribunal has the power to reject the application and impose cost of not exceeding rupees one lakh. This is certainly a boon regulation to companies in cases where such applications may practically be mischievous in nature.

- Though the minimum number of member/depositor for the application is 100, it may further be brought down as the number of members in case of a private company is 50 under the existing Act. The present Bill increases the number from 50 to 200, but not sure what is the rationale behind the same.

- Inclusion of depositors in case of class action is not justified. Depositors cannot be put on the same footing as the shareholders. If at all depositors are included, the same has to be restricted to the deposits and has to have a separate recovery process. However, specifications are needed in case of what will amount to act of mismanagement and/or how to ensure that members/depositors have acted in good faith.

Removal of names of companies from the Register of Companies- chapter XVIII- section 248

- Earlier the heading was- Power of Registrar to strike defunct company off register (section 560)

- The provisions have been completely changed. The period for in-operation of the company set out as one year from incorporation or two years immediately preceding financial years (the same was one year in case of Companies Bill 2009); also to keep in mind whether the company has suo moto applied for status of a dormant company within the time prescribed;

- The provisions also include case where the subscribers to the MoA have not paid the subscription within 180 days from the incorporation of the company;

- A company may also, after extinguishment of all its liabilities, with a consent of atleast 75% of the members (of the paid-up share capital) vide special resolution file an application to the Registrar for removal of name of the company from the Register of Companies;

- Restrictions laid down in case of making application u/s 248 such as company not to make an application in case of change of its registered office in the previous three months; (these vary in comparison to Companies Bill 2009)

Analysis of amendments in light of Companies Bill 2009

Meaning of "Associate"

Companies Bill 2009	Companies Bill 2011
2 (1) (*f*) "associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence or of any other company. ***Explanation*.—For the purposes of this**	2 (6) "associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company. *Explanation*.—For the purposes of this

clause, "significant influence" means control of at the least twenty-six per cent of total voting power, or of business decisions under an agreement;	clause, "significant influence" means control of at least twenty per cent. of total share capital, or of business decisions under an agreement;

Analysis:

Though in both the bills, the only difference brought in is that in terms of the percentage of control, but the terminology "control" is surely wrongly used. In case of a control, the essence of associate goes away and it establishes a holding subsidiary relationship. Therefore, though the definition explicitly says that there is no holding-subsidiary relationship between the associates but the usage of "control" takes away the substance.

A reading of the definition of associate company under AS-23 clearly brings out the difference between control and participation. Moreover, the said definition excludes joint venture to a considered a part of associate company unlike the present Bill.

Meaning of "Interested Director"

Companies Bill 2009	Companies Bill 2011
(zy) "interested director" means a director who is in any way, whether by himself or through any of his relatives or firm, body corporate or other association of individuals in which he or any of his relatives is a partner, director or a member, interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into by or on behalf of a company;	(49) "interested director" means a director who is in any way, whether by himself or through any of his relatives or firm, body corporate or other association of individuals in which he or any of his relatives is a partner, director or a member, interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into by or on behalf of a company;

Analysis:

On a plain reading of the definition on Interested Director, it would mean that even if a director is a shareholder in the company, he becomes interested.

Meaning of "Net Worth"

Companies Bill 2009	Companies Bill 2011
(zzg) "net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and share premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous	(57) "net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous

expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;	expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

Analysis:

Though both the Bills have the same definition and are in line with the definition in the existing Act, but the entire definition may need a recast once IFRS gets applied, as companies are allowed to use revaluation model for assets – whereby the concept of revaluation reserve disappears. In addition, several financial assets are mandatorily to be valued at fair value and the changes in valuation go to a gain on revaluation, similar to revaluation reserve. The entire definition is anchored to old accounting standards which the world have already bid a good bye and India is doing that soon.

Meaning of "Private Company"

Companies Bill 2009	Companies Bill 2011
(zzp) "private company" means a company which, by its articles,— (i) restricts the right to transfer its shares; (ii) limits the number of its members to fifty: *xxx*	(68) "private company" means a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles,— (i) restricts the right to transfer its shares; (ii) except in case of One Person Company, limits the number of its members to two hundred: *xxx*

Analysis:

The earlier Bill had the text similar to the existing Act; however, the new text increases the limit of number of members from 50 to 200. Not sure, what is the logic behind it and how is it justified of having closely held companies to have such number of shareholders. In case of class action by a member, the minimum number has been fixed to that of 100, and possibly one of the reasons to increase the number of members in case of private company is to get the same at par with the requirement under class action.

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Meaning of "relative"

Companies Bill 2009	Companies Bill 2011
(*zzz*) "relative", with reference to any individual, means the spouse, brother, sister and all lineal ascendants and descendants of such individual related to him either by marriage or adoption;	(77) "relative", with reference to any person, means anyone who is a related to another, if— (i) they are members of a Hindu Undivided Family; (ii) they are husband and wife; or (iii) one person is related to the other in such manner as may be prescribed;
Analysis: The text of the new Bill has replaced the one in the earlier Bill and is completely in line with that of the existing Act. However, the manner of ascertaining a person as related is yet to be prescribed unlike existing Schedule 1A of the existing Act.	

Meaning of "small company"

Companies Bill 2009	**Companies Bill 2011**
(*zzzg*) "small company" means a company, other than a public company,— (*i*) whose paid-up share capital does not exceed such amount as may be prescribed and the prescribed amount shall not be more than five crore rupees; or (*ii*) whose turnover as per its last profit and loss account does not exceed such amount as may be prescribed and the prescribed amount shall not be more than twenty crore rupees: Provided that nothing in this clause shall apply to — (*A*) a holding company or a subsidiary company; (*B*) a company registered under section 4; or (*C*) a company or body corporate governed by any special Act;	(85) "small company" means a company, other than a public company,— (i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or (ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees: Provided that nothing in this clause shall apply to— (A) a holding company or a subsidiary company; (B) a company registered under section 8; or (C) a company or body corporate governed by any special Act;
Analysis: Though a new definition, but the text is different from the earlier Bill. However, the limit of excess amount was not prescribed earlier which has now been fixed to Rs. Fifty lakh in case of paid up capital and Rs. Two crore in case of turnover.	

Look forward to more of it……