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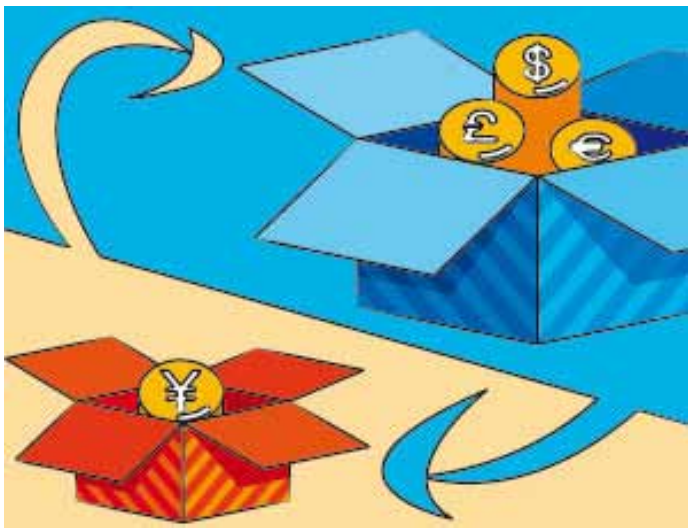
Disclosure of Interest and Related Party Transactions: Some Intricate Issues

The Companies Act, 2013 vide sections 184 and 188 has made elaborate provisions to control related party transactions and ensure that related party transactions are not used as a tool to divert resources and funds of the company for personal benefit of directors or controlling shareholders.

The Companies Act, 2013(the 'Act') at first glance manifests sweeping changes in the corporate governance system of our country and highlights the intention of the Government to change from the control based or regulatory regime to a disclosure based and transparent regime. The Act, amongst other things, focuses on good corporate governance practices, amongst other things, by (i)Increasing the roles and responsibilities of the Board of Directors and Independent Directors,(ii)Protecting shareholders interest, and give them *inter alia* special rights to sue; (iii) Enhancing the disclosures and transparency; (iv) Increasing accountability of company's management and auditors and (v) Encouraging Corporate Social Responsibility (CSR) etc.

The expanded vistas of the disclosure of interest by an interested director which assumes immense importance under the Act is a tool through which board members recognize their fiduciary duty to the shareholders and the company and operate in an accountable and transparent manner so that there is no conflict of interest of a director with his duty considering his fiduciary role *vis-a-vis* the company. The Act, amongst other things, focuses on good corporate governance practices by bringing in a disclosure based regime and built in deterrence through self-regulation. The Act significantly changes the way in which Companies shall be governed.

Section 184 (which is almost similar to its corresponding Section 299 of the Companies Act 1956) relates to newly appointed directors having to disclose their concern or interest in any



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> Section 184 not only supports the directors to have interests in other contracts or arrangements, but also has some strict provisions, which hover over the directors thereby compelling them to do the right thing and follow the best practices.
> If any director does not disclose the interest in the first meeting, the contract/ arrangement shall be voidable at the option of the company and the director would also be subject to punishment of imprisonment and fine.

company, body corporate, firm, association of individuals at the very first meeting of the Board of Directors in which he participates and thereafter by all directors at the first meeting of the Board of Directors in every financial year or at the first meeting following any change in disclosures already made. Further the section also provides for specific disclosures, which have to be made by directors with regard to their direct or indirect concerns or interests (within certain parameters as provided for in the section itself) in respect of contracts or arrangements or any proposed contracts or arrangements being discussed at any board meeting. This section also contains penal clauses in case of defaults on the part of the Directors.

The section's overall scope is very wide as the disclosure of concern or interest by directors is not only the responsibility, but also a duty imposed on the Board of Directors of the company. "Disclosure of interest" is an important information for the Board, the Company and other shareholders, which has to be duly recorded by the Board of Directors under Rule 8(5) of Companies (Meetings of the Board and its Powers) Rules, 2014 under Chapter 12 of the Act and to further enable the Board to pass the requisite resolutions at the meetings of the Board. At the same time, Rule 9(1) and (2) of Companies (Meetings of the Board and its Powers) Rules, 2014 under Chapter 12 of the Act renders the same to be a duty of each Director to duly disclose such concern or interest.

Some clarifications however, are necessary to further elucidate a situation and dispel doubts wherein a contract or arrangement is entered into by a company, without a disclosure of concern or interest by director who is not present at the meeting, or with participation by a director who is interested but not aware of any such interest in any way, directly or indirectly, in the contract of arrangement. In such circumstances, it is possible to take a view that such an interested director may make the disclosure at the first available opportunity, as and when such director becomes aware of the same and the company may then take a decision, as to whether to continue with the contract or arrangement or to declare it void, under its option of contract being voidable.

Sub-section (2) of section 184 emphasizes on the situation wherein if any director holds more that 2% shares in any body corporate, and any other entity in which he is interested directly or indirectly or in which he is a promoter or manager or Chief Executive Officer, individually or together with other directors is bound to make such disclosures as mentioned above. However, as per Rule 16(1)(a) of Companies (Meetings of the Board and its Powers) Rules, 2014 under Chapter 12 of the Act, if a director himself or together with any other director holds less than two Percent of the paid-up share capital, then such a disclosure shall not be required to be entered in the register, wherein every company shall maintain a record of the interest of the Director in any Body Corporate or other entities.

Section 184, nevertheless, has emerged as more stringent than its corresponding Section under the Companies Act, 1956, as it makes any director who contravenes the provisions to be liable for a punishment of an imprisonment for a term that may extend to one year or a fine between Rs. 50,000 to Rs. 1,00,000 to be paid or both.

The basic objective of Section 184 is to enhance transparency in the companies with the disclosures made in the very beginning of the year or time of appointment by their directors and thereafter as required under the Act. This section does not limit the powers of the directors, or creates obstruction in their interests in any contracts or arrangements or proposed contracts or arrangements, but, for the sake of transparency and fairness, conditions them to make disclosures in the first meeting and thereafter, if required. Section 184 not only supports the directors to have interests in other contracts or arrangements, but also has some strict provisions, which hover over the directors thereby compelling them to do the right thing and follow the best practices. If any director does not

There is tremendous emphasis on the approval process for related party transactions. The mandatory code of conduct for independent directors stipulates that they should pay sufficient attention and ensure that adequate deliberations are held before approving RPTs, and assure themselves that the same are in the interest of the company.

disclose the interest in the first meeting, the contract/arrangement shall be voidable at the option of the company and the director would also be subject to punishment of imprisonment and fine. Thus under this Section, the onus of discharge of responsibility lies on the Director and not on the Company.

Another important aspect is that Section 184 in its normal course of action may in relation to a director's direct and indirect interest be read with Section 188 of the Act, which refers to related party transactions.

The term 'Related party' determining this section, as per Section 2 (76) of Companies Act, 2013 includes the primary entities like director or his relative, a key managerial personnel or his relative, a firm wherein director, manager or his relative is a partner, a private company in which a director or manager is a member or director, and likewise others as set out in the section. A related-party transaction can also play a beneficial role by saving transaction costs and improving the operating efficiency of a company on one hand, but on the other hand it could be seriously misused against the interest of the company and to the detriment of public shareholders and other stakeholders, also.

In India, regulations related to Related Party Transactions ("RTPs") are found in the erstwhile Companies Act, 1956, the Companies Act, 2013, the Indian Accounting Standard 18, the Auditors Report Order, and Clause 49 of the Listing Agreement. The Income Tax Act 1961 also contains provisions related to transfer pricing issues on such transactions. Recent changes in Income Tax (domestic transfer pricing), Companies Act, 2013 and Clause 49 are significant steps by regulators towards addressing risks arising from RPTs, that have until now been somewhat inadequately addressed and concern from adverse related party transactions are not particularly redressed. There are some more important issues which also need clarification, particularly in case of companies with captive consumption of raw material and unfinished products in integrated manufacturing complex, controlled by various companies/firms by the same set of shareholders and directors where raw material and semi-finished goods are transferred and used on daily basis for manufacture of final products or for exports. The central government may thus make some rules for mitigating such difficulties. It may be appreciated that such arrangement or transactions are done on daily basis and in such cases it is not possible to obtain Board or shareholders approval in each case separately.

Changes introduced through Clause 49 and Companies Act, 2013 are an attempt to improve the corporate governance framework in India and respond well to the global practices in this regard. These changes have expanded definition of related party; coverage of type of such transactions; have brought in the concept of approval of audit committee or board of directors or the shareholders for all related party transactions. Implementation effectiveness would be result of application of these new regulations by various stakeholders.

The new regime for RPTs seems complex because the definition of 'related party' has changed significantly. The scope of transactions has been significantly enhanced and proposes to cover sale, purchase, and leasing of any property of any kind (including immovable property).

There is tremendous emphasis on the approval process for related party transactions. The mandatory code of conduct for independent directors stipulates that they should pay sufficient attention and ensure that adequate deliberations are held before approving RPTs, and assure themselves that the same are in the interest of the company.

Section 188 provides for the matters that require the consent of Board of Directors of company or prior approval in case of special resolution, which is defined under Section 114 of the Act. It also mentions that the agenda of the Board meeting at which the resolution is proposed to be moved shall disclose the name of the related party and nature of relationship; the particulars and material terms of the contract or arrangement, any advance paid or received for the contract or arrangement, if any, etc. It also mentions that the interested directors cannot participate in case of special resolutions under this section. In this regard, some difficulty

will arise in cases, where same set of directions and shareholders "control" the related parties (i.e. companies/firms). It will be difficult, rather impossible to pass Board or shareholders resolution in such related companies, unless some extra measures are taken, such as appointing more uninterested directors and shareholders for requisite quorum. However, the flexibility of this section is depicted as it also includes that nothing would apply to any transactions entered into by the company in its ordinary course of business other than transactions, whichare not on arm's length basis. 'Arm's length transaction' herein means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest. Another feature depicting flexibility of this Section is that the limit is further marked in Rule 15(3) of Companies (Meeting of the Board and its Powers) Rules 2014 under Chapter 12 of the Act, contracting the paid-up share capital to Rs. 10 Crores. Even though the objective is to make the Act's approach to be sizeable, the line is drawn herewith, as the section seeks to provide that every such contract or arrangement shall be referred to in the Board's report to the shareholders along with the justification. The Arms length transaction, thus are intricate, as such transactions may require some evidence that is tangible in order to prove the bonafide in case of dispute, particularly in class action suit or petition complaining oppression and mismanagementand the same may be true for transaction in ordinary course of business of company.

The liberal character of the section is exhibited by doing away with the approval needed by the Central Government for related party transactions. Under the Act, a company is now allowed to proceed against a director or any other employee for recovery of any loss sustained by it as a result of a contract/arrangement entered into by such person in contravention of the provisions and therefore, the extensive reporting of related party transactions to the regulators and shareholders will entail transparency in the process. Non-executive and independent directors are entitled to immunity from prosecution only when they can demonstrate evidence of due diligence. Companies will have to gear up to face greater scrutiny and questioning by independent directors. The management would have to design a format and structure for recording discussions in Board meetings, which will help in asking the right questions and provide evidence of due diligence as well. This may even lead to class action suit, in case of any dereliction of duty.

A new concept of 'interested member' has been introduced in this section. If an interested member is covered under the definition of 'related party', he/ she cannot vote. This is to check misuse of shareholding power by controlling shareholders, and to prevent stifling of the minority by the majority. Since major transactions have to be approved by shareholders through special resolution, denial of voting rights to interested members would sometime mean approval by majority consisting of the minority shareholders. It may however, be noted that even after passing of necessary resolution, as above, legal actions, such as class action suit or petition for oppression and mismanagement cannot be ruled out completely.

Further under Rule 15 (2) of the Companies (Meeting of the Board and its Powers) Rules 2014 under Chapter 12 of the Act, in case of wholly owned subsidiaries, resolution passed by the parent company shall be sufficient thereby recognizing the corporate democracy of majority rule as applicable to such a subsidiary.

Similar to section 184, this section also puts out itself to be profound, but at the same time restrains the directors from entering into any contract or arrangement not in compliance with the provisions of the section, making it voidable at the option of the Board in case the approving authority does not ratify it. The strictness also bounds the directors under this section by penalizing them for entering into or authorizing any contract or agreement in violation of the provisions in case of listed or unlisted company.

Therefore, the Act, vide Sections 184 and 188 has made elaborate provisions to control such related party transactions and ensure that related party transactions are not used as a tool to divert resources and funds of the company for personal benefit of directors or controlling shareholders. CS

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New Private Placement Norms: A New Regime of Funds Raising by India Inc.

In the light of recent happenings like the one at Sahara, the new Companies Act has incorporated stringent provisions relating to mobilization of funds by corporates by way of private placement and the like. This article makes an incisive evaluation of the new provisions.

PREFACE

It is rightly said that "Money makes the world go around and around……."In today's era, the entire gamut of business's prosperity stands upon the availability of funds… At the right time and at a right place and in right quantum!

For any corporate, when it comes to fund raising, the available means can be equity or debt, depending upon the requirement of fund, size, stage of business, its payout capacity, industry or business risks and so on. A few variations of these two may be quasi-debt instruments such as redeemable preference shares. Substantial amount of debt funds are raised in the form of secured loans from banks and financial institutions, NBFCs, inter-corporate loans and public deposits. However, when it comes to modes of raising funds through issue of securities, the law provides three broad modes for corporates - Public Issues (raising funds from a large and wide range of persons), Rights Issue (or raising money from its existing shareholders on proportionate basis) or Private Placements (or raising money from selected view persons).

Of all the modes, Private Placements have always been one of the most favored modes used by companies. The main reason behind this favouratism is the ease available to companies and their managements, in terms of less legal hassles, choice available for selecting the allottees or amounts to be raised etc. Till the promulgation of Companies Act, 2013, the Companies Act, 1956 and SEBI guidelines and regulations governed and mandated the conditions for private placements, depending upon the nature of the company and their status as to being private limited or public limited or listed ones.

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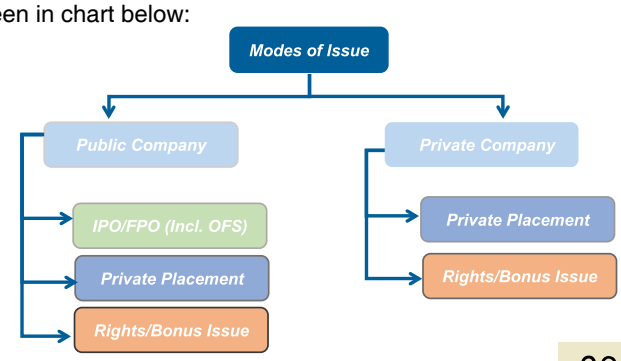
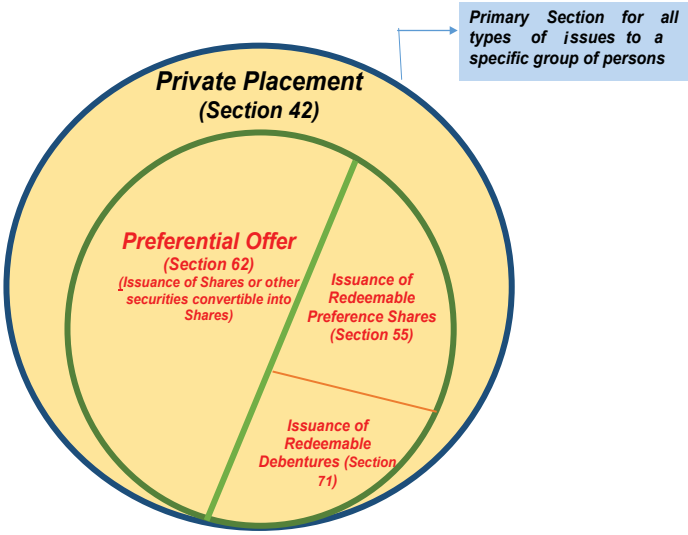
BEGINNING OF A NEW ERA - THE COMPANIES ACT 2013

Under the new Companies Act there are three major sections which governs issue of securities by private placement by any company. First, there is Section 23 which prescribes the modes of issue of securities which a company uses to issue securities. The Private Placement is an available mode for both public as well as private companies. The available modes of issue of securities may be seen in chart below:



Second, there is Section 42, read with the Companies (Prospectus and Allotment of Securities) Rules, 2014, which prescribes detailed procedural guidelines for offer or invitation of securities by way of private placement. The ambit of this section is very wide and covers offer of all kind of securities be it equity shares, convertible preference shares/debentures, redeemable preference shares or debts instruments.

The ambit of Private Placement as per Companies Act, 2013



LEGAL POSITION OF PRIVATE PLACEMENTS:

Before we go any further to discuss the provisions relating to Private Placements under the CA '13, it is necessary to understand the meaning and connotation of the terms that have direct implication on understanding how lawmakers have plugged all the lacunas in the extant legal regime. Until the promulgation of CA '13, the term 'Private Placement' was not defined under any law though the Securities And Exchange Board of India (Issue Of Capital And Disclosure Requirements) Regulations, 2009 ("ICDR Regulations") do define the term "Preferential Allotment" as any allotment to one or more shareholder(s) or person(s) instead of all the existing shareholders.

The Unlisted Public Companies (Preferential Allotment) Rules, 2003 as amended in 2011 provided that:

"Preferential allotment" means allotment of shares or any other instrument convertible into shares including hybrid instruments convertible into shares on preferential basis made pursuant to the provisions of sub-section(1A) of section 81 of the Companies Act, 1956.

For the 1st time in Indian legal history, the term "Private Placement" has been defined under the CA '13. Section 42 of the Act defines

*"**Private Placement**" to mean any offer of securities or invitation to subscribe **securities** to a select group of persons by a company (other than by way of public offer) through issue of private placement offer letter.*

In most simple words, private placement refers to an offer or invitation to subscribe of securities to a select group of people on preferential basis. Meaning thereby, any issue/ allotment other than a Public Issue or a Rights Issue shall be a private placement.

To ensure proper regulation and reporting of issue of all kind of instruments for raising funds by companies the term "securities" has been used in this section in place of shares.

Securities	Securities as defined in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956

As per Clause (h) of Section 2, *Securities include:*

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other investments issued by any collective investment scheme to the investors in such schemes;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and preferable

(iii) rights or interest in securities.

Thus, CA '13 promises better protection of stakeholders by tightening the provisions relating to private placement and creating transparency in the processes. Some of the key provisions, governing Private Placements have been given hereunder:

- Under New Companies Act, at present the process and provisions relating to Private Placement is common for all class of companies, be it private, public or listed company. SEBI has power to prescribe additional procedural or disclosure requirements and may regulate the listed companies.
- An offer of securities or invitation to subscribe securities shall be made through a **private placement offer letter** (in Form PAS-4) to a selected group of persons by a company (other than by way of public offer) only if the proposed offer has been **approved by the shareholders** of the Company, by way of a **Special Resolution.**
- The Explanatory Statement to the General Meeting Notice should contain the **basis or the justification for the**

proposed issue price.

- This Offer Document is needed to be **serially numbered** and addressed specifically to the concerned person. It can be **sent either in writing or in electric mode**, within a time period of 30 days.
- In case the company makes an offer or invitation for **non-convertible debentures**, **the Company may pass a special resolution only once in a year for all the offers or invitations for such debentures during the year.**
- The offer or invitation shall be made to **not exceeding 200 persons in aggregate in a financial year,** individually, for each kind of security (equity share, preference share or debenture). For the calculation of the limit of 200, any offer to Qualified Institutional Buyers or to the employees under a scheme of employee stock option, shall not be considered. **[PAS Rule 14 (2)]**
- Further, it has also been mandated that the **value of such offer or invitation shall not be of less than Rs. 20,000/- of the face value of the securities, per person.[PAS Rule 14 (2)]**
- The above mentioned limit of 200 allottees and Rs 20,000/- Face Value of Investment shall not be applicable to:
  - NBFC Companies; and
  - Housing finance companies;

  Provided they comply with the Regulations made in respect of offers on private placement basis, by RBI or National Housing Board (NHB).

  However, if RBI or NHB have not specified any similar regulations, even such companies would be required to comply with the provisions of these Rules.
- **No fresh offer or invitation of any securities shall be made unless allotments in respect of all earlier offers of any other security are completed.**
- The subscription money may be **paid through cheque or demand draft or other banking channel but not by cash**, that too **only from the proposed allottee's bank account**. In case of joint holders, the payment is needed to be received from the 1st holder's bank account.
- The **allotment of securities should be completed within 60 days of the receiving application money for private placement.** If the company is not able to complete allotment within 60 days, then it shall refund the money within 15 days of the expiry of such 60 days or else repay along with interest @12% p.a. calculated from the sixtieth day.
- **The application money shall be kept in separate bank account** and shall not be utilized for any purpose other than for adjustment against allotment of securities or for repayment of money where the company is unable to allot securities.
- **Complete record** of private placement offers and acceptances shall be maintained by the company in Form PAS 5.
- The Record of Private Placement in Form PAS 5 along with the Form PAS 4 are **needed to be filed with the Registrar of Companies and in case of listed entities, with SEBI, as well, within a period of 30 days of circulation of relevant private placement offer letter.** As per the rules, the date of the private placement offer letter shall be the date of circulation of the offer letter. Under the existing SEBI Regulations on preferential allotment, no documents were required to be filed with SEBI and the Stock Exchanges were the only regulators to give in principle listing approvals. But, pursuant to the CA '13, now the Offer Document would be filed with SEBI as well.
- Issue of any kind of advertisement or utilize any media, marketing or distribution channels or agents to inform the public at large about the offer is prohibited.
- Now the return of allotment shall be filed with the Registrar (in Form PAS 3) by the company making allotment of all kinds of securities including complete list of all the security holders mentioning their full details, including name, address, mail id, date of allotment etc., within 30 days of allotment.

The above requirements and procedural compliances as prescribed in section 42 of CA '13 and Rule 14 of Companies (Prospectus and Allotment of Securities) Rules 2014 are common to all class of securities, be it equity, preference shares or debt instruments. However, the law also prescribes certain additional requirements/ compliances in case the securities being issued are equity shares or securities convertible into equity shares on preferential basis. These additional requirements are prescribed in Section 62 of CA '13 read with Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014.

PREFERENTIAL OFFER OF EQUITY SHARES OR OTHER CONVERTIBLE SECURITIES

As per Explanation to Rule 13 of the Companies (Share Capital

> The lawmakers have clearly demonstrated that preferential offer of equity or convertible securities of any company shall be with proper planning and with full disclosures. Many of the requirements are in line with the provisions of Chapter VII of the SEBI (ICDR) Regulations, 2009. However, in certain aspects especially with regard to disclosures to the proposed allottees through Offer Documents as well as monitoring of money flow, the new Act and rules thereunder has gone far beyond.

and Debentures) Rules, 2014, 'Preferential Offer' means an issue *of shares or other securities*, by a company to any select person or group of persons on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities.

It is pertinent to note that "Shares or other securities" mean equity shares, fully convertible debentures, partly convertible debentures or any other securities, which would be convertible into or exchanged with equity shares at a later date.

For issuance of equity shares or other securities convertible into equity on preferential basis, in addition to the requirements of Section 42 as discussed above, companies are required to comply with the provisions of Section 62 as well as Rule 13 of Companies (Share Capital and Debentures) Rules, 2014. Where the preferential offer of shares or other securities is being made by any listed entity then the provisions of Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014 shall not be applicable but such companies shall comply with SEBI prescribed Regulations in this respect.

THE KEY PROVISIONS GOVERNING PREFERENTIAL OFFER HAVE BEEN GIVEN HEREUNDER:

- The offer must be authorized by Articles of Association of the Company
- Prior approval of Shareholders is required to be obtained *via* Special Resolution for issuance of shares on preferential basis
- No partly paid securities shall be issued
- Allotment to be made within 12 months from the date of Special Resolution
- Mandatory disclosures in the Explanatory Statement to the Notice calling General Meeting, *inter-alia*, includes the following:
  a) Object of the issue
  b) intention of the promoters, directors & KMPs
  c) Change in control, if any, consequent to the preferential offer
  d) Justification for the allotment proposed to be made for consideration other than cash
  e) Details of the proposed allottees along with post preferential shareholding
  f) Basis on which price is arrived along with the report of ***Registered Valuer***

Till the time provision related to an independent valuer are not notified, valuation can be done by an Independent Merchant Banker or by Independent Chartered Accountant in Practice having minimum experience of 10 years. (as amended on 18.06.2014).

In light of the aforesaid provisions, it can be construed that the lawmakers have clearly demonstrated that preferential offer of equity or convertible securities of any company shall be with proper planning and with full disclosures. Many of the requirements are in line with the provisions of Chapter VII of the SEBI (ICDR) Regulations, 2009. However, in certain aspects especially with regard to disclosures to the proposed allottees through Offer Documents as well as monitoring of money flow, the new Act and rules thereunder has gone far beyond.

ISSUANCE OF REDEEMABLE PREFERENCE SHARES

In line with the erstwhile provisions, the CA'13 prescribes the issuance of Redeemable Preference Shares for ***the maximum term of 20 years.*** The Rule 10 of Companies (Share Capital and Debentures) Rules, 2014 allows companies who are primarily engaged in the business of setting up and dealing with infrastructure projects to issue preference shares redeemable ***within 30 years*** provided an option to redeem minimum 10 percent of such preference shares per year be given to such preference shareholders from the 21st year onward or earlier.

Some of the key provisions, governing issuance of Redeemable Preference Shares have been given hereunder:

- Prior approval of shareholders *via* Special Resolution is required for issuance of Redeemable Preference Shares
- Enhanced disclosure requirement in the Explanatory Statement to the Notice calling General Meeting of the Shareholders
- Specific requirement of making disclosures of certain parameters in the shareholders' resolution that have a direct bearing on the interest of shareholders
- Maintenance of Register in respect of such preference shareholder(s) in terms of Section 88 of the CA'13.

ISSUANCE OF REDEEMABLE DEBENTURES

Some of the key provisions, governing issuance of Redeemable Debentures have been given hereunder:

- The Company may issue secured Debentures for a tenure not exceeding 10 years. Rule 18 of Companies (Share Capital and Debentures) Rules, 2014 as amended on 18.06.2014 allows following class of companies to issue redeemable debentures with a tenure exceeding 10 years but up to 30 years:
  - Companies engaged in Infrastructure Projects
  - Infrastructure Finance Companies
  - Infrastructure Debt Fund Non-Banking Financial companies
  - Such issue shall be secured by the creation of a charge on the properties and assets of the Company having sufficient value to repay the debentures and interest thereon
- Creation of Debentures Redemption Reserve (DRR) out of the profits of the Company available for payment of dividend, equivalent to atleast 50% of the amount raised through the Debenture issue before debenture redemption commences
- DRR to be utilized only for the redemption of Debentures
- Every Company required to create DRR shall on or before the 30th day of April in each year, invest or deposit, a sum constituting 15% or more of the amount maturing during the year ending on 31st March of succeeding year, in any one or more of the following modes:
  (a) Deposits with any scheduled bank, free from any charge or lien
  (b) Unencumbered securities of the Central Government or State Government
  (c) Permissible unencumbered securities and bonds under Section 20 of the Indian Trusts Act, 1882
- The amount so deposited or invested as above shall be utilized only for redemption of matured debentures

PENAL PROVISIONS FOR CONTRAVENTION WITH THE STIPULATIONS OF PRIVATE PLACEMENTS

The new Act has drastically increased the penal provisions relating to an offer or accepts monies in contravention with the provisions of Section 42, its promoters & directors shall be liable for a penalty which may extend to:

(a) The amount involved in the offer or invitation; or
(b) Rupees 2 Crores,
} whichever is higher

And

The Company shall also refund all monies to subscribers within 30 days of the order imposing the penalty.

> The CompaniesAct, 2013is likely to curb malpractices in private placement and also ensure greater coordination between SEBI and MCA by regulating such offers

BACKGROUND AS TO WHY THE NEED ARISES FOR FRAMING THE STRINGENT PRIVATE PLACEMENT NORMS

In the extant legal regime, there existed certain grey areas, which were being misused from time to time, by the companies and their promoters, thereby compromising the interest of innocent stakeholders. The highlights of the private placement provisions under Companies Act, 1956 and its impact on the economy as a whole are outlined as follows:

- No specific provisions on private placement existed in the Act of 1956, apart from the requirements of Section 81(1A). Beyond this, unlisted companies were required to follow Unlisted Public Companies (Preferential Allotment) Rules, 2003 as amended in 2011 while listed companies were required to follow the guidelines or regulations of SEBI. However, these were applicable to only public companies that to only in relation to the issue of equity shares or convertible securities.
- Section 67(3) of the Companies Act, 1956 did put a restriction on the number of persons to whom the shares shall be allotted under single offer or invitation on preferential basis to 49. While a private placement could have been made only to a maximum of 49 persons at one go, but there existed no provision to prevent companies from convening multiple board meetings to approve such allotments. As a result, companies started calling several meetings and made allotments to 49 allottees at each such meeting, thereby manipulating the law.
- Apart from the above mentioned provisions, Companies Act 1956 was primarily silent as to determination of issue price, collection and utilization of money, disclosures to the proposed allottees etc.To quite an extent, it was this 'no legal provision' regime, which led to cases like Sahara and many others, not even known, to happen, thus resulting in loss of public money, amounting to thousands of crores of rupees and loss of investor confidence.

We all are very well aware about the case of Sahara group who raised crores of rupees from the public, through private placement of optionally fully convertible debentures. Over the last two years, the controversy over the money raised by Sahara group companies played out with the market regulator SEBI where it termed the said funds raised as 'private placement' and beyond the jurisdiction of SEBI. The regulator ordered the Sahara group companies – Sahara India Real Estate Corporation (now known as Sahara Commodity Services Corporation Ltd) and Sahara Housing Investment Corporation to refund Rs. 19,400 crore raised from 2.21 crore investors. The Sahara group companies stated that the funds were raised through private placement of optionally fully convertible debentures, which were outside the definition of 'securities' specified in SEBI regulations. These companies also contended that since they were unlisted companies, the issue of these debentures was outside the jurisdiction of SEBI. SEBI, however contended that the method of raising capital violated various regulations and given that the offer was made to more than 50 persons at a time, it could not be termed as a private placement and was required to abide with the conditions prescribed by SEBI for such issuance. The Securities Appellate Tribunal (SAT) and the Supreme Court has also upheld the SEBI order regarding refunding money to investors.

While Sahara was a high profile case, and came to lime light, the Regulators realized that there must have been several other instances as well, where companies have manipulated and misused laws and regulations on private placement.

Thus, to plug all the loopholes that existed under the extant 1956 Act, the legislature thought it prudent to make stringent conditions, so that the managements are left with no excuses to flout the laws. Accordingly, the Regulators have come out with various Amendments, including the promulgation of Companies Act 2013 (CA '13/ the Act).

HOW CA '13 ENSURES GOVERNANCE REGIME?

- The Companies Act, 2013 is likely to curb malpractices in private placement and also ensure greater coordination between SEBI and MCA by regulating such offers.
- Provisions of the Act that will curb malpractices are as under:
  - **Use of term 'securities' instead of 'shares'** - Use of the term shares in the Companies Act, 1956 restricted regulations of issuances of various other instruments by Company to raise funds. **Companies manipulated this loophole by using other terminology or nomenclature for instruments used to raise funds, thereby easily escaping the regulatory oversight.** Having understood the practices, the government decided to cover issue of all types of securities in the Companies Act and thus minimize the chances of manipulation.
  - **Restriction on number of persons to whom a private placement offer can be made in a financial year** –The number of persons to whom invitation or offer for private placement can be made in a financial year has been restricted to 200 in aggregate for a financial year, with an

investment size of not less than Rs 20,000/- face value has been mandated.

- **Use of banking channels for private placement:** Since the subscription money will have to be paid through a cheque or demand draft or other normal banking channels, opportunities to launder money will go down.
- **Requirement to complete allotment in 60 days:** It has been specified that allotment under private placement should be made within 60 days of receiving the application money. This proposal will curb a common practice under which companies used to accept funds as application money without adequately complying with rules and regulations for accepting deposits. These companies would accept application money from any person, use the money for various purposes and then refund them, as there was no time-table for allotment of shares or refund of funds raised.
- It has been specifically provided that where the private placement does not comply with the provisions of the Act, it shall be treated as a public offer and that all provisions of the Securities Contracts (Regulation) Act 1956 and SEBI would apply. This will ensure greater coordination between the two regulators.

MAJOR CONCERN OF THE CORPORATES WITH THE PROMULGATION OF NEW REGIME

1. Nowadays, one of the major dilemmas that Corporate Houses are facing as to how to deal with the application money outstanding in the books of accounts as on 1st April, 2014?

   As per Section 42(6) of the CA'13, "a company making *an offer or invitation under this section* shall allot its securities within *sixty days from the date of receipt of the application money* for such securities and if the Company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the date of completion of sixty days and if the Company fails to repay the application money within the aforesaid period, it shall be liable to repay the money with interest at the rate of twelve percent per annum from the expiry of the sixtieth day".

   Similarly, the new law requires the application money received pursuant to private placement to be kept in a separate account and to be used only after allotment for appropriation against the securities so issued or for refund if no allotment is made.

   These above two obligations are practically not possible to comply with, in case the application money is already in the books as on 1st April 2014. Similarly, there is no possibility of preferential allotment against unsecured loans outstanding as on 1st April 2014 due to these mandatory requirements.

   The cardinal principle of harmonious construction as well as Clause 6 of General Clauses Act, 1897 clearly states that unless a different intention appears, the repeal or replacement of any law shall not affect any right, privilege, obligation or liability acquired, accrued or incurred under any enactment so repealed.

   On applying the principles of harmonious construction, it can be construed that the intent of the statute is to regulate the private placements made under this Act and not the application money received under old law. However, keeping in view the provisions of sections 23, 42 and 62 read with rules made thereunder the companies are finding it impossible to comply with these requirements when the money had come much before and are already used. The hardship is more genuine to the private companies, which were totally unregulated.

2. Under Section 42(7), a requirement has been included that in case of private placement, offer shall be made only to such persons whose names are recorded by the company prior to invitation to subscribe, and such persons should receive the offer in their name. It may be practically very difficult to undertake Qualified Institutional Placements under the SEBI ICDR Regulations, due to this requirement.

3. SEBI presently allows listed Companies to issue option warrant which gives holders to subscribe equity shares within 18 months. However, Companies Act, 2013 indirectly restricts the issuance of such warrants as the term securities does not explicitly cover these warrants. In such a scenario, whether the listed entities can still opt for issuance of warrants convertible into Equity Shares within a span of 18 months? Would it not tantamount to outstanding share application money? If so, then the warrants would require to be converted within 60 days instead of 18 months.

4. From the perspective of timing and ease of capital raising *via* private placement route, the requirement of offer letter is onerous, especially in case of very small number of allottees and for private companies which tend to make allotments to its promoter, directors and their relatives and friends who are very well aware about the Company and its prospects.

Besides the above few concerns, the new law relating to private placement is quite forward looking and encompasses the basic concept of high level of corporate governance and transparency which the legislature has tried to inculcate in the functioning of India Inc. through this new Companies Act. The Act gives sufficient power to the Central Government to regulate and manage companies through rules in this every dynamic corporate environment. It is well expected that the government shall take necessary measures to modify/clarify the provisions wherever there is genuine hardship to the industries. CS

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Compounding of Offences – Companies Act, 2013

As in the Companies Act, 1956, the new Act of 2013 also has provisions enabling compounding of certain offences. The new provisions, certain guidelines propounded by the Courts under the earlier law and the procedural aspects relating to application for compounding have all been briefly explained here.

The provisions pertaining to compounding of offences, under the new Companies Act, 2013, is given in Section 441. The provisions of section 441, for easy reference, are reproduced herein below:-

441. (1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), any offence punishable under this Act (whether committed by a company or any officer thereof) with fine only, may, either before or after the institution of any prosecution, be compounded by –

(a) the Tribunal; or

(b) where the maximum amount of fine which may be imposed for such offence does not exceed five lakh rupees, by the Regional Director or any officer authorized by the Central Government, on payment or credit, by the company or as the case may be, the officer, to the Central Government of such sum as that Tribunal or the Regional Director or any officer authorized by the Central Government, as the case may be, may specify:

Provided that the sum so specified shall not, in any case, exceed the maximum amount of the fine which may be imposed for the offence so compounded:

Provided further that in specifying the sum required to be paid or credited for the compounding of an offence under this sub-section, the sum, if any, paid by way of additional fee under sub-section (2) of Section 403 shall be taken into account:

Provided also that any offence covered under this sub-section by any company or its officer shall not be compounded if the investigation against such company has been initiated or is pending under this Act.

(2) Nothing in sub-section (1) shall apply to an offence committed by a Company or its officer within a period of three years from the date on which a similar offence committed by it or him was compounded under this section.

Explanation: For the purposes of this section, -

(a) any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence;

(b) "Regional Director" means a person appointed by the Central Government as a Regional Director for the purposes of this Act.

(3) (a) Every application for the compounding of an offence shall

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be made to the Registrar who shall forward the same, together with his comments thereon, to the Tribunal or the Regional Director or any officer authorized by the Central Government, as the case may be.

(b) Where any offence is compounded under this section, whether before or after the institution of any prosecution, an intimation thereof shall be given by the company to the Registrar within seven days from the date of which the offence is so compounded.

(c) Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, either by the Registrar or by any shareholder of the company or by any person authorized by the Central Government against the offender in relation to whom the offence is so compounded.

(d) Where the compounding of any offence is made after the institution of any prosecution, such compounding shall be brought by the Registrar in writing, to the notice of the Court in which the prosecution is pending and on such notice of the compounding of the offence being given, the company or its officer in relation to whom the offence is so compounded shall be discharged.

(4) The Tribunal or the Regional Director or any officer authorized by the Central Government, as the case may be, while dealing with a proposal for the compounding of an offence for a default in compliance with any provision of this Act which requires a company or its officer to file or register with, or deliver or send to, the Registrar any return, account or other document, may direct, by an order, if it or he thinks fit to do so, any officer or other employee of the company to file or register with, or on payment of the fee, and the additional fee, required to be paid under section 403, such return, account or other document within such time as may be specified in the order.

(5) Any officer or other employee of the company who fails to comply with any order made by the Tribunal or the Regional Director or any officer authorized by the Central Government under sub-section (4) shall be punishable with imprisonment for a term which may extend to six months, or with fine not exceeding one lakh rupees, or with both.

(6) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), -

(a) any offence which is punishable under this Act, with imprisonment or fine, or with both, shall be compoundable with the permission of the Special Court, in accordance with the procedure laid down in that Act for compounding of offences;

(b) any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.

(7) No offence specified in this Section shall be compounded except under and in accordance with the provisions of this Section.

NATURE OF OFFENCES WHICH CAN BE COMPOUNDED

2. The offences, which are punishable with fine, only can be compounded either by Regional Director (hereinafter called "RD") or by the National Company Law Tribunal (hereinafter called NCLT). In other words, the offences, which are punishable with imprisonment only or imprisonment and also with fine cannot be compounded. Further, the offences punishable with imprisonment or fine or with imprisonment or fine or both, shall be compoundable with the permission of the Special Court as provided under Clause (a) of Sub-Section (6) of Section 441 of the Act.

WHERE PETITION SHALL LIE

a) If the fine does not exceed Rs. 5 lakhs, the offence can be compounded by the RD or any other officer as may be authorized by the Central Government.

b) If the offence is punishable with fine exceeding Rs 5 lakhs, the same can be compounded by the NCLT.

c) Any offence punishable with imprisonment or fine or with imprisonment or fine or with both shall be compoundable with the permission of Special Court.

3. A detailed "Table" indicating the sections, subject matter, amount of fine imposable by the Authority/Tribunal/Special Court before whom the petition shall lie, is given separately as per **ANNEXURE-I.**

RESTRICTION ON COMPOUNDING

4. The third proviso to sub-section (1) of Section 441 says that

(a) The offence cannot be compounded in case either the investigation has been initiated or is pending.

(b) The offence cannot be compounded in case similar offence committed has been compounded and period of three years has not expired.

(c) Any offence which is punishable under this Act with imprisonment only or with imprisonment and also with the fine; cannot be compounded.

> The Third proviso to Section 441 of Companies Act, 2013 says that in case where either the investigation has been initiated or is pending, the offence cannot be compounded. However, in Section 621A of Companies Act, 1956, there was no such embargo.

WHAT IS NEW IN SECTION 441

5. The "Third" proviso to Section 441 of Companies Act, 2013 says that in case where either the investigation has been initiated or is pending, the offence cannot be compounded. However, in old Section 621A of Companies Act, 1956, there was no such embargo. In other words, offence could have been compounded notwithstanding the fact that either the investigation has been ordered or is pending against the company.

   Explanation (a) to Sub-Section (2) of Section 441:

   After the expiry of three years from the date of compounding of offence, if the second or subsequent offence had been committed, the same shall be treated as the first offence.

HOW THE APPLICATION TO BE MADE

6. As per sub-section 3(a) of Section 441, every application of compounding of offence shall be made to the Registrar of Companies, who, in turn, shall forward the same along with his comments to the NCLT or RD or any other officers, as may be authorized by the Central Government for the purpose of adjudication. There is no change under the new provisions.

CONSIDERATION TO BE KEPT IN MIND WHILE LEVYING FINE

7. The Delhi High Court in the case of *N C Bakshi* v. *Delhi District & Cricket Association Ltd* 2013(112) CLA 347 Delhi, has observed as under:-

   Since the offence was committed by the company for the breach of the conditions of the license granted to the company under Section 25 of the Companies Act, Section 629A of the Companies Act rightly stood attracted. No specific penalty having been provided for contravention of sub-section (5) with regard to the conditions and regulations of the licence; accordingly the Company and its officers shall in default be punishable under Section 629A; Section 629A not creating any offence but only providing a penalty for such contravention of the Act for which no specific penalty is provided.

   Discretion was properly exercised by the CLB in imposing a penalty of Rs. 1,00,000/- on the company and Rs. 50,000/- on each of the members of the Council who had paid remuneration/honorarium to its members without prior approval of the Central Government. It was a fair exercise of the its discretion based on reasoned findings..

8. The Delhi High Court in the case of *Prayaga Construction India (P) Ltd* v. *Competent Holding (P) Ltd* MANU/DE/4910/2012 has held that where compounding petition under Section 621A of the Companies Act, 1956 is pending before CLB/RD, the Scheme of Merger/Amalgamation under Section 391 of the Companies Act, 1956 could be sanctioned/approved.

9. The Company Law Board in the case of *M/s Reliance Industries Limited* cited as MANU/CL/0010/1997 has observed as under:-

   I have considered the various submissions made. From the facts stated it is clear that there is a failure on the part of the company to deliver share certificates lodged for registration of transfer within two months of their lodgment and thus the company, RCS, and the aforesaid officers of the company have rendered themselves liable for penal action under Section 113(2) of the Companies Act. The filing of the compounding application itself implies admission of default by the applicants. It is noted that the Company Law Board is empowered under Section 621A of the Companies Act to compound the offence wherein default is punishable with fine. In the case of a default under Section 113(1) of the Companies Act, 1956, read with Section 113(2) of the said Act, the company and every officer in default is liable for fine.

10. The Company Law Board in the case of *Amadhi Investment Ltd* 2009(149) Comp Cas, 612 has made the following observations:-

    Taking into consideration the submissions of counsel for the petitioner, I am of the opinion that neither the Registrar of Companies nor the Central Government or SEBI have discretion to reject the compounding request made by accused officers in default. I agree with the opinion expressed in the book "Guide to the Companies Act by A. Ramaiya" where it is stated that discretion to purchase peace by compounding of offence or face prosecution and prove innocence in the court of law, is with the accused officers in default and once they opt for a particular posture neither the government nor the Registrar of Companies has any chance except to go with their decision.

11. The Delhi High Court in the case of *VLS Finance Ltd* v. *Union of India* 2005(123) Comp Cas 433 = MANU/DE/1001/2003 has observed as under:-

> Section 441(6)(a) of the Act says that offences punishable with imprisonment or fine or with imprisonment or fine or with both, shall be compoundable with the permission of Special Court, in accordance with the procedure laid down in that Act for compounding of offence. It is not clear as to which Court or Authority will compound such offences.

Therefore, it appears from the aforesaid provisions that an offence committed by a company or any officer not being an offence punishable with imprisonment only or imprisonment and also with fine can be either before or after institution of any prosecution compounded by the Company Law Board. The criminal court is also invested with a similar power to compound an offence as provided for under sub-section (7), after institution of a prosecution.

Almost an identical issue came up for consideration before the Company Law Board in Hoffland Finance Ltd., In re., which is reported in 1997 Comp Cas (Vol.90) 38. After taking notice of the various relevant provisions including that of Section 621A, the Company Law Board held as follows:

"The position which emerges from the above discussion is that, sub-section (1) confers powers on the Regional Director to compound offences punishable with fine only subject to certain limitation. It confers powers on the Company Law Board to compound offences which are punishable with fine only, those punishable with fine or imprisonment and those which are punishable with fine or imprisonment or with both, and sub-section (7) confers upon the court, concurrent jurisdiction to compound offences which are punishable with fine or imprisonment or both and that while the Company Law Board/Regional Director would follow the procedure laid down in the Companies Act, the court will follow the procedure laid down in the Criminal Procedure Code.

Accordingly, we hold that the exercise of powers by the Company Law Board under 621A(1) is independent of exercise of powers by the court under sub-section (7), and all offences other than those which are punishable with imprisonment only or with imprisonment and also fine, can be compounded by the Company Law Board without any reference to sub-section (7), even in cases where the prosecution is pending in a criminal court."

12. An interesting question has arisen as to whether the CLB can compound the offence under the Companies Act, 1956 without the consent of the Court, where the prosecution has been filed by the SEBI for violation of Companies Act, 1956 and prosecution is pending before Court, the CLB has negatived the contention of Counsel for SEBI and held as under:-

    In the light of the above settled legal position, I am unable to appreciate and accept the contentions of learned counsel for SEBI that the CLB would have no jurisdiction to compound offences punishable with imprisonment or fine or with both, in view of Sub-section (7) of Section 621A, which confers jurisdiction exclusively upon the criminal court and that the criminal court has already assumed jurisdiction with initiation of the prosecution for such offences and therefore do not merit any consideration. Accordingly, this issue is answered in the affirmative.

POST COMPOUNDING OBLIGATION

13. Wherein the offence has been compounded, either before or after the institution of any prosecution, an intimation shall be given to the Registrar of Companies within seven days from the date on which, the offence is so compounded. In case the offence has been compounded before the institution of any prosecution, no prosecution shall be filed either by ROC or by any shareholder or by any person authorized by the Central Government. It is needless to point out that the period of seven days shall be reckoned with from the date on which the order is made available to the petitioner/applicant.

14. The Section 441(6)(a) of the Act says that the offences punishable with imprisonment or fine or with imprisonment or fine or with both, shall be compoundable with the permission of Special Court, in accordance with the procedure laid down in that Act for compounding of offence. It is not clear as to which Learned Court or Authority will compound such offences because the Sub-Section (6) says permission from Special Court but which Learned Court or Authority will compound such offence, in my humble and respectful view, is not clear. The sub-section (6) only envisage permission from Special Court and it does not envisage compounding by the Special Court – otherwise the language in sub-section (6) would have compoundable by the Special Court instead of permission by Special Court as the word "compoundable" by NCLT or RD has been used in Sub- Section (1) of Section 441. Ideally speaking, it would have been better if the NCLT would have been made single competent authority to compound the offences instead of Regional Director who neither have judicial bent of mind nor adequate judicial time to deal with such cases and matters remain pending for fairly long time.

ANNEXURE-I

LIST OF COMPOUNDABLE OFFENCES UNDER THE COMPANIES ACT, 2013		
Offences compoundable by Regional Director	Offences compoundable by the NCLT	Offences compoundable by Special Court
11(2) - Failure of company in complying with the requirements relating to commencement of business.	**8(11)** - default in complying with the requirements relating to formation of companies with charitable objects etc.	**8(11) -** Default in complying with the requirements relating to formation of companies with charitable objects etc.
16(3) - Default of company in complying with the directions issued under sub-section (1) relating to rectification of name of company.	**40(5) -** Default of company in complying with the provisions of this section relating to securities to be dealt with in stock exchanges.	**26(9) -** Contravention of provisions relating to issue of a prospectus.
26(9) - Violations of provisions relating to issue of a prospectus.	**46(5)** - Fraudulently issuing duplicate share certificates by a company.	**40(5) -** default in complying with the provisions of this section relating to securities to be dealt with in stock exchanges.
53(3) - contravention of provisions relating to issue of shares at discount.	**66(11) -** Default in publishing the order of confirmation of the reduction of share capital by the Tribunal.	**48(5)** - Failure in complying with the provisions regarding variation of shareholders' rights.
56(6) - Failure of company to comply with the provision relating transfer and transmission of securities under sub-section (1) to (5).	**67(5)** - Default in complying with provisions relating to purchase by company or loans by company for purchase of its own shares.	**53(3) -** Contravention of provisions relating to issue of shares at discount.
59(5) - Default in complying with the orders made by Tribunal relating to rectification of register of members.	**74(3)** - Failure to repay the deposit or part thereof or any interest thereon within the time prescribed or such further time as may be permitted by the Tribunal.	**59(5) -** Failure in complying with the order of Tribunal relating to rectification of register of members.
64(2) - Default in filing a notice related to alteration, increase or redemption of share capital along with the altered memorandum with the Registrar.	**117(2)** - Failure in filing with the Registrar the copy of notice or agreement within stipulated time.	**68(11) -** If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board relating to buy back of securities.
67(5) - Contravention of provisions relating to purchase by company or loans by company for purchase of its own shares.	**124(7) -** Default in transfer of amount of accumulated profits to unpaid dividend account and violating other provisions of section 124.	**71(11) -** default in complying with the order of Tribunal relating to redemption of debentures.
68(11) - Failure in complying with the provisions of this section or any regulation made by the Securities and Exchange Board relating to buy back of securities.	**143(15) -** Failure of auditor to intimate to Central Government regarding fraud against the company by officers or employees.	**74(3) -** If a company fails to repay the deposit or part thereof or any interest thereon within the time specified or such further time as may be allowed by the Tribunal.
86 - Violation of any provision relating to Registration of Charges (Chapter VI).	**185(2) -** Contravention of the provisions of sub-section (1) relating to loans, guarantee or security.	**86 -** Contravention of any provision of Chapter VI relating to registration of Charges.
88(5) - Failure to maintain register of members/debenture-holders/ other security holders as as may be prescribed.	**245(7) -** Committing default in complying with the order of Tribunal under this section.	**92(5) -** Failure to file annual return before the expiry of the period specified under section 403 with additional fee.
89(5) - Failure to file declaration not holding beneficial interest in any share.	**314(8) -** Default in complying with the provisions of this Section except sub-section (5).	**128(6) -** Failure to keep proper books of account.
89(7) - Failure to file return relating to beneficial interest in any share before the expiry of the time specified U/S 403(1)(i) proviso.	**316(2)** - Failure to send quarterly report on winding up and call meeting by company liquidator.	**129(7) -** Failure to keep proper financial statement.
92(6) - If a company secretary in practice certifies the annual return not in conformity with the requirements of this section or the rules made there under.		**134(8)** - Default in complying with the provisions regarding financial statement and Board's report.

LIST OF COMPOUNDABLE OFFENCES UNDER THE COMPANIES ACT, 2013		
Offences compoundable by Regional Director	Offences compoundable by the NCLT	Offences compoundable by Special Court
99-Default in holding a meeting of the company u/s 96 /97 /98 or in complying with any directions made by the Tribunal.		**137(3) -** Failure to file financial statements with the Registrar.
102(5)- Default in complying with the provisions of this section relating to statement to be attached to the notice.		**147(1) -** Failure of company to comply with the provisions of sections 139 to 146 with regard to auditors.
105(3)- If default is made in complying with sub-section (2) pertaining to proxies.		**159 -** Contravention of the provisions u/s 152, 155 and 156.
105(5) - If invitations to appoint as proxy a person or one of a number of persons specified in the invitations are issued.		**167(2) -** Functioning as a director after vacation of office.
121(3)-Failure to file Report on annual General meeting.		**178(8)** - Default in complying with the provisions u/s 177 & of this section relating to Committees like Nomination, Remuneration and Stakeholders Relationship committee.
124(7) - Failure to transfer the amount of accumulated profits to unpaid dividend account and violating other provisions of section 124.		**184(4) -** Failure to disclose of director's interest and Participation in Board meeting by interested director.
137(3) - Failure to file financial statements with the Registrar.		**185(2) -** Contravention of the provisions of sub-section (1) relating to loans, guarantee or security.
140(3) - Non-Compliance by auditor of sub-section (2) relating to filing of resignation information.		**187(4) -** Contravention of the provisons of this section relating to investment of company held in its name.
147(1) - Failure of company to comply with provisions of sections 139 to 146 with regard to auditors.		**188(5)(i) -** Contravention of this section relating to Related party transaction in case of listed Company.
157(2) - Failure to furnish DIN to Registrar.		**194(2) -** Forward dealing in Securities of the company by Key Managerial personnel or director.
165(6) - Acting as a director of more than 20 companies.		**195(2) -** Contravention of this section (195) relating to Insider trading of securities by Key Managerial personnel or director.
166(7) - Default in complying with the provisions of this section relating to directors duties.		**221(2) -** Any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1).
172 - Contravention of the provisions of Chapter XI relating to appointment and qualifications of directors.		**222(2) -** Securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1).
178(8) - Default in complying with the provisions of section 177 & of this section relating to Committees like Nomination, Remuneration and Stakeholders Relationship Committee.		**232(8)** - Contravention of the provisions by the transferor and transferee company in case of merger or amalgamation.
188(5)(ii) - Related party transaction in case of other company.		**242(8) -** Contravention of the order of Tribunal relating to alterations in memorandum or articles.

LIST OF COMPOUNDABLE OFFENCES UNDER THE COMPANIES ACT, 2013		
Offences compoundable by Regional Director	Offences compoundable by the NCLT	Offences compoundable by Special Court
186(13) - Contravention of the provisions of this section relating to loans and investment.		**243(2) -** Acting as managing or other director or manager, whose agreement has been terminated or set aside.
187(4) - Contravention of the provisions of this section relating to investment of company held in its name.		**274(4)** - Failure to file statement of affairs.
191(5) - Contravention of the provisions of this section relating to payment to director for loss of office in connection with transfer of property.		**284(2)** - Failure to extend full cooperation to the company liquidator.
197(15) - Contravention of the provisions of this section relating to managerial remuneration in case of absence or inadequacy of profits.		**305(4)** - Without reasonable grounds giving declaration of solvency in case of proposal to wind up voluntarily.
203(5) - Contravention of the provisions of this section relating to appointment of Key Managerial personnel.		**306(5)** - Default in calling the meeting of the creditors; to prepare a statement of the position of the company's affairs alongwith a list of creditors, estimated amount of claim and filing the resolution with Registrar.
204(4) - Contravention of the provisions of this section relating to Secretarial Audit for bigger companies.		**347(4)** - contravention of any rule framed or an order made under sub-section (3).
206(7) - Failure to furnish any information during inspection or inquiry.		**348(7) -** Wilful default by company liquidator.
221(2) - Any removal, transfer or disposal of funds, assets, or properties of the company in violation of the order of the Tribunal under sub-section (1).		**392** - Contravention of the provisions of Chapter XXII by a foreign company.
222(2) - securities in any company are issued/ transferred/acted upon in violation of an order of the Tribunal under sub-section (1).		**405(4) -** Failure to furnish information or statistics etc. by the companies required by the Central Government.
232(8) - Contravention of the provisions by the transfer and transferee company in case of merger or amalgamation.		**441(5) -** Failure to comply with the order made by Tribunal or Regional Director in relation to Compounding of offences.
238(3) - Failure to register the offer of Schemes involving transfer of shares.		**454(8) -** Failure to pay the penalty imposed by the adjudicating officer or Regional Director.
242(8) - Contravention of the order of Tribunal relating to alterations in memorandum or articles.		
247(3)(*Proviso*) - Contravention of the provisions of this section by the valuer.		
249(2) - Filing of application in restricted cases for removal of name.		
302(4) - default by official liquidator in forwarding a copy of the order of dissolution of company by tribunal within the period specified in sub-section (3).		

LIST OF COMPOUNDABLE OFFENCES UNDER THE COMPANIES ACT, 2013		
Offences compoundable by Regional Director	Offences compoundable by the NCLT	Offences compoundable by Special Court
306(5) - Default in calling the meeting of the creditors; to prepare a statement of the position of the company's affairs along with a list of creditors, estimated amount of claim and filing the resolution with Registrar.		
307(2) - Default in publication of resolution to wind up voluntarily.		
312(2) - Failure to give notice of appointment of Company Liquidator to Registrar.		
314(5) - Failure to prepare quarterly statement of accounts by company liquidator in voluntary winding up and file with the Registrar under sub-section (5).		
318(8) - Failure to complying with the provisions of this section relating to final meeting and dissolution of company.		
342(6) - Failure or neglect to give assistance required under sub-section (5).		
344(2) - Failure to give statement that the company is in liquidation.		
348(6) - Contravention of the provisions of information as to pending liquidation.		
356(2) - Failure to file certified copy of the order of Tribunal relating to dissolution of company void with the Registrar.		
392 - Contravention of the provisions of Chapter XXII by a foreign company.		
405(4) - Failure to furnish information or statistics etc. by the companies required by the Central Government.		
450 - No specific penalty or punishment is provided in the Act.		
451 - Repeated default within 3 years.		
452(1) - Punishment for wrongful withholding of property.		
453 - Improper use of the words "limited" and "private limited".		
454(8) - Failure to pay the penalty imposed by the adjudicating officer or Regional Director.		
464(3) - Being a member of a company formed exceeding certain numbers.		
469(3) - Contravention of the Rules framed by Central Government.		

CS

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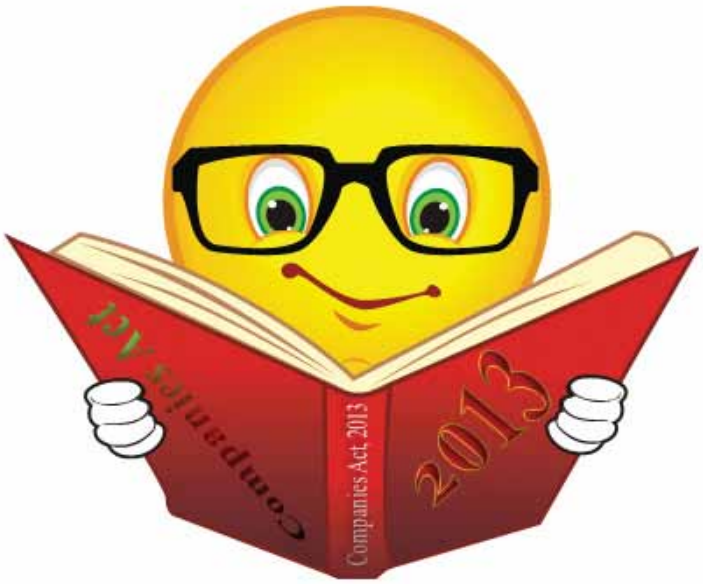
Companies Act, 2013 Enlightened Enactment or Regressive Law?

While the objective of enacting a new company legislation in place of the 1956 Act was to bring about the much needed simplification, it appears that the said objective has not been realized completely since some of the new provisions have complicated the law instead of simplifying it. This article takes a look at some of the notable shortcomings of the new law.

LAW IN THE MAKING

It was with a sense of fulfilment that the entire corporate sector in particular and the businessmen and professionals at large were looking forward to the enactment of the new Companies Act, 2013 that would take the place of the old Act of 1956. After all, the new company law had been in the making for the last more than a decade and all concerned persons were waiting eagerly for the new law to emerge on the scene.



It had been a painfully long process with several committees being constituted over the years starting with the Naresh Chandra Committee for simplification of Company Law applicable to Private and Small companies in 2003, of which the author had the honour of being a member. During the last five years we have been witness to the phenomenon of a new Companies Bill being laid almost every year starting with the Companies Bill, 2008, which became Bill of 2009, followed by a new Bill in 2011 and eventually the Bill of 2012 that finally got enacted as the Companies Act, 2013.

The original Companies Bill of 2008 having undergone so many avatars, one would have expected a very well drafted piece of legislation that would meet the needs of the changing times in the manner befitting our society. The unduly long time taken in

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bringing the new Company law legitimately generated a feeling that we will have a modern company law complete in all respects.

However, inspite of the fact that the new Companies Act took ages in coming, instead of solving the existing problems faced by the companies and simplifying the law and procedure, has brought in more pain and despair for most of the companies in India.

SHORT AND SIMPLE ACT

One of the promises made by the then Minister for Corporate Affairs was that the new Act will have fewer sections and the law and procedure will also be simplified.

What is the reality?

Prima-facie, it would appear that the new Act indeed has fewer sections as it comprises of only 470 sections against 658 in the earlier Companies Act. However, it would be pertinent to note that while the number of sections has been curtailed to 470, many of the sections of the old Act have been combined into a single section. But more importantly, the new Act cannot be read in isolation as rules form an equally important part of the Act. Incidentally, there are also more than 330 rules that need to be constantly referred to while reading any provision of the Act.

Hence, effectively speaking, taking the Act and the rules together there are nearly 900 provisions now against the nearly 700 sections of the old Act. So much for reducing the number of sections.

Similarly, far from simplifying the law, the new Act and rules have raised several issues and created more hurdles in the functioning of the companies.

PERILS OF DELEGATED LEGISLATION

The Companies Act, 1956 used to pose problems at times particularly in the context of absolute financial limits specified in the Act. Moreover, it was also realised that when everything is mentioned in the statute itself, then for effecting even a small change the Government has to go through the entire legislative process, which is not only tedious but also time consuming. Past experience indicated that it took on an average two to two and a half years to get an amendment passed through the legislative process.

As a result, it had been difficult for the Government to respond swiftly to the changing needs of the corporate sector. Therefore, to overcome this difficulty it was advised that in certain respects powers should be delegated to the Executive so that the Government can effect changes when deemed necessary. Incidentally, the new Act seems to have gone to the other extent by providing for 330 rules. In other words, huge powers have been delegated to the Executive and the ill effects of the same have been evident in the last few weeks.

The major fear of such vast delegation of powers to rule makers is that it goes much beyond the purview of the section itself by encroaching upon the domain of substantive law; law undergoing a change through circulars and notifications, rather than the legislative process.

Hence, there is a need for striking a proper balance between maintaining stability of law and providing flexibility for effecting changes to meet the needs of the situation. Otherwise, a time would come when the rules may change the law itself and gain primacy over the substantive law.

EVERY DIRECTOR IS SUSPECT

It is sad but true that the new Companies Act appears to be based on the premise that all the directors of companies are suspect, so they cannot be trusted nor one can depend on them. Hence, to overcome this disability or limitation the boards have to be virtually manned by Independent directors. While there can be no denying that there are promoters / managements who misuse the law for personal gains; they treat company assets as personal property. There is every reason to bring such persons to book and hold them accountable for their misdeeds.

However, what we find is that instead of going hammer and tongs after such culprits who are the bane of the corporate sector, the law makers have taken the easy way out by making it tough for all those who want to use the company form of organization.

While the enhanced role of Independent directors and fixed tenure for them indicates the Government belief that it is the only way to run companies honestly, it would be better if the Government also focuses on holding defaulters accountable through speedy and effective judicial process.

COMPANY LAW FOR WHOM? IS IT ANTI PRIVATE COMPANIES?

It is a matter of fact that of all the companies registered in India a very large majority comprises of private companies. In fact, a very large number of private companies are small companies owned and managed by family members or friends and their relatives. As per the Government's own statistics, as on 31.12.2012, a total of 12,89,229 companies were on the Register (consisting of 11,67,226 private limited companies and1,22,003 public limited companies).

Out of the above, 8,72,957 companies were active, comprising of 8,06,666 private limited and 66,291 public limited companies. (Source: MCA Annual Report 2012-13).

In other words, private companies account for over 90% of the total number of companies registered in the country. Similarly, the number of private companies that are active account for over

> A classic example of over regulation is when an innocuous mistake, an inadvertent error or submission of incorrect information is treated as equivalent to false statement and treated as fraud with attendant penal consequences. In Section 7 sub-sections (5), (6) & (7) relating to incorporation of company are examples where submission of incorrect information will invite provisions applicable to fraud.

92% of the total active companies. Ironically, the new law instead of being alive to the needs of 90% of the companies could spell a death knell for private companies as most of the exemptions have been done away with.

It is also recognized that a private company is a glorified partnership, as upheld by the Company Law Board in various cases over the years. Therefore, it has come as a shock for private companies who were looking forward to a simplified regime under the new Act. Some of the major problems now being faced by private companies as a result of the new Act are highlighted in the subsequent paragraphs.

The benchmark of the law cannot be as that applicable to a listed company that utilises public funds but should be tailor made to cater to the needs of the small companies. The Companies Act, 2013 seems to be anti-private companies in its approach.

OVER REGULATION – ANTI-DOTE TO BUSINESS

Business invariably thrives in an open and transparent economic environment, so it is very important to provide environment conducive to business. While it is nobody's case that the companies should not be regulated or that there should not be adequate regulation; what is important is that in the zeal to keep control over suspect companies, the regulations do not end up treating every company guilty unless proved otherwise.

If there are fewer but effective regulations it would be easier even for the regulators to keep a check on the functioning of the companies; too many regulations not only hamper the business, but also kill the entrepreneurial initiative.

A classic example of over regulation is when an innocuous mistake, an inadvertent error or submission of incorrect information is treated as equivalent to false statement and treated as fraud with attendant penal consequences. In Section 7 sub-sections (5), (6) & (7) relating to incorporation of company are examples where submission of incorrect information will invite provisions applicable to fraud.

Similarly, section 405 provides that submission of incorrect or even incomplete information in material respect can invite a jail sentence. Unless the submission of incomplete or incorrect information is deliberate, such a default should not be treated on par with fraud.

Hence, the Government needs to find a balance between effective regulation vis-à-vis freedom to do business in India. Unfortunately, the new Act is a let down on this score and needs to be changed.

IMPRACTICAL PROVISIONS

A good enactment should contain provisions that further the objective of that Act and do not act as impediments. The Companies Act, 2013 has many such provisions which are highly impractical and would result in closing down of business. Few of them have been highlighted below:

Raising of Funds by Private Companies

A private company predominantly raises funds from its members and directors. The new law has not only made it cumbersome but also very difficult for a private company to raise funds from its own members. In fact, the law is virtually treating a private company on par with a public company, even as a private cannot raise funds from the public. Sections 42 and 62 of the Companies Act, 2013 need to be drastically amended.

Providing loans, security or Guarantee to Subsidiary Company

Section 185 of the new Act has brought in such a damaging

The hall mark of any good piece of legislation is the clarity and simplicity of drafting. Unfortunately, the Companies Act, 2013 provides several examples of poor drafting resulting in contradictions and anomalies leading to avoidable confusion and unintended consequences. For example section 135 of the new Act relates Corporate Social Responsibility (CSR). The section requires every company falling within the ambit to appoint a Committee of the Board comprising of at least three directors including one independent director.

provision for companies that they are barred from providing any loans or giving security or guarantee in connection with the loan if a director of the lending company is also a director of the borrowing company. Every subsidiary company would have common directors who would also be on the board of the holding company.

The new law prohibits any such assistance from the holding company to the subsidiary company. It is easy to imagine the adverse consequences of such a measure on the business of the companies. Earlier, there was a specific exemption to this effect in the section itself. Hence, there is an urgent need to restore this exemption or to remove the new section from the statute.

The law needs to distinguish between the loans which are given for the benefit of directors and loans that are given or security that is provided or guarantee given in the course of business on commercial terms to a firm or a company in which a director may be concerned or interested. By prohibiting all such transactions, the interest of genuine companies will be very adversely impacted. Hence, section 185 needs to be replaced or the necessary exemption provided in the new section.

Inter Corporate Loans & Investments (Section 186)

The terms and conditions of any such loan or investment should be left to the wisdom of the directors and not mandated by law. This is another example of lack of confidence in the directors. There could be several factors that could come in play for a company while deciding the terms for giving a loan or making an investment or providing a guarantee.

Related Party Transactions

Section 188 of the new Act dealing with related party transactions contains a provision that is creating serious practical difficulties for most of the private companies and closely held unlisted public companies.

According to the new section, related parties cannot participate in voting while seeking members approval, but in so many companies all the shareholders are related parties and as such ineligible to vote.

Consequently, it is not possible for such companies to pass a resolution under section 188 as no unrelated parties are available. What should such companies do? This has already started impacting several companies causing them immense hardships.

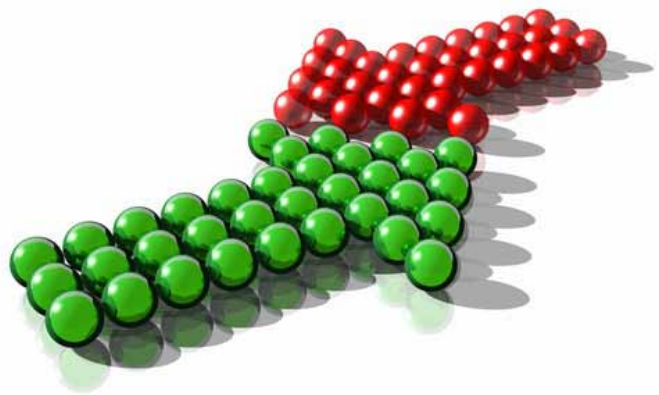
Even the criteria for classifying whether a contract or arrangement falls within the ambit of section 188 needs a relook as there are serious shortcomings in the same.

Contradictions / Anomalies

The hall mark of any good piece of legislation is the clarity and simplicity of drafting. Unfortunately, the Companies Act, 2013 provides several examples of poor drafting resulting in contradictions and anomalies leading to avoidable confusion and unintended consequences.For example section 135 of the new Act relates Corporate Social Responsibility (CSR). The section requires every company falling within the ambit to appoint a Committee of the Board comprising of at least three directors including one independent director.

However, the fact is that a private company requires having a minimum of two directors and is not required to have an independent director; so how does a private comply with this provision?

When confronted with this situation, the Ministry took the easy way out by providing in the relevant rules that if a company is required to have only two directors then the committee can comprise of two directors. Similarly, the said rule states if the company is not



required to appoint an independent director, then the committee need not have an independent director.

Changing the law by effecting change in the rules is not a correct way of addressing the issue of bad drafting. This amounts to encroaching on the powers of the Legislature.

There are contradictions in the provisions of section 42 and 62 of the Act that need to be rectified.

Contradictions / anomalies in the rules 20 and 22 relating to voting through electronic means and Postal Ballot.

ABSENCE OF TRANSITION PERIOD

The manner in which the different sections of the new Act were notified has left many a professional also speechless. When major changes in any law are proposed it is always advisable to have a transition period. In this case, the entire Companies Act of 1956 was being substituted by a new enactment and no transition period was provided at all.

When the Act was notified it was stated that different provisions would be notified later. The general belief was that enough transition period will be provided to the companies to familiarize themselves with the new law. This would have enabled all the companies to gear up their systems and be prepared to comply with the changed provisions of the new law.

Here it would be pertinent to refer to the order of Bombay High Court in the matter of Godrej Industries Ltd., delivered on 8th May, 2014. While considering an application in the context of a merger scheme, Justice G.S.Patel questioned the validity about some 21 rules keeping in view the manner in which they were notified by the MCA.The Court had serious objection about notifying by issuing a single sheet signed by an official of MCA, without actually notifying the said rules in the official gazette.

Hence, the impression that has been conveyed is that the Ministry was in a great hurry to implement the new, notwithstanding several shortcomings which needed to be addressed before the same were notified.

CONFLICT BETWEEN MCA AND SEBI

SEBI as a regulator has certain exclusive powers to regulate the functioning of listed companies, but in that process many times there have been contradiction with the provisions of the Companies Act. SEBI has issued circulars from time to time which provide for stringent compliances by listed companies, although the same may not be required under the Companies Act.

The latest example being with respect to Postal Ballot and E-voting. While the Companies Act, 2013 did not make it mandatory to provide for E-voting along with a Postal Ballot, SEBI made it compulsory for all listed companies to provide for postal ballot as well as E-voting. The Recently the Bombay High Court in Godrej Case (supra) expressed strong views with respect to the several grey areas in the Companies Act, 2013 and the SEBI Circulars and Notifications.

Similarly, MCA vide its circular dated 17th June, 2014 has clarified that providing e-voting facility by companies will not be mandatory till 31st Dec. 2013. However, SEBI is yet to change its view and as a result listed companies are forced to provide e-voting facility even as MCA has made it non-mandatory.

Therefore, there is an urgent need for better co-ordination between the two regulators so that they can work seamlessly and this would result in elimination of avoidable irritants and uncertainities.

RELIEF / REMEDY

The Government needs to provide immediate relief to the corporate sector from the harsh and impractical provisions of the new Act. This can be done either by staying the operation of the entire new Act or alternatively putting on back burner all the offending provisions for the time being. In the meantime, the Government should appoint a task force to consider all such issues within a fixed time frame of 2/3 months.

CONCLUSION

In conclusion I would like to quote Clarence Darrow, who said that,"Law should be like clothes. They should be made to fit the people they are meant to serve."Hence, the Government needs to ensure that the Companies Act, 2013 becomes an enlightened enactment and not a regressive law. CS

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CSR Under Companies Act, 2013: An Analysis

Section 135 of the Companies Act, 2013 has mandated that every company having net worth of Rs. 500 crore or more or turnover of Rs. 1000 crore or more or a net profit of Rs. 5 crore or more during any financial year should constitute a CSR Committee of the Board and spend a specified percentage of their profits on social upliftment programmes. The Ministry of Corporate Affairs, Government has framed the Corporate Social Responsibility (Policy) Rules 2014 and Schedule VII of the Act has enlisted the CSR activities. An attempt has been made in this article to unfold the significance of these Rules.

INTRODUCTION

Today, businessmen are aware that society is the biggest force which controls the entire business operations, right from acquisition of land to final produce. They now feel that they cannot operate in societal isolation. Profit still being the major determinant for business houses, it is extremely difficult to strike a balance between the conflicting needs of business in earning profit and society's need to take care of its many constituents. The success of a business depends on the growth of the society because the goods and services of business are ultimately consumed by the society. So, an organization must initiate steps which will ultimately lead to economic upliftment of the people. At the initial stages, investment for such welfare measures may appear to be a losing proposition. In the long run, it will have a twin positive effect -the image of the organization will be enhanced and there will be an economic resurgence of the people through adoption of such welfare measures which will create a new set of consumers for their products.

> Business organizations should come out with liberal contribution for setting up research laboratories for product quality improvement. In addition, business houses should shun unethical practices such as price rigging of the product through hoarding and creating scarcity, quality deterioration due to adulteration, and resorting to advertisements which lead to formation of biased attitude. As business is now considered to be a part of social order, it itself will determine its ethical standards through cross-current interactions.

The term CSR has various dimensions. There is no single definition. In fact, different personalities have defined CSR in different ways and thus the concept of CSR has been widened and discussed at various forums at the global level. According to the World Bank Group, the term corporate responsibility is defined as *"the commitment of business to behave ethically and to contribute to sustainable economic development by working with all relevant stakeholders to improve their lives in ways that are good for business, the sustainable development agenda and society at large".* The definition set by the European Union is "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis".

According to the definition of the United Nations (1987), CSR is the overall contribution of business to sustainable development; it being defined as: "a pattern of resource use that aims to meet human needs while preserving the environment so that these needs can be met not only in the present, but also for future generations."

CORPORATES - A PART OF SOCIETY

A society cannot function without a set of values. Society is undergoing social change. Business system is a product of customs and beliefs of the society in which it exists. Ethical considerations decide whether the business is on par with the society's needs. In today's recession in businesses world over survival itself is at stake and a corporate cannot afford to think of anything else but its products, customers, and stakeholders. Therefore, it is imperative that corporates have to realign their priorities on par with the societal needs. Accordingly, corporates are expected to be more ethical and responsible. A corporation represents a mixture of diverse social interests. The interests belong not only to the present living generations but also to the future including the generation which is yet to come. It has enormous economic and social prowess.

GOVERNMENT'S INTROSPECTION TOWARDS SOCIETY

Governance is an essential requirement for socio-economic development and for overall inclusive growth. As such it is a matter of paramount importance for governments, corporates and civil society at large. There are two main drivers which have led to an integration of governance with Corporations. First, an increasing incidence of unethical practices and debacles taking place in the corporate domain and secondly the faces of deregulation, disintermediation, institutionalization, globalization and tax reforms have made the minority shareholder more aware and powerful. Governments, in order to promote social welfare,expect from the business community a qualitative improvement of the product. This necessitates huge investment in research and development, which government alone cannot afford. Accordingly, business organizations should come out with liberal contribution for setting up research laboratories for product quality improvement. In addition, business houses should shun unethical practices such as price rigging of the product through hoarding and creating scarcity, quality deterioration due to adulteration, and resorting to advertisements which lead to formation of biased attitude. As business is now considered to be a part of social order, it itself will determine its ethical standards through cross-current interactions. The corporate sector is a key component of the socio-economic structure of any country and principled and genuine corporates are fully aware of their social responsibility. The Government, basically a political institution, also has mostof itsfunctions directed towards social welfare.

According to **Peter Drucker** "The 21st century will be the century of the social sector organization. The more economy, money, and information become global, the more community will matter." A business has a lot of responsibility to the community around its location and to the society at large. In the changed environment, companies have lot of opportunities to serve various stakeholders.

For the first time in the history of Indian corporates, the Central Government has redefined the role of CSR. In the present era of stiff and intense competition, it is imperative on the part of corporates to generate and sustain goodwill among their stakeholders and the community at large. Today, the stakeholders are intelligent and they are aware of their various rights. They can file complaints easily in courts in case their rights are wronged. Further, information technology has sharpened the skills of stakeholders. In the changed economic environment, corporates have a greater responsibility to society as a whole.

PERSPECTIVES ON CSR

There are divergent views on CSR. Economists like Adam Smith and Milton Friedman were of the opinion that the only responsibility of business was to perform its economic functions efficiently and provide goods and services to society and earn for itself maximum profit. It was better to leave social functions to other institutions like the government. According to Adam Smith, it is the profit-driven market system and price mechanism that drives business organisations to promote social welfare, though they work for private gain.

Prof. Samuelson strongly advocates a spirit of social responsibility as an inherent feature of any modern business organization because he believes firmly that business organizations are part and parcel of the society and hence, they have to serve primarily the social interests rather than work for narrow economic gains. Moreover, governments cannot and need not be the sole custodian forever to ensure promotion of welfare for the masses.

JUDICIAL PRONOUNCEMENTS PERTAINING TO CSR

Indian Courts have already stressed the social character of companies on many occasions. In *Panchrnahals Steel Ltd* v. *Universal Steel Traders* [1976] 46 Comp. Cas. 706, 718, the Gujarat High Court pointed out that a company has a three-fold reality-economic, human and public. Again in *National Textile Workers' Union P.R. Rarnakrishnan*[1983], the Supreme Court emphasized that a company is a social institution with duties and responsibilities towards the community in which it functions. It is assumed that social welfare of the people is the sole responsibility of the State. The State meets this expectation in two ways: by direct action through various schemes launched by it, and by encouraging others, including the corporates, to take the lead in some areas and share some of the responsibilities of social welfare.

TRIPLE BOTTOM LINE

In traditional business accounting, the 'bottom line' refers to the sum of revenue minus expenses, which is either 'loss' if negative, or 'profit' if positive. The term originated because profit is always shown as the very 'bottom line' on a statement of revenue and expenses. Over the last *50* years, environmentalists and social justice advocates have struggled to bring a broader definition of 'bottom line' into public consciousness, by introducing full cost accounting. For example, if a corporation shows a monetary profit, but their asbestos mine causes thousands of deaths from asbestosis, and their copper mine pollutes a river, and the government ends up spending taxpayer money on health care and river cleanup, how do we perform a full societal cost benefit analysis?

The concept of a triple bottom line (abbreviated as TBL or 3BL, adds two more 'bottom lines'; namely, social and environmental concerns. The three together are often paraphrased as "Profit, people, planet", or referred to as "the three pillars"). With the ratification of the United Nations and ICLEI, TBL standard for urban and community accounting in early 2007, this became the dominant approach to public sector full cost accounting. Similar UN standards apply to natural capital and human capital measurement to assist in measurements required by TBL.

GOVERNMENT'S INITIATIVES TOWARDS CSR

(1) The Government of every country formulates and executes a set of policies and programmes for the welfare of the society. These policies are executed through legislation. Today there are so many laws that at every turn a business- man meets law; modern businessmen need legal advice constantly. Modern business is more in the nature of a legal contract than a social contract. The corporate sector is a key component of the socio-economic structure of any country and principled and genuine corporates are fully aware of their social responsibility.

(2) Policies of the Government are executed through legislative enactments, rules, regulations, systems and procedure, policies, plans, guidelines, and directives that constitute the politico-legal environment in which business has to find a way of existing and flourishing. The Government shall encourage corporates to assume a participatory role in schemes of social reforms formulated by the Government by offering suitable incentives to them.

> Corporate social responsibility means giving back to society what it gets from society. Corporate social responsibility is about capacity building for sustainable livelihoods. CSR means the obligation of companies to stress on their social, ethical and environmental performance as on their financial performance. The concept is broad enough to include things ranging from excessive managerial pay, employee retention during downturns and disposal of effluents to participation in community projects and funding of social causes. CSR refers to companies taking account of the social and environment, and not just financial consequences of their actions.

(3) The Ministry of Corporate Affairs had released Voluntary Guidelines on CSR in 2009 as the first step towards mainstreaming the concept of Business Responsibilities. Keeping in view the feedback from stakeholders, it was decided to revise the same with a more comprehensive set of guidelines that encompasses social, environmental and economical responsibilities of business.

(4) The National Voluntary Guidelines on Socio-Economic and Environmental Responsibilities of Business brought out by the Ministry of Corporate Affairs have encouraged the corporate sector in their efforts towards inclusive development. The guidelines were released by the Ministry of Corporate Affairs on 8 July 2011. The Central Government, through these guidelines, has spelt out clearly the role of corporates in national building for bringing about a Welfare State. The guidelines are given in the form of nine principles and core elements. These are enumerated below:

PRINCIPLE 1: Businesses should conduct and govern themselves with ethics, transparency and accountability

PRINCIPLE 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle

PRINCIPLE 3: Businesses should promote the well being of all employees

PRINCIPLE 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

PRINCIPLE 5: Businesses should respect and promote human rights

PRINCIPLE 6: Business should respect, protect, and make efforts to restore the environment

PRINCIPLE 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner

PRINCIPLE 8: Businesses should support inclusive growth and equitable development

PRINCIPLE 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner

COMPANIES (CSR POLICY) RULES, 2014

The Ministry of Corporate Affairs, has issued Companies (CSR Policy) Rules 2014 on 27.2.2014. The term CSR policy relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company. The CSR (Policy) Rules, 2014 mandate companies to formulate a CSR policy including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programmes. Further, the CSR policy of the company shall specify that the surplus arising out of the CSR projects or programmes or activities shall not form part of the business profit of the company. The Central Government through the CSR (Policy) Rules has given directions to the companies that the Board of Directors of the company shall after taking into account the recommendations of CSR Committee, approve the CSR policy for the company and disclose contents of such policy in its report and the same shall be displayed on the company's website as per the particulars specified.

PHILOSOPHY BEHIND THE PROVISIONS

Social responsibility is an integral part of business and society. Social responsibility should enhance the competitiveness of business and maximize the value of wealth creation to society. Corporate social responsibility means giving back to society what it gets from society. Corporate social responsibility is about capacity building for sustainable livelihoods. CSR means the obligation of companies to stress on their social, ethical and environmental performance as on their financial performance. The concept is broad enough to include things ranging from excessive managerial pay, employee retention during downturns and disposal of effluents to participation in community projects and funding of social causes. CSR refers to companies taking account of the social

and environment, and not just financial consequences of their actions. CSR is a process with the aim to embrace responsibility for the company's actions and encourage a positive impact through its activities on the environment, consumers, employees, communities, stakeholders and all other members of the public sphere who may also be considered as stakeholders.

Guiding principles

CSR is the process by which an organization thinks about and evolves its relationships with stakeholders for the common good, and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies. The guiding principles as enshrined in the Draft Corporate Social Responsibility Rules, 2013, stated as follows:

1. CSR is not charity or mere donations.

2. CSR is a way of conducting business, by which corporate entities visibly contribute to the social good. Socially responsible companies do not limit themselves to using resources to engage in activities that increase only their profits. They use CSR to integrate economic, environmental and social objectives with the company's operations and growth. 3. CSR projects/programmes of a company may also focus on integrating business models with social and environmental priorities and processes in order to create shared value.

CSR UNDER THE COMPANIES ACT, 2013

Companies within the ambit of CSR Obligations

According to Section 135(1) of the Companies Act, 2013, CSR requirements are applicable to every company (qualifying company) which is having: (1) net worth of 500 crore or more, or (2) turnover of 1,000 crore or more, or (3). a net profit of *5* crore or more *during any financial year.* The words used in section 135(1) of the Companies Act are 'during any financial year' and not 'at any time during any financial year'. This implies that the applicability of CSR obligations will have to be determined independently for every financial year.

Net worth: According to Section 2(57) of the Companies Act, 2013 , the term 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. Further, the net worth will not include there serves created out of revaluation of assets, reserves created out of the write-back of depreciation and the reserves created out of amalgamation.

Turnover: According to section 2(91) of the Companies Act, 2013, the term turnover means the aggregate value of the realisation of amount made: (i) from the sale, supply or distribution of goods, or (ii) on account of services rendered or (iii) both by the company during a financial year.

Net profit: According to Rule 2(f) of Companies (CSR Policy) Rules, 2014, the term net profit means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely:-(i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise and (ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act. However, net profit in respect of financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956 shall not be required to be re-calculated in accordance with the provisions of the Act. However, in case of foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared interms of clause (a) of section 381(1) (a) read with section 198 of the Act.

Mandatory CSR Obligations

The Companies Act, 2013 mandatorily requires every qualifying company:

1. To constitute a CSR Committee of the Board
2. To formulate a CSR Policy based on CSR Committee's recommendations
3. To undertake activities included in CSR Policy
4. To spend at least 2% of average net profits on CSR

Constitution of CSR Committee

Section 135(1) of the Companies Act, 2013 requires every qualifying company to constitute a CSR Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. According to Rule 2(d) CSR Committee" means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act.

Responsibility of CSR Committee

Section 135(3) of the Companies Act, 2013 states that the CSR Committee shall:-

(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;

(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and (c) monitor the Corporate Social Responsibility Policy of the company from time to time.

Responsibility of the Board of Directors

As per section *135(4)* of the Companies Act, 2013, the Board of every qualifying company referred to in sub-section (1) shall (a) after taking into account the recommendations made by the CSR Committee, approve the CSR Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and *(b)* ensure that the activities as are included in CSR Policy of the company are undertaken by the company. Under section 135(5) of the Act, the Board of every company referred to in sub-section (1), shall ensure that the qualifying company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. However, the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities. In case the company fails to spend such amount, the Board shall in its report made u/s134(3) specify the reasons for not spending the amount.

Analysis of Companies (CSR Policy) Rules, 2014

As per Rule 2(c) of Companies (Corporate Social Responsibility Policy) Rules, 2014 notified on 27.2.2014, "Corporate Social Responsibility (CSR)" means and includes but is not limited to:(i)Projects or programs relating to activities specified in Schedule VII to the Act; or (ii) Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

CSR Policy

Rule 2(e) of Companies (Corporate Social Responsibility Policy) Rules,2014, states that "CSR Policy" relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon. excluding activities undertaken in pursuance of normal course of business of a company. The CSR Committee constituted under section *135(1),* shall prepare the CSR Policy of the company which shall include the following;(a)a list of CSR projects or programs which a company plans to undertake falling within the purview of Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and *(b)* monitoring process of such projects or programs.

However, the CSR activities do not include the activities undertaken in pursuance of normal course of business of a company. Further, that the Board of Directors shall ensure that activities included by a company in its Corporate Social Responsibility Policy are related

to the activities included in Schedule VII of the Act.

Companies that are required to comply with CSR policy Rules

Rule 3: Rule 3(1) of Companies (CSR Policy) Rules provides that every company including its holding or subsidiary, and a foreign company defined under section 2(42) of the Act having its branch office or project office in India, which fulfills the criteria specified in section 135(1) of the Act shall comply with the provisions of section 135 of the Act and these rules. However, net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of section 381(1)(a) and section 198 of the Act.

Rule 3(2): Further, Rule 3(2) states that every company which ceases to be a company covered under section 135(1) of the Companies Act, 2013 for threee consecutive financial years shall not be required to (a) constitute a CSR Committee and (b) comply with the provisions contained in sub-sections (2) to (5) of the said section, till such time it meets the criteria specified in section 135(1) of the Act.

Rule 4(1): The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

Rule 4(2): The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the Act or otherwise: However (i) if such trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established track record of three years in undertaking similar programs or projects; *(ii)* the company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

Pooling of resources for CSR activities

Rule 4(3): A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

Rule 4(4): Subject to provisions of section 135(5) of the Act, the CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure. It implies that the Indian society must be benefitted out of the CSR projects.

Rule 4(5): The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

Rule 4(6): Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.

Rule 4(7): Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

Rule 5: Rule 5 of Companies (CSR) Policy Rules, 2014 deals with formation of CSR Committees. According to Rule 5(1), the companies mentioned in rule 3 shall constitute CSR Committee as enumerated below:

(i) an unlisted public company or a private company covered under section 135(1) which is not required to appoint an independent director pursuant to section 149(4) of the Act, shall have its CSR Committee without such director;

(ii) a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;

(iii) with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under section 380(1)(d) of the Act and another person shall be nominated by the foreign company.

Rule 5(2): The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

Rule 6: Rule 6 of Companies (CSR Policy) Rules deal with CSR Policy. According to Rule 6(1), the CSR Policy of the company shall, *inter alia,* include the following, namely:—

(a) a list of CSR projects or programs which a company plans to undertake falling within the purview of Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

(b) monitoring process of such projects or programs.

However, the CSR activities do not include the activities undertaken in pursuance of normal course of business of a company. Further, the Board of Directors shall ensure that activities included by a company in its CSR policy are related to the activities included in Schedule VII of the Act.

Surplus arising out of CSR activities

According to Rule 6(2), the CSR policy of the company shall specify

that the surplus arising out of the CSR projects or programs or acitivities shall not form part of the business profit of a company.

CSR Expenditure

Under Rule 7, CSR expenditure shall include all expenditure including contribution to corpus for projects or programs relating to CSR activities approved by the board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which fall within the purview of schedule VII of the Act.

Disclosure in Board's report

The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee [Section 135(2)].

CSR Reporting in Board's Report: Rule 8(1) requires that the Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR containing particulars specified in Annexure to the CSR Policy Rules, 2014. Further, in case of a foreign company, the balance sheet filed under sub- clause *(b)* of sub-section (1) of section 381 shall contain an Annexure regarding report on CSR [Rule 8(2)].

Rule 9: Display of CSR activities on its website

The Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approve the CSR Policy for the company and disclose contents of such policy in its report and the same shall be displayed on the company' s website, if any, as per the particulars specified in the Annexure of CSR Policy Rules, 2014.

Greater opportunities for corporates to benefit society

In the changed economic environment, corporates have a greater responsibility to society as a whole. Schedule VII was amended by Notification F.No.1/15/2013 – CL.V, dated 27.2.2014 in respect of activities which may be included by companies in their CSR policies. This notification came into force with effect from 1.4.2014.

Accordingly, companies have abundant opportunities and can do take up CSR activities such as:

(i) eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro-forestry, conservation of natural resources and maintaining quality of soil, air and water;

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(vi) measures for the benefit of armed forces veterans, war widows and their dependents;

(vii) training to promote rural sports, nationally recognized sports, paralympic sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

(x) rural development projects.

Format for the Annual Report on CSR Initiatives to be included in the Board Report by the Qualifying Companies: The Annexure to the Companies (Corporate Social Responsibility Policy) Rules, 2014, prescribe the following reporting format:

1. A brief outline of the company's CSR policy, including overview of projects or programs proposed to' be undertaken and a reference to the web-link to the CSR policy and projects or programs.
2. The Composition of the CSR Committee.
3. Average net profit of the company for last three financial years.
4. Prescribed CSR Expenditure (two per cent of the amount as in item 3 above).
5. Details of CSR spent during the financial year:
   (a) Total amount to be spent for the financial year;
   (b) Amount unspent, if any;
   (c) Manner in which the amount spent during the financial year is detailed below:

1	2	3	4	5	6	7	8
Sr No.	CSR project or activity identified	Sector in which the Project is covered	Projects or Progammes (I) Local area or other (2) Specify the State and district where projects or programs was undertaken	Amount outlay (budget) project or programs wise	Amount spent on the projects or programs Sub-heads: (1) Direct expenditure on projects or programs. (2) Overheads:	Cumulative expenditure upto to the reporting period,	Amount spent: Direct or through implementing agency*
2.							
3.							
	TOTAL						

*Give details of implementing agency:

6. In ease the company has failed to spend the two per cent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.

7. A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

SD /-	SD/-	SD/-
(CEO/MD/ Director	(Chairman CSR committee	(Person specified u/s 380(1)(d) (wherever applicable)

CONCLUSION

The Government is a political institution but it has a social purpose. It enacts, formulates guidelines and executes societal policies. It provides the ways and means of maximizing social benefits and minimizing social costs. The Government itself has a social value and culture. Policies of the Government are executed through legislative enactments, rules, regulations, systems and procedure, policies, plans, guidelines, and directives that constitute the politico-legal environment in which business has to find a way of existing and flourishing. It is the earnest hope of the Government of India that the corporates shall come forward to adopt CSR activities best suited to their company's philosophies and businesses. Laws are required to protect consumers, workers, managers, owners, shareholders, and the society at large. The success depends upon the extent of co-operation and co-ordination among the various social, economic and legal organizations, institutions and bodies. The concept of corporate social responsibility is now firmly rooted on the global business agenda. But in order to move from theory to concrete action, many obstacles need to be overcome. Some of the positive outcomes that may arise when businesses adopt a policy of social responsibility are benefits to the community, charitable contributions, employee volunteer programs, corporate involvement in community education, employment and provision of homes to the homelessness, product safety and quality, greater material re-cycling like better product durability and functionality; greater use of renewable resources; integration of environmental management tools into business plans, including life cycle assessment and costing, environmental management standards, and eco labeling. However, CSR activities should not be construed as a cover to conceal the irregularities or violation of norms by corporates. CS

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Getting to grips with e-Voting in General Meetings

As companies get ready in implementing electronic voting at general meetings, practices are in the process of evolution. The practices must be such as make shareholder democracy more meaningful, rather than chaotic or cumbersome. The idea of the lawmaker is certainly benevolent – to make remote participation in general meetings possible, and thereby, enhance shareholder participation.

Section 108 of the Companies Act entitles the Central Government to prescribe the class of companies where the facility of voting by electronic means will be provided in general meetings of companies. In pursuance of this power, the Central Government has enacted Rule 20 of the Management and Administration Rules to provide that every listed company, or a company having not less than 1000 shareholders, will mandatorily provide the option of electronic voting to its shareholders[1].

Obviously, the section has left companies with loads of questions and very few answers. The section has already come into force on 1st April 2014[2]. Many companies would either have already approved their general meeting notices shortly, or will be doing the same in course of next few days. Hence, the question is of utmost significance.

Among other things, the major questions that arise are:

1 Revised Listing agreement clause 35B also requires e-voting to be mandatorily offered. This clause, applicable to all listed companies, is already effective.

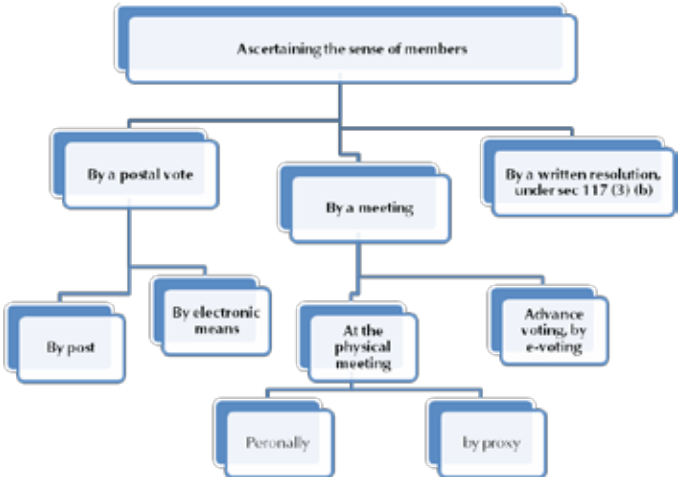
2 By Companies (Management and Administration) Amendment Rules 2014, dated 23rd June 2014, the e-voting facility has been made mandatory only for a general meeting held on or after 1st January 2015. However, in case of listed companies, SEBI's amendment by insertion of Clause 35B in the Listing Agreement mandates listed companies to provide e-voting facility immediately.

- Is there a voting at the meeting, as well as voting electronically?
- If there is only electronic voting, then what is being done at the meeting?
- On the contrary, if there is voting in both the means, then how does voting happen at the meeting?, and so on.

Some of these questions were answered by MCA, vide its Circular, though the author does not agree with MCA's interpretation of the provisions of the law or e-voting practices, particularly as regards show of hands. E-voting may be a new concept in India, but has been around in several other countries for some time now. Hence, this article assimilates the e-voting rules from other countries to impart sense to the e-voting process in India.

VARIOUS WAYS OF ASSESSING THE SENSE OF MEMBERS

The process of meeting or getting the votes is, after all, a method of ascertaining the wishes or the sense of the members. Currently, there are several ways of getting sense of the members:



All of these are devices to make the democratic process of corporate governance more meaningful by allowing shareholders more say in corporate decision-making. Lately, corporate laws and governance principles in most countries are trying to enable wider participation in company "meetings". The traditional concept of "meetings", meaning a coming together of members, obviously does not hold good in an age of technology. Besides, proxy voting has become the cult in corporate meetings with the advent of institutional shareholders.

MEETING OF MINDS

UK lawmakers as well as Courts have always been prepared to be pragmatic and adopt contemporaneous practices on company meetings. Decades ago, the ruling in *Re, Duomatic Ltd.,* (1969) 1 All ER 161 had accepted a written shareholders' resolution as equivalent to resolution passed in a meeting.

Lately, the use of technology has openly been accepted by courts. In *Wagner* v *International Health Promotions* (1994)15 ACSR 419, a board meeting was held through telephone. In delivering his decision, Santow J addressed the true meaning of expression "the directors meeting together" and stated as follows: "I agree that the words 'meet together' connote a meeting of mind made possible by modern technology and not of bodies".

Much before remote communication became the order of the day, in *Byng* v. *London Life Assurance Limited* [1990] 1 Ch 170 the Court accepted that there was a valid meeting when people seated in different rooms were connected by use of audio-visual devices.

EU REGULATIONS ON ELECTRONIC VOTING

Known by various names such as electronic voting, remote voting, direct voting etc., the concept of voting without a "meeting" has been there for quite a while.

Among the important legislative steps taken to enable shareholding voting by remote means was the European Union's directive 2007/36/EC, dated 11th July 2007[3]. This Directive mandated companies to allow general meetings via electronic means, and allow cross-border shareholders to vote. Note that cross-border voting was considered essential to a border-less economic community such as the European Union. Rule 9 of the Directive provided: "Companies should face no legal obstacles in offering to their shareholders any means of electronic participation in the general meeting. Voting without attending the general meeting in person, whether by correspondence or by electronic means, should not be subject to constraints other than those necessary

3 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:184:0017:0024:EN:PDF

for the verification of identity and the security of electronic communications."

Article 8 provides the detailed rules for electronic voting. It provides as follows:

Participation in the general meeting by electronic means

1. Member States shall permit companies to offer to their shareholders any form of participation in the general meeting by electronic means, notably any or all of the following forms of participation:

   (a) real-time transmission of the general meeting;

   (b) real-time two-way communication enabling shareholders to address the general meeting from a remote location;

   (c) a mechanism for casting votes, whether before or during the general meeting, without the need to appoint a proxy holder who is physically present at the meeting.

2. The use of electronic means for the purpose of enabling shareholders to participate in the general meeting may be made subject only to such requirements and constraints as are necessary to ensure the identification of shareholders and the security of the electronic communication, and only to the extent that they are proportionate to achieving those objectives.

   This is without prejudice to any legal rules which Member States have adopted or may adopt concerning the decision making process within the company for the introduction or implementation of any form of participation by electronic means.

As may be noted, the Directive provides the option of either a real-time two-way participation electronically, or an electronic transmission of the meeting, both of which will be interactive. But in case of votes cast before or after the meeting electronically, there is no benefit of interaction. It appears that most companies covered by the EU regulations are actually offering the facility of e-voting *before* the meeting.

The most obvious question is – if voting happens before the meeting, then how do shareholders get the benefit of interaction? The very purpose of the meeting is canvassing the proposals, discussion thereon, and finally, the voting. Voting is the culmination of the process of decision-making. If the shareholders would have voted already, then what takes care of the shareholders' need of interaction?

This question is answered by Directive 9 of the EU Regulations, which allows shareholders the right of asking questions pertaining to any item on the agenda of the meeting. In essence, therefore, the discussion on the agenda item happens by way of shareholder questions, and then shareholders who opt not to attend at the meeting would have cast their vote electronically, usually before the meeting.

US REGULATIONS

Light-regulation regimes such as Delaware permit companies to use remote participation. Companies may not hold physical meetings at all and opt for what is known as virtual-only shareholder meetings (VSMs), or may hold *hybrid* meetings, where some shareholders may attend personally, and some may opt to attend remotely[4]. Several other states too allow VSMs. A 2012 report by Harvard Law School Forum on Corporate Governance and Financial Regulation[5] lists 22 states that permit VSMs.

However, a 2010 policy of the Council of Institutional Investors states that "Companies should hold shareowner meetings by remote communication (so-called "virtual" meetings) only as a supplement to traditional in-person shareowner meetings, not as a substitute.

Companies incorporating virtual technology into their shareowner meeting should use it as a tool for broadening, not limiting, shareowner meeting participation. With this objective in mind, a virtual option, if used, should facilitate the opportunity for remote attendees to participate in the meeting to the same degree as in-person attendees."

Thus, the essence of US regulations seems to be to permit hybrid meetings, where shareholders' right to attend physically at meetings is not prohibited; remote participation is only an option, not a compulsion.

OTHER JURISDICTIONS

Several countries have lately been permitting the use of technology

4 Section 211 of the Title 8, Corporations law, Delaware.
5 https://blogs.law.harvard.edu/corpgov/2012/07/19/online-shareholder-participation-in-annual-meetings/

the intent of the law is to make shareholder participation in general meetings more meaningful, and therefore, to make corporate decision-making more participative. The idea is not to render corporate meetings chaotic and unmanageable. If all resolutions are mandatorily put to physical voting by poll, is it serving any purpose, if the sense of the meeting could be ascertained by a much simpler and convenient device – show of hands – which has exited over decades? Of course, there is always an option with both the chairman as also the eligible members to demand or order a poll.

in company meetings. It seems very anachronistic to think of companies necessarily insisting on members to meet.

In Australia, section 249S of the Australian Corporations Act provides that:-

"A company may hold a meeting of the member at two or more venues using any technology that give the members as a whole a reasonable opportunity to participate."

In Malaysia, the legal provision is almost a replica of the Australian law. Section 145A of the Companies Act 1965 provides as follows:

"A company shall hold all meetings of its members within Malaysia and may hold a meeting of its members within Malaysia at more than one venue using any technology that allows all members a reasonable opportunity to participate"

THE INDIAN RULE

India has enacted rules for mandatory e-voting in general meetings vide Rule 20 of the Management and Administration Rules. Amendments to the Listing Agreement also mandate the said requirement in case of all listed companies. However, as the Rules were made effective from 1st April, 2014, companies have been left with loads of questions on how to conduct meetings coupled with advance electronic votes. Common response has been to dispense with show of hands at all, and put all resolutions at the meeting to vote by poll. This also seems to be the recommendation of the ICSI's draft of Secretarial Standard 2, Para 6.3 whereof seems to rule out show of hands in case where e-voting is offered. The same is the view of the MCA vide its Circular dated 17thJune, 2014[6]('Circular') which attempts to provide clarity on issues pertaining to voting through electronic means. The Circular also mandates that show of hands will be ruled out altogether. This interpretation will make company meetings a chaotic and marathon affair, as all resolutions will have to put to vote by poll.

Generally, this impression seems to have come from section 107 (1). However, it is important to note that sec. 107 (1) states the most obvious: it states there will be no show of hands where voting is carried electronically. Voting is carried electronically *before* the meeting, and not *at* the meeting. In case of electronic voting, the voting system splits itself into two: advance voting before the meeting, which is electronic, and proxy or personal voting at the meeting. There is no question of voting by show of hands in the electronic voting process, but where voting is happening at the meeting, there is nothing to mandate every resolution to be put to vote by poll.

The practice of show of hands as *ex facie*, convenient and practical way of assessing the mood of the meeting is prevalent in several countries. These countries have also implemented electronic voting. Therefore, the potential predicament that we are facing in India must have already been faced in these jurisdictions. For example, the Chartered Secretaries Australia has put up a guidance on electronic voting (there, called direct voting), which clearly suggests how to conduct and collate the results of a show of hands with those of remote voting[7].

We must appreciate that the intent of the law is to make shareholder participation in general meetings more meaningful, and therefore, to make corporate decision-making more participative. The idea is not to render corporate meetings chaotic and unmanageable. If all resolutions are mandatorily put to physical voting by poll, is it serving any purpose, if the sense of the meeting could be ascertained by a much simpler and convenient device – show of hands – which has existed over decades? Of course, there is always an option with both the chairman as also the eligible members to demand or order a poll.

SOME QUESTIONS ON E-VOTING

There are several questions that arise in context of e-voting. The answers below have also taken into account the author's views on the subject, based on study of international jurisdictions making them fit into Indian law.

1. Is e-voting mandatory?

Yes, for listed companies, and other companies having not less than 1000 members. Note that several private companies too, having issued employee stock options, may have 1000 or more members.

6 http://www.mca.gov.in/Ministry/pdf/General_Circular_20_2014.pdf
7 See http://www.governanceinstitute.com.au/media/37721/Guide_implementing_direct_voting.pdf

2. Is e-voting mandatory for class meetings, or meetings of debenture-holders?

In view of the language of Rule 20, it seems the e-voting mandate is applicable only in case of general meetings. Hence, the mandatory provisions do not apply in case of class meetings, or in case of meetings of debenture-holders.

3. Can a shareholder opt to either e-vote, or attend the meeting?

The MCA Circular in this regard has provided that where a company allows e-voting at a general meeting, voting by show of hands would not be allowed in view of Section 107 (1) of the Act, 2013. However where a person has e-voted, he still reserves the right to participate in the meeting but will not be able to vote in the meeting again and his e-vote would be treated as final.

On the question of whether a shareholder's right to attend and vote at the meeting rather than by advance voting can be taken away, the global position seems well settled. Remote voting in general meetings is only to broaden shareholder participation and not limit the same. It is a facility, and not a curb. Section 108 provides for a member the right to exercise his vote through electronic means. The language of Rule 20 also says "*facility* to exercise their right to vote at general meetings". Clause 35B of the Listing Agreement also speaks of a facility, though 35B (ii) says those shareholders who cannot vote electronically may be allowed to vote by postal ballot.

The idea of the law is to give a facility, and not to take it away. The right to attend, speak and question the directors is a fundamental right of shareholders. After all the directors are the appointees of the shareholders, and they cannot use the electronic wall of separation to shield or shelter themselves from the shareholders.If the law is so interpreted as to take away the shareholders' right to attend and vote at the meeting, it would be a bad law.

We have seen the AGM notices of several European companies[8], and we note that they consistently allow members the right to choose either to attend the meeting or to vote electronically. Of course, a shareholder who has elected to vote electronically foregoes his right to vote at the meeting, but the right to attend the meeting personally has not been taken away.The scenario may be different in the case of virtual shareholder meetings (VSMs) such as in Delaware, but those meetings allow for a 2-way participation by the shareholders, such that there is an interactive virtual meeting.

The same view has been upheld in India as well by the Bombay High Court in its recent ruling in the matter of *Wadala Commodities Limited* v. *Godrej Industries Limited*[9]. In the said ruling it very rightly pointed out that *"What corporate governance demands is the government of the tongue, not the tyranny of a finger pressing a button".*

It further goes on to say that *"..the shareholder has an inalienable right to ask questions, seek clarifications and receive responses before he decides which way he will vote. It may often happen that a shareholder is undecided on any particular item of business. At a meeting of shareholders, he may, on hearing a fellow shareholder who raises a question, or on hearing an explanation from a director, finally make up his mind. In other cases, he may hold strong views and may desire to convince others of his convictions. This may be in relation to matters that are not immediately obvious to the shareholder merely on receipt of written information or a notice".*

While pronouncing its judgement, the Court observed that "Greater inclusiveness demands the provision of greater facilities, not less; and certainly not the apparent giving of one "facility while taking away a right".

4. If our views were to be considered, would a show of hands be compatible with electronic voting, where voting is by number of shares?

The author notes the fact that the MCA Circular has ruled out show of hands in case of companies that offer e-voting facility. However, taking cue from several countries such as Australia where e-voting co-exists with show of hands, the author will like to make a case that it would be sensible for regulations to allow the most convenient way of taking votes at meeting, that is, show of hands.

The author is aware that there will be a huge change of mindset if companies were to allow physical voting in meetings

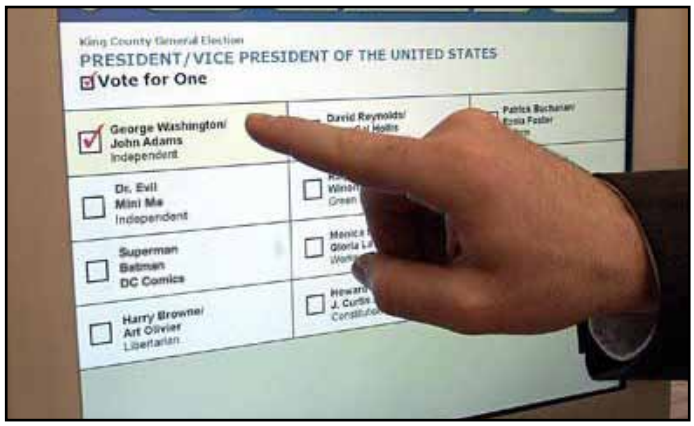
8 For example, http://new.abb.com/investorrelations/annual-general-meeting/questions-on-electronic-voting

9 The full text of the ruling is available at:http://bombayhighcourt.nic.in/generatenewauth.php?auth=cGF0aD0uL2RhdGEvan VkZ2VtZW50cy8yMDE0LyZmbmFtZT1PU0NTRDQ0NzE0LnBkZiZzbWZsYWc9Tg==

alongside electronic voting. In a physical meeting, the easiest way to ascertain the consent has been show of hands, which is essentially shareholder count, rather than shares-count. A poll is conducted only where either company itself opts for it, or a poll is validly demanded. There is no question of "show of hands" in case of electronic vote – see section 107 (1). At the same time, in the electronic vote count, the counting obviously will be by number of shares. So, how does one add up the results of the two – as the two are not capable of being added?

With a little bit of gap-filling in the regulatory language, it is very easily possible to synthesize electronic voting with show of hands.

First of all, when section 107 (1) says voting shall not be on a show of hands in case of electronic vote, it is saying but the obvious. There is no question of any show of hands in case of electronic voting. But that does not mean head count, that is, the counting of number of shareholders rather than number of shares, is not possible in an electronic vote. The so-called show of hands is actually nothing but a head count, which is the easiest and the most commonly-used way. Thus, the results of a head count in electronic vote may easily be added with those of the physical voting, to see whether the resolution is carried or not. If poll is at all demanded or ordered by the chairman, the results of electronic voting show the number of shares as well, to which the results of the poll at the meeting may be added.

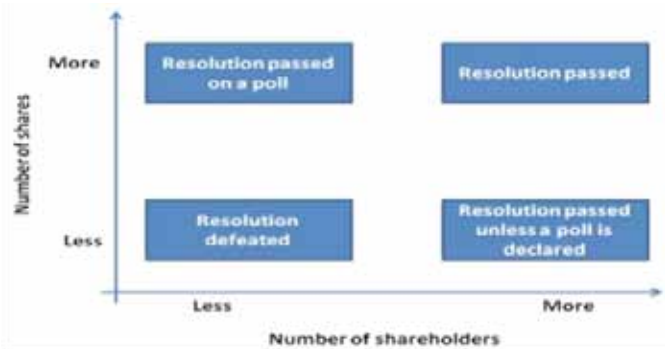


Note that the show of hands voting is always based on a subjective assessment of the Chairman. It is not practical to actually count the number of hands going up at any large meeting. Hence, the Chairman takes a view based on the weight of the hands going up for and against. Likewise, he would have already had the results of the electronic vote, by head count as well as votes count. In case he has any doubt as to the clarity of the sense of the meeting, he may always prefer a poll. If the sense of the meeting and electronic voting is clear enough, he may declare the results of the voting.

Let us take an illustrative example here:

E-voting (exact)				Voting at the meeting				Comments	Result
For		Against		For		Against			
No. of share-holders	No. of shares	No. of share-holders	No. of shares	Show of hands (apprx.)	Poll (exact)	Show of hands (apprx.)	Poll (exact)		
1000	100000	100	10000	500	NA	50	NA	Results of both are clear and decisive	Passed
1000	100000	100	10000	50	NA	500	NA	The excess of number of shareholders voting for, over those voting against, in e-vote is 900. This is exceeding the total number of shareholders voting at the meeting. Hence, even if all shareholders at the meeting opposed the resolution by show of hands, it would have still been carried.	Passed
100	100000	1000	10000	500	NA	50	NA	By head count test on e-vote, the resolution is getting lost. Hence the chairman must order a poll	Order a poll
100	100000	1000	10000	500	50000	50	10000	After counting the results of e-vote and the poll, the total number of shareholding strength for the resolution exceeds the total number of shareholding strength against.	Passed by poll
100	100000	1000	10000	500	10000	50	50000	After counting the results of e-vote and the poll, the total number of shareholding strength for the resolution exceeds the total number of shareholding strength against.	Passed by poll

The inter-relation between voting by poll and voting by show of hands has been graphically represented below:



5. Can a member voting electronically demand a poll?

If, going by the MCA Circular, one takes a view that there will be no show of hands at the meeting, it transpires that every resolution will be put to vote on a poll, at the outset. Hence, the question of a demand for poll does not arise. In other words, the poll is ordered by the chairman, and does not have to be demanded by anyone at all.

6. Does this mean that there will be no voting in the meeting at all?

Going by the Circular, every resolution put before the meeting will put to vote on a poll. Those members who have voted electronically will not be allowed to vote on the poll. Those attending by person or proxy will be allowed to vote on poll. As is usual practice with companies, poll may not be taken on the date of the general meeting itself – the law allows poll to be conducted within 48 hours. The results of the poll will be aggregated with the results of e-voting to decide the fate of the resolution.

7. Is the right to appoint a proxy available to a member voting electronically?

The whole concept of proxy voting is applicable where a member is not able to attend personally. The entire concept is not applicable to remote voting, whether by postal ballot or by e-voting.

8. Is quorum applicable in case of members voting electronically?

Quorum is the minimum number of members to constitute the minimum strength required to render sense to a plural decision-making. A meeting is not "sufficient meeting of minds" if the minimum number is not present. In our view, it is basic to the whole concept of plural decision-making. Hence, a quorum should be deemed applicable in case of electronic voting too.

9. Is quorum applicable to the physical meeting? Will the members voting remotely also be added?

It would be proper to count the members present in the meeting, and those voting remotely, together. Both are contributing to the process of decision-making. Hence, there is no question of excluding either type.

10. The MCA has made amendment in the Rules to make e-voting mandatory only from 1st January 2015. However, it appears that the Listing Agreement currently mandates companies to offer e-voting. How to reconcile these conflicting provisions?

While any lack of coordination between the MCA and SEBI is undesirable, it is not be noted that the Listing Agreement had introduced e-voting for larger companies much before the Companies Act 2013 was enacted. Hence, the divergence between the requirements of the Listing Agreement and those of the Companies Act is not new. Having said that, there will only be a handful of companies - unlisted companies having more than 1000 shareholders – who will be able to make use of the deferral of mandatory e-voting by the MCA Circular.

CONCLUSION

As companies engage in implementing electronic voting at general meetings, we are all trying to evolve practices. The practices must be such as make shareholder democracy more meaningful, rather than chaotic or cumbersome. The idea of the lawmaker is certainly benevolent – to make remote participation in general meetings possible, and thereby, enhance shareholder participation. The provisions of the law must not be interpreted either to make meetings meaningless, or to render the conduct of the meeting unwieldy. The suggestions made by the author above imbibed from international practices, to carry forth the objective of the law. CS

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Independent Directors: Emerging to Emerged

With a view to bring about better corporate governance practices and prevent recurrence of financial and other scams the new Companies Act has mandated appointment of independent directors by all listed companies. This article highlights the salient features of the new provisions and requirements.

The term "independent director" as the name indicates, is an individual, appointed as a Board director and has no monetary relationship of any nature directly or indirectly with the company and is therefore considered as a person capable of exercising objective judgment on matters relating to the company and balances the conflicting interests of all stakeholder, acting at all times in the interest of the company.

Companies had independent directors even under the erstwhile Companies Act, 1956 ("Old Act"), but the Companies Act, 2013 ("New Act"), takes the role and scope to a new level of governance and transparency as well as lays down in clear and unambiguous terms, the requirements, duties, rights and obligations of independent directors and sets the expectation on eligible persons who qualify in age, experience and expertise to serve on the Boards of companies in India.

A few high-profile scams due to corporate governance failures in India and attendant criticism from stakeholders across the globe temporarily dented the image of India Inc and perhaps influenced the stringent requirements prescribed under the new law. For listed companies the additional requirement of compliance with clause 49 of the listing agreement has been further reinforced with amendments to the listing agreements that have imposed stricter norms to ensure that over time, governance practices in Indian companies will be on par with the best in the world.

DEFINITION AND MEANING

Section 149 (6) of the new Act defines an "independent director as a person

- who is not a managing, whole-time or nominee director
- of integrity and experience in the Board's view and
- With relation to a company, its holding, subsidiary or associate ("Entity")
  - Was/is not a promoter or related to any director or promoter of any of them
  - Has/had no financial transaction/relationship of any sort with any Entity or their promoters or directors for current and previous two financial years
  - Is not a CEO or director of a NGO that receives 25% funding from the company, its promoters or directors
  - Holds by himself/herself or with relatives in excess of 2% shareholding/voting interest in the company
  - Relatives of such director have no pecuniary transaction with any Entity for the current or two previous financial years exceeding 2% of their gross turnover or income exceeding INR 5 million
  - Relative/ director not a KMP, employee of any Entity for the preceding 3 years

> The appointment process of independent directors shall be independent of the company management and while selecting independent directors the board must ensure that there is appropriate balance of skills, experience and knowledge in the board so as to enable the board to discharge its functions and duties effectively.

- Relative/director was not a partner or employee for 3 preceding years of a firm of auditors, company secretaries, cost auditors of any Entity
- Relatives/director not a partner, employee for preceding 3 years of legal or consulting firm that was involved in any monetary transaction with an Entity exceeding 10% gross turnover of such firm.

NUMBER AND THRESHOLD LIMITS: WHO NEEDS TO APPOINT AND HOW MANY

Any public company that has a paid up capital of INR 100 million or more or a turnover of INR 1 billion or has in the aggregate outstanding loans, debentures or deposits exceeding INR 500 million is required to appoint at least 2 independent directors, though the number may increase to meet other criteria. Such companies also need to have an audit committee and a nomination and remuneration committee.

The provisions of clause 49 of the listing agreement have also been revised to align with the Act effective 1 October 2014. This provides in addition to the above criteria that a person cannot be an independent director in more than seven listed companies, which is further reduced to three if such person is a whole time director in a listed company. The amendment prescribes a maximum of two tenures of five consecutive years with a cooling off period of three years and companies are to issue formal letters of appointments to independent directors with terms that have to be disclosed on the website of the company and the stock exchanges forthwith. Any vacancy in such position has to be filled in within 3 months or the next Board meeting, though this is not mandatory if the Board already has the minimum prescribed number of independent directors.

While the new Act prescribes that the Boards of every listed company shall comprise of at least one third independent directors (to be complied within a year) the listing agreement requires that if the chairman is not a regular chairman, is an executive director, a promoter or his/her relative or related to a person in the Board or in the management one level below the Board, at least half the Board needs to be independent directors effective 1 October 2014.While one can take the view that the Act is legislation and hence superior to the listing agreement or directive of SEBI, it is not practical since the stock exchanges have the right to take penal action and delist a company for non compliance of its "agreement".

MANNER OF APPOINTMENT AND TENURE

Independent directors are not liable to retire by rotation but are required to be appointed by the shareholders on recommendation of the Board who have to justify the appointment and terms in the explanatory statement. The subsequent appointment will require a special resolution. If for some reason, the meeting is adjourned without approving such appointment, they will have to demit office unless elected at a subsequent meeting.

The government also envisages a "data bank" of eligible directors to be maintained by notified institutions from which companies can select independent directors though the liability of due diligence vests with the company. While the purpose of making the selection wide and neutral is to be lauded, the practical aspect of expecting very senior and talented individuals applying to data banks for empanelment remains a question mark.

Although the new Act prescribes a maximum of two tenures of five consecutive years, clause 49 also requires a cooling off period of three years before being considered for reappointment in the same company as an independent director.

In response to many queries, the government has recently clarified that-

(a) An independent's previous tenure will not be counted as long as such director is appointed under the new norms by 31 March 2015.

(b) A person may be appointed for a tenure of less than five years at a time but will then be entitled to two tenures only and not 10 years.

(c) Since the new norms are quite different, all independent directors will have to be newly appointed by the Board and shareholders before 31 March 2015. Since directors are appointed at general meetings only, all independent directors will be appointed at the forthcoming annual general meetings in most companies or in a general meeting convened for this purpose. Unless the tenure of each of the directors is different (unlikely since the Board has to justify the appointment including tenure in the explanatory statement)this may create a piquant situation of all the independent directors having a uniform tenure and retiring after completing their terms on the same date and the Board reconstituting its entire line up of independent directors once every five/ten years.

The appointment process of independent directors shall be independent of the company management and while selecting independent directors the board must ensure that there is appropriate balance of skills, experience and knowledge in the board so as to enable the board to discharge its functions and duties effectively. A formal letter of appointment is required to be given to all independent directors including the current directors who are appointed during the year. The letter should contain among other things the term of appointment, the expectation of the board from the appointed director, the board-level committee(s) in which the director is expected to serve and its tasks, the fiduciary duties that come with such an appointment along with accompanying liabilities, provision for directors and officers (D and O) insurance, if any, the code of business ethics that the company expects its directors and employees to follow, the list of actions that a director should not do while functioning as such in the company and the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the boards and other meetings and profit related commission, if any.

Interestingly, the terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours and shall also be posted on the relevant company's website.

It is also relevant to note that their reappointment is subject to evaluation of performance by the Board excepting the interested director. This adds a new dimension to transparency since Boards would find it exceedingly difficult to make public their evaluation of a colleague's performance if the rating is not high and provide this as an explanation for not recommending reappointment or for lesser tenure. Under the new Act, directors are required to state the reason for their resignation from the Board and the same has to be reported in the Director's report.

REQUIREMENTS AND RESTRICTIONS

Independent directors are not entitled to employee stock option, which by its very name is clearly meant only for employees and executive directors. In addition to sitting fee, directors are entitled to commission up to the limits set out in the Act in addition to reimbursement of actual expenses incurred for traveling to Board meetings but not for any other remuneration. The Ministry has recently clarified that "*pecuniary relationship does not include receipt of remuneration, as independent director, from the holding, subsidiary or associate company" or any service availed that would be available on the same terms to any member of the public(telephone services etc).*

The minimum and maximum eligible age is 21 and 70 years respectively though this can be extended by a special resolution. All directors have to obtain a director's Identification no (DIN) prior to appointment or else they are disqualified to be appointed. A director who does not attend meetings for 12 months automatically vacates office even if he/she has sought leave of absence.

PERFORMANCE EVALUATION

Performance of independent directors is to now be a closely monitored by the board of directors and the evaluation criteria in this regard finds a place in the annual reports of listed companies.

Under both new clause 49 and the new Act, independent directors are to meet at least once in a year without the presence of the non-independent directors at such meetings where among other things, the independent director will review the performance of the other directors of the company as well as of the chairman of the company and assess the quality, quantity and timeliness of flow of information between the company management and the board that is necessary for the Board to effectively and reasonably perform their duties. Likewise, performance of independent directors is evaluated by the Board and the criteria for the same has to be noted in the Board's report to the members.

Annual reports of listed companies are to also provide details of training imparted to independent directors on a variety of aspects of the company and their role in the same. Clearly, while the powers of the independent director are far more fortified under the current regime, the quantum of responsibility has amplified and it is now all the more important for a director to possess necessary skills and experience to perform the functions diligently.

The disclosure requirements of performance of the members of the Board in the Board report is a double edged sword and while a thumbs- up for transparency may create interpersonal issues in Board dynamics and perhaps even legal problems.

BOARD COMMITTEES: COMPOSITION AND ROLE

The new Act emphasizes on the relevance of appointing independent directors as members and chairpersons in various Board committees. Companies that need to appoint independent directors (public companies with a paid up capital of INR 100 million or more or a turnover of INR 1 billion or has in the aggregate outstanding loans, debentures or deposits exceeding INR 500 million) have also to form committees for various matters.

Audit committees must comprise at least three directors with a majority of independent directors and an independent director as chairman all members being financially literate. Audit committees are entrusted with various critical fiscal duties including assisting the board in the appointment of the auditors, issuing approval for related party transactions, examining financial statements and auditor's report, reviewing auditor's independence, providing valuation for the undertakings or assets of the company, evaluating the internal financial controls, monitoring the utilization of funds raised through public offers and conducting investigation into

The new Act has provided a level of comfort to independent directors from unnecessary harassment and prosecution for matters that are beyond their control as long as they acted in good faith with the organization's interest and above all sought information and clarification and relied on management for information regarding decisions.

any issues relating to these functions, if required, with a view to preventing fraudulent acts and omissions by companies. A vigil mechanism for reporting breach by employees and others is also required to be set up with protection to genuine complainants.

Corporate Social Responsibility Committee is a new requirement to recommend and later monitor the CSR policy, projects and spending and reporting. The minimum number is three directors with at least one independent director as its members. CSR approved activities include health, social, economic and environment development, education, sanitation, eradication of povery, gender equality and other matters that may be notified from time to time. Since the entire concept of mandatory CSR (explain or spend principle) is new, this committee will be the cynosure of all eyes and the success of CSR schemes an indicator of their performance.

Nomination and remuneration committee needs three or more non-executive directors of which one-half must be independent. The chairman of the Board may be a member but cannot chair the committee. Major agendas of this committee include identifying suitably qualified persons for directorships, recommending appointment and removal of directors, evaluating director's performances, formulating suitable remuneration policies and establishing criteria for determining qualifications, positive attributes and independence of directors.

Stakeholder relationship committee is required in every public company that has at least 1000 shareholders or debenture holders comprising at least three directors with the majority as well as the chairman being independent directors. The objective of this committee is oversight over the grievance redressal mechanism of shareholders.

DUTIES AND LIABILITY

Under the new Act, a large number of issues may be discussed and approved only at Board meetings, which means that major decisions of the company have to be mandatorily approved by the Board. Some of the new matters inter alia include appointment and removal of key managerial personnel, appointment of internal auditors and secretarial auditors, noting the appointment or removal of persons one level below the Board, buying and selling of non trade investments in excess of 5% of the paid up capital and free reserves, diversification of business, acquisition of controlling stake in a company, approving financial statements and Board report. Further, one third of the Board can now insist that a particular matter can be decided only at Board meetings and not by circulation. The agenda for meetings has to sent out at least 7 days in advance, though a shorter notice/agenda is permitted if one independent director is present at the meeting. If there are no independent directors present at a particular Board meetings, decisions taken at such meetings on the above matters shall be final only upon ratification by at least one independent director, even though the quorum was complete even without the presence of any independent director.

Duties of directors may be broadly classified as follows:

(a) Fiduciary duties

a. Duty of care to exercise appropriate diligence and make informed decisions
b. Duty of loyalty to act in good faith and honesty of purpose
c. Duty of acting always in the interest of the company
d. Balancing the conflicting interests of all stakeholders

(b) Business judgment rule

a. It is assumed that independent directors of a company will act in good faith and this provides a level of immunity from liability for loss incurred by companies in business decisions unless there is an allegation/incidence of misconduct or fraud
b. Directors are guilty and liable for acts of omission or commission on any matter that they knew and participated deliberately or should have known and were negligence, hence failed to know
c. Directors always need to ask the relevant questions, seek information and entitled to ask whether such information is complete, accurate and timely since only this will enable them to take informed and considered decisions objectively without bias or undue favour.

The new Act has provided a level of comfort to independent directors from unnecessary harassment and prosecution for matters that are beyond their control as long as they acted in good faith with the organization's interest and above all sought information and clarification and relied on management for information regarding decisions.

Following a recent commodity exchange scam, in order to strengthen the boards of the Forwards Market Commission, Government of India, has issued guidelines which draw attention to the importance of independent directors on boards. As per the

fresh guidelines, commodity exchanges must constitute a selection committee for hiring a managing director and that such committee must comprise five persons including two independent directors. Additionally, the new guidelines mandate that one independent director be made part of the selection committee and the meetings of such committee at all times.

The new Act seeks to balance the broad spectrum of responsibilities, functions and duties imposed on an independent director. Schedule IV of the new Act lays down a specific code on the professional conduct, role and functions including relating to safeguarding the interest of all stakeholders, particularly the minority holders, harmonizing the conflicting interest of the stakeholders, analyzing the performance of management, mediating in situations of conflict between management and the shareholder's interest, duties, manner of appointment, re-appointment, resignation, meetings and evaluation of independent directors. The code raises the bar of standards and expectations from independent directors to a great extent by imposing a significant amount of onus on them of investor protection.

As per the guidelines on professional conduct under Schedule IV of the new Act, an independent director is expected to uphold ethical standards of integrity and probity, act objectively and constructively while exercising his duties, exercise his responsibilities in a *bona fide* manner in the interest of the company, devote sufficient time and attention to his professional obligations for informed and balanced decision making, not allow any extraneous considerations that will vitiate the objectivity and independent judgment of an independent director, not abuse his/her position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person and refrain from any action that would lead to loss of his/her independence.

The role and functions of an independent director as stipulated Schedule IV of the new Act include helping in bringing an independent judgment and view on the board's deliberations, scrutinizing the performance of management in meeting agreed goals and objectives and monitoring the reporting of performance, satisfying themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible, safeguarding the interests of all stakeholders, particularly the minority shareholders, balancing the conflicting interest of the stakeholders, determining appropriate levels of remuneration of executive directors, key managerial personnel and senior management and having a prime role in appointing and where necessary recommending removal of executive directors, key managerial personnel and senior management, moderating and arbitrating in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

The various duties of independent directors outlined in Schedule IV of the new Act are a more detailed version of the roles and functions as above and include undertaking appropriate induction and regularly updating and refreshing their skills, knowledge and familiarity with the company, seeking appropriate clarification or amplification of information and where necessary, taking and following appropriate professional advice and opinion of outside experts at the expense of the company, striving to attend all meetings of the board of directors and of the board committees, participating constructively and actively in the committees of the board, striving to attend the general meetings of the company, in case of concerns about the running of the company or a proposed action, ensuring that these are addressed by the board and to the extent that they are not resolved, insisting that their concerns are recorded in the minutes of the board meeting, keeping themselves well informed about the company and the external environment in which it operates, not to unfairly obstruct the functioning of an otherwise proper board or committee of the board, paying sufficient attention and ensuring that adequate deliberations are held before approving related party transactions and assuring themselves that the same are in the interest of the company, ascertaining and ensuring that the company has an adequate and functional vigil mechanism, reporting concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy, acting within his/her authority, assisting in protecting the legitimate interests of the company, shareholders and its employees, not disclosing confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the board or required by law.

An interesting development in the UK listing rules for Controlled companies in which a single promoter owns at least 30% of voting power require that in a shareholder meeting, voting on independent directors is by majority of the minority shareholders with the promoter not casting any vote on these resolutions. If no approval is obtained, another meeting may be held within 120 days in which all shareholders can vote but this authority will be used judiciously and only in exceptional circumstances. However, it is important to note that all the power on independent directors does not lie with the minority shareholders and they are only bound to consider voting on resolutions of persons nominated by the Board, hence unlikely to cause a revolution.

Most Boards all over the world today, follow textbook standards for functioning with all the boxes ticked correctly but sometimes lacking in substance though perfect in form. There is a marked distinction between theory and practice and many a time independent directors are appointed for reputational reasons rather than proven ability though this is changing and will keep changing for the better as companies seriously cast a wide net to attract the best talent and not marquee names. The composition of the Board should reflect where the Board is going and not where is has been in the past. We are fighting the wrong battle if procedural rules are tightened and human elements underestimated. Critical requirements of the Board require fearless independence, constructive criticism and functioning of a team. The Act and the listing agreement has set the right tone, it is upto the Boards to make them effective. CS

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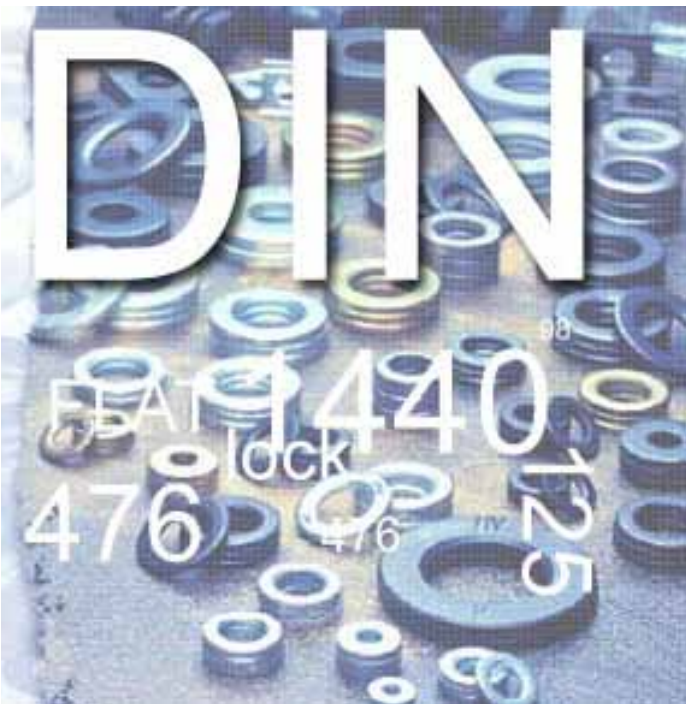
'DIN' For Director's Appointment Will Enable Tracking Accused Company Directors to Face Prosecution

The mandatory requirement of every appointee director to obtain 'Director's Identification Number' (DIN) to be issued by the Central Government will help the regulating/prosecuting agencies, to identify and trace the company directors to face prosecution.

The passing of the new Companies Act, 2013 ('the Act') and bringing into force a large number of provisions of the Act and the notification by the Central Government of relevant Rules framed under the Act have already energized the professional bodies like the Institute of Company Secretaries of India (ICSI); the Institute of Chartered Accountants of India (ICAI) and the Institute of Cost and Works Accountants of India (ICWAI) and all such professional bodies had been holding discussion meetings/seminars to apprise its members about the impact of the provisions of the new Act and how to comply with the same. Also, the regulatory bodies like the Registrar of Companies (ROC); the Securities and Exchange Board of India (SEBI) and the various Regional Directorates under the Ministry of Corporate Affairs (MCA) are gearing themselves up to the task of finding out whether the companies, be they listed or non-listed, comply strictly with the stringent provisions of the Act and its Rules. Already SEBI has issued amended listing guidelines for corporate governance norms to be fulfilled by the listed companies, highlighting, *inter-alia*, the role and responsibilities of the Independent Directors (ID) and the professionals associated with such companies are



> Seeking the vital information from the appointee directors is a pragmatic step because the prosecuting agencies often waste crucial time to obtain the bare details of the company directors whenever any mishap happens and/or where the company directors are to be prosecuted for offences committed by the company and to trace/track such directors to bring them to justice. Though this may not wholly eliminate the continuation of dubious promoters/directors who employ employees/officials to run the show from the front, even though the real control/ beneficial interests may be exercised by such promoters through 'behind the scene'/through remote control devices.

busy with preparation of check-lists of compliances to avoid show-cause notice for non-compliance.

Further, taking into account the difficulties being faced by companies in complying with the new provisions of the Act, almost on a regular basis, the MCA had been issuing notifications clarifying the procedural requirements to be followed by the companies. Put together, all these seem to be a heavy burden for the company directors and the company professionals entrusted with the task of compliance. The pious hope is that strict compliance with the Act and the Rules will ensure good corporate governance and will prevent corporate frauds and will boost investor confidence and the Indian companies can enhance their image in the country and in the international markets. It appears that the provisions of the new Act and the Rules are being treated as a panacea of all corporate ills, but time only will tell how far this pious hope gets implemented in letter and in spirit.

While many seminars were/are being organised by the professional bodies to apprise their members about the changes in the Companies Act in 2013 and the new role and responsibility of the professionals, in almost all the professional journals and the economic dailies, critically analysed articles were published regularly about the provisions of the new Act and its Rules. These became very handy for the professionals and the corporate sector.

Simultaneously, many private practitioners and various chambers of commerce and industry started voicing their serious viewpoints and apprehensions about the usefulness of many provisions of the new Act and the consequential difficulties in implementing the provisions of the new Act and Rules. They pointed out that the provisions of the new Act are too stringent, particularly for the private limited companies which are not subsidiaries of any public limited company and which have not availed of public finance and/ or where the large body of public are not interested. Objections have also been raised about the compulsory appointment of woman director on the Board of certain companies. Objectors have also highlighted the non-availability of Independent Directors who could meet all the required parameters for such appointments. Objections have also been raised about the provisions in the Act about 'corporate social responsibility' (CSR) clauses and the compulsory spending required from the concerned companies. It has been pointed out that being a voluntary initiative, many companies have already been spending monies on socially relevant projects aimed at upgrading the quality and welfare of human life.

Recent newspaper reports also suggest that with the new Government in place at the Centre, is likely to be thoroughly review of the Companies Act, 2013 and objectionable provisions of the Act will be relooked and changed to give relief to the industry body. Though the new Act has incorporated provisions for setting up of Special Courts to deal with corporate offences, including 'corporate frauds' for which a new chapter has been included in the Act, the trade and industry bodies are seeking relief in the laws and regulations to shield/insulate company directors who are hauled up by the Courts under the provisions of the Indian Penal Code (IPC) on the allegations of cheating; breach of trust; fraud and deliberate hoodwinking of gullible public/investors through attractive schemes. It is a cause of concern that while the new Companies Act has enacted many stringent provisions to prevent corporate fraud and to penalise the brains behind such frauds and to bring to justice the real beneficiaries of such fraudulent activities, how proposed dilution of penal provisions of the new Act and in the IPC will help the investors and stakeholders and how it will boost investors' confidence in the corporate sector. Such exercises should not be undertaken lightly and in a hurry

to please one segment of the society at the cost of large body of common people and hapless investors.

Though this article will not do detailed threadbare analysis of the various provisions of the Act relating to directors, which the listed and unlisted companies will have to comply with, yet, it will highlight some significant changes which will curb the escape route for the company directors, whom the prosecuting agencies would like to haul up for various non-compliances. **The mandatory requirement of every appointee director to obtain 'Director's Identification Number' (DIN) to be issued by the Central Government will help the regulating/prosecuting agencies, to identify and trace the company directors to face prosecution.** Though 'DIN' is not a new provision in the Companies Act, 2013, yet the changed provision in the new Act and its Rules seek relevant details of the directors and makes the applicant liable to prosecution for giving false, incorrect details and/or suppressing material information. With the important details of the directors which are furnished at the time of applying for 'DIN', it is hoped that the Central Government will not be handicapped for want of detailed information about those directors, who are ostensibly the persons in-charge of and responsible for the conduct of business and affairs of the accused/non-compliant company.

It is felt that seeking the vital information from the appointee directors is a pragmatic step because the prosecuting agencies often waste crucial time to obtain the bare details of the company directors whenever any mishap happens and/or where the company directors are to be prosecuted for offences committed by the company and to trace/track such directors to bring them to justice. Though this may not wholly eliminate the continuation of dubious promoters/directors who employ employees/officials to run the show from the front, even though the real control/beneficial interests may be exercised by such promoters through 'behind the scene'/through remote control devices. It is hoped that mandatory obtaining of information about promoter directors at the time of formation of a company will exercise some curb on misuse of company form of organization by dubious promoters who carry on illegal, harmful and unhealthy activities.

With regard to the requirements of 'DIN', the Central Government has framed the 'Companies (Appointment and Qualification of Directors) Rules, 2014' which elaborately prescribe the Rules to be followed by the companies in appointing directors and the particulars to be furnished and the supporting documents to be filed with the Central Government by the appointee (proposed director). The Central Government has framed the said Rules by exercising powers under the second proviso to sub-section (1); clause (f) of sub-section (6) of Section 149; sub-section (3) and (4) of section 150; sections 151; 160 and sub-section (1) of section 168 and provisions of section 170 read with the provisions of Section 469 of the Companies Act, 2013. The law now mandates that no company can appoint a person as a 'director' on its Board who has not been allotted a Director's Identification Number (DIN) and for applying for DIN, the Central Government has prescribed Form DIR-3, which require the applicant director(proposed appointee) to furnish his full name; father's name; (in case of married woman applicant, in addition to husband's name, the name of her father is required to be given); the nationality of the applicant; whether resident in India or not; occupation; educational qualification; date of birth; gender; place of birth; Income-Tax Permanent Account Number details; voter identification card number; passport number; driving license number; Aadhaar Card number; details of permanent residential address – phone number, mobile number; fax number; e-mail; and whether the permanent residential address and the present residential are the same or not. The applicant has to be file documents on proof of identity and proof of residence and has to vouch that the particulars furnished and the documents attached to the application form are true, correct and complete and that no material information has been suppressed. The applicant has also to vouch and will have to agree that the applicant will be liable for action under section 449 of the new Act for any wrong certification, if found at any stage, which will also make him/her liable for penal action under sections 448 and 449 of the new Act. Any person accepting the position of a director in any company will henceforth be required to understand and appreciate that the position of 'company director' is not merely decorative, but entails huge responsibility and utmost diligence, care and caution is required to be exercised in fulfilling such a role. Since the activities of companies impact virtually all the stakeholders and since companies usually use the natural resources of the nation, the companies, which act through the directors, owe a duty to the society at large to account for every action taken in the name of the company and no negligence, fraudulent manipulation and illegality can be allowed.

> In a criminal proceeding against the accused director, the Court has no power to grant relief from civil liability incurred by the accused. Where a director apprehends that he may be hauled up in a court, he can then apply to the High Court for relief under Section 463(2) of the Act. However, before granting relief, the High Court will give notice to the Registrar of Companies to show cause why such relief cannot be granted.

Under the aforesaid Rules, the Central Government has the power to call for further information from the DIN applicant and it may ask him to rectify the defects/inaccuracies noticed in the application. If these details are not furnished, the application for DIN may even be rejected. Rule No.6 of the said Rules stipulate that the DIN allotted to an applicant under the Rules is valid for the life-time of the applicant and shall not be allotted to any other person. Further, Rule 11 of the said Rules provides for cancellation or surrender or deactivation of DIN by the Central Government, where the DIN is found to be duplicated in respect of the same person, and the data related to both the DIN can be merged with the validly retained number; or the allotted DIN can be cancelled where it is found that the DIN was obtained in a wrongful manner or by fraudulent means; or on the death of the concerned individual; or where the concerned individual has been declared as a person of unsound mind by a competent Court; or if the concerned individual has been adjudicated an insolvent. By way of explanation, the said Rules make it clear that the term "wrongful manner" means if the DIN is obtained on the strength of documents which are not legally valid or incomplete documents are furnished or on suppression of material information or on the basis of wrong certification or by making misleading or false information or by misrepresentation; and that the term "fraudulent means" means if the DIN is obtained with an intent to deceive any other person or any authority including the Central Government.

Section 156 of the Act stipulates that every existing Director, within a period of 30 days, of receipt of his DIN shall inform the same to the company concerned or companies where he is a director. Section 157 of the Act stipulates that every company shall, within 15 days of receipt of intimation under section 156 of the Act about the DIN of all its directors shall furnish to the Registrar of Companies the said particulars with the prescribed fee. Failure to furnish such particulars within the stipulated period will make the company liable for fine which may range between Rs.25,000/- to Rs.1,00,000/-. Again, section 158 of the Act stipulates that every person or company while furnishing any return, information or particulars required to be furnished under the Act, shall mention the DIN of directors in such return, information or particulars. Section 152 of the Act regarding appointment of Directors, provides, *inter-alia*, that no person shall be appointed as a director of a company unless he has been allotted the DIN under Section 154, which mandates the Central Government to allot the DIN within one month of receipt of the application for DIN under section 153. Section 155 prohibits obtaining more than one DIN. It is worth noting that Section 159 of the Act stipulates that if any individual or director of a company contravenes any of the provisions of section 152, section 155 and section 156, such individual or director of the company shall be liable for punishment with imprisonment for a term which may extend to 6 months or with fine which may extend to Rs.50,000/- and where the contravention is a continuing one, with further fine which may extend to Rs.5,000/- for every day after the first during which the contravention continues.

Rule 12 of the said Rules stipulates that every individual who has been allotted a DIN under the aforesaid rules shall, in the event of any change in his particulars as stated in his application for DIN intimate such change(s) to the Central Government within a period of thirty days of such change(s) in the prescribed form and fill in the relevant changes, attach copy of the proof of the changed particulars and that the same be verified in the prescribed form, all of which shall be scanned and submitted electronically; and that the said form shall be digitally signed by a chartered accountant in practice or a company secretary in practice or a cost accountant in practice. The Central Government, upon being satisfied, after verification of such changed particulars from the enclosed proofs, shall incorporate the said changes and inform the applicant by way of a letter by post or electronically or in any other mode confirming the effect of such change in the electronic database maintained

by the MCA. The DIN cell of the Ministry shall also intimate the change(s) in the particulars of the director submitted to it to the concerned Registrar of Companies (ROC) under whose jurisdiction the registered office of the company(s) in which such individual is a director is situated. The concerned individual shall also intimate the change(s) in his particulars to the company or companies in which he is a director within fifteen days of such change.

Section 164 of the Act stipulates disqualifications for appointment of directors and clause (h) of sub-section (1) of the said section states that the appointment of a person who has not been allotted a DIN will be treated as a disqualification. Rule 14 of the aforesaid Rules stipulates, inter-alia, that whenever a company fails to file the financial statements or annual returns, or fails to repay any deposit, interest, dividend, or fails to redeem its debentures, as specified in sub-section (2) of section 164 of the Act, the company shall immediately file Form DIR-9, to the Registrar of Companies furnishing therein the names and addresses of all the directors of the company during the relevant financial years. When a company fails to file the Form DIR-9 within a period of thirty days of the failure, that would attract the disqualification under sub-section (2) of section 164 and the officers of the company specified in clause (60) of section 2 of the Act shall be the 'officers in default'. Upon receipt of the Form DIR-9 the ROC shall immediately register the document and place it in the document file for public inspection. Any application for removal of disqualification of directors shall be made in Form DIR-10.

Section 166 of the Act defines the duties of directors, which stipulate, *inter-alia*, that a director of a company shall act in good faith in order to promote the objects of the company for the benefit of members as a whole and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment. The said section further stipulates that a director shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment and that a director shall not involve in a situation in which he may have direct or indirect interest that conflicts or possibly may conflict with the interests of the company. A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or the relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay to the company an amount equal to that gain. It is the duty of every director to ensure that the annual accounts of a company are prepared, audited and that the annual returns are prepared in accordance with section 92 of the Act and filed with the ROC in accordance with the law. Contravention of provisions of the said section will entail fine ranging between Rs. 1 lakh to Rs.5 lakhs. Section 134 of the Act stipulates that it shall be the duty of the Board of Directors (BOD) of a company to prepare, for disclosure to shareholders, a Financial Statement including consolidated financial statement, if any and such a statement shall be approved by the BOD before they are signed on behalf of the Board by the Chairperson of the company where he is authorised by the Board or by two directors, out of which one shall be the Managing Director and Chief Executive Officer, if he is a director of a company; the Chief Financial Officer and the Company Secretary for submission to the Auditors for their report thereon.

The circumstances in which the office of a director shall stand vacated are enumerated in section 167 of the Act. Section 195 of the Act prohibits indulging in insider trading. It is worth noting that so long as the directors exercise due diligence, care and caution in performing their duties, they incur no personal liability. In this regard it is important to note that as per section 149(12) of the Act, a non-executive director including an independent director or nominee director will be held liable and accountable only in respect of such acts or omission or commission by a company which occurred with his knowledge and can be attributable to the Board processes and with his consent or connivance or where he had not acted diligently.

For directors who perform their duties diligently, section 463 of the Act provides some relief. Section 463(1) stipulates that in any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against an officer of a company (which includes director), if it appears to the Court hearing the case that the accused person has acted honestly, reasonably and diligently, then the Court can grant him relief as it may deem fit and proper. However, in a criminal proceeding against the accused director, the Court has no power to grant relief from civil liability incurred by the accused. Where a director apprehends that he may be hauled up in a court, he can then apply to the High Court for relief under Section 463(2) of the Act. However, before granting relief, the High Court will give notice to the Registrar of Companies to show cause why such relief cannot be granted.

CONCLUSION

Since heavy and onerous duties are cast on company directors to perform in accordance with the laws and regulations and since non-compliances result in imposition of fine and even imprisonment, the company director's position ought to be accepted after due consideration and deliberation. By virtue of their unique position on the company's Board, the directors can have access not only to the in-house legal help, but can even seek outside legal help and assistance, wherever necessary and thus they need not feel helpless in performing their duties diligently. When hauled up in a court of law, since it becomes very difficult to get automatic relief from the court without going through the process of trial (which is always tedious, cumbersome and lengthy), the directors can and should avoid that stage to come and should exercise vigil, care, caution and diligence in performing their duties in ensuring good corporate governance. This brings the importance of in-house training facilities for the company directors and in this regard the ICSI and its experienced members in the profession can be of great help. CS

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Impact of The New Rules Under Companies Act, 2013

Unlike the Companies Ac, 1956, the new Act contains basically the substantive provisions only, relegating the procedural provisions to the rule making powers of the Executive. The Government has by now put in place a plethora of rules to support the substantive provisions. The impact of the Rules are critically examined here.

INTRODUCTION

The Companies Act, 2013 was passed by Lok Sabha on 18th December, 2012, and by the Rajya Sabha on 8th August, 2013 and 98 sections were notified on 12th September, 2013. Finally on 1st April, 2014 most of the other Sections were notified except certain sections under chapters relating to inspection, inquiry and investigation; compromise, arrangements and amalgamations; prevention of operation and mismanagement; registered valuers; removal of names of companies from the register of companies; revival and rehabilitation of sick company; winding up; winding up by the tribunal; voluntary winding up; provisions applicable to every mode of winding up; official liquidators; companies authorized to register under this act; national company law tribunal; special courts.

Companies Act 2013 has replaced the more than six decades old Companies Act of 1956. In doing so the Parliament has compressed many scattered provisions under the old Act and consolidated the same by deleting obsolete provisions. As a result, the new Act has 470 Sections under 29 Chapters and seven Schedules as against 658 sections under 12 Chapters and fifteen Schedules of the 1956 Act. In the process, the Parliament has moved away from the old format of retaining substantial and procedural provisions in the statute. It has retained only substantial powers in the Act and procedural matters have been transferred to delegated rules. Thus more than 70 per cent of the provisions of the statutes would be dealt by the Government without seeking prior approval of the Parliament. Thus they have adopted a new approach of retaining substantial provisions in the Act and delegating the procedural aspects to the Rule making body. The

procedural aspects would be easy to modify to keep pace with the fast changing economic and other requirements. These rules shall be laid before each house of Parliament, while in session for a total period of 30 days.

DRAFT RULES

One of the unique features of Rules under the Act is that draft rules were kept open for public comments. While finalizing the draft rules the Government has taken into consideration the views of Industries Associations, Professional bodies and Institutions. The above system has helped in modifying various draft rules while finalizing the same. Some of the important features are discussed herein.

a. Relatives:

The definition of related party in the draft rules was very wide and unwieldy for practical operations this would be clear from the comparison of two definitions in the draft and final rules.

Draft Rules	Final Rules
List of relatives For the purposes of sub-clause (iii) of sub-section (77) of section 2, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner: (1) Spouse (2) Father (including step-father) (3) Father's father (4) Father's mother (5) Mother (including step-mother) (6) Mother's mother (7) Mother's father (8) Son (including step-son) (9) Son's wife (10) Son's son (11) Son's daughter (12) Daughter (including step-daughter) (13) Daughter's husband (14) Brother (including step-brother) (15) Sister (including step-sister)	"Relative" with reference to any person, means anyone who is 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 as per following list. (1) Father: Provided that the term "Father" includes step-father. (2) Mother: Provided that the term "Mother" includes the step-mother. (3) Son: Provided that the term "Son" includes the step-son. (4) Son's wife. (5) Daughter. (6) Daughter's husband. (7) Brother: Provided that the term "Brother" includes the step-brother; (8) Sister: Provided that the term "Sister" includes the step-sister.

In the draft rules the list of relatives was very wide covering 17 relatives including HUF and the spouse. The draft Rules covered relatives spread over 5 Generations. In the Final Rules the relatives had been limited to three generations. In the old system of Joint Hindu Family relative used to reside under one roof. With the globalization and growth of job opportunities in cities the relatives are widespread and Joint Hindu Families had been substantively replaced by unit family as a result one brother does not know what the other brother is doing, not to speak of brother in laws and sister in laws. In the process directors and Key managerial personal were finding difficult to ascertain the interest of relatives in holding or subsidiaries companies.

As a matter of fact only dependent parents and dependent children could be legitimately included in the List of Relatives, in which case the head of the family is aware of the transaction. The matter gets complicated when such details are asked from Foreign Directors.

b. Related Party

A Related Party definition under section 2 sub clause 76

A Public Company in which a director or manager is a director and holds along with his relatives more than *2%* of its paid up share capital (the word "or holds" has been changed to "and holds" by Company's 1st (Removal of Difficulties) Order, 2014. Thus a Public Company does not become its related party merely because there is a common director. This difficulty was removed by the Ministry after Public comments and practical difficulties faced by Corporate World.

c. Difficulties in Incorporation

The incorporation process has been made more complicated and costly. This results in delay of incorporation of Companies which is found more painful when foreign national want to incorporate Company in India. According to World Bank Report incorporation in advanced countries is carried out in one day where as in India it takes 25 to 30 days. Therefore, there is an urgent need to re-visit the incorporation procedure and simplify the same. According to new procedure for filing forms resubmission is allowed only once, whereas, under the old Act resubmission was not limited to one time only.

ACCEPTANCE OF DEPOSIT

Under the 1956 Act, acceptance of deposits from members, directors or their relatives could be done without any regulatory compliance. Under section 73 of the 2013 Act, a private company is required to undergo lot of formalities before accepting any deposits from its members also. It also has become costly even as compared to bank deposits. By a recent circular the MCA has clarified that insurance cover for deposit is not required. However, the following two suggestions deserve consideration:

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1. Under the Act the company is required to create deposit repayment reserve account and deposit 15% of deposits maturing during immediately two years with any schedule bank. Thus in aggregate a company is required to deposit 30 per cent of deposit maturing in the immediately two years. (Current Financial Year and the next financial year). Further, the amount so deposited shall not be utilized for any purpose other than for repayment of deposits. The 15% deposit be restricted to only deposits maturing during the year. This will reduce the cost of acceptance of deposit.

2. The eligibility criteria for public companies to accept deposit be reduced from net worth of 100 Crores rupees to Rs. 50 Crores and turnover of Rs. 500 to Rs. 250 Crores. Further, the track record of the company in repayment of deposit and interest may be taken into consideration while reducing the eligibility criteria. For example there are many companies which have been resorting to public deposits and honouring their commitments for repayment of deposit and interest thereon without any default, such companies would be put to sever financial constrains.

PARTICIPATION IN BOARD AND GENERAL MEETINGS

Most of the private companies are two member companies comprising of husband and wife as directors and members. Such couples also create other private companies. In their dealings between two such companies, the restriction imposed by Section 184 of the Companies Act, 2013 for passing board and general meeting resolutions has brought many such transactions to a deadlock, even in cases where there are only two directors and one of the directors is interested in a transaction, the transaction shall not be possible, in as much as related parties are prohibited from participating in a discussion and voting on the resolutions. As a result, such companies have to induct outside person both as a director and shareholder. Such inducted persons who carry 0.1 per cent of the shares of the company pass resolutions in respect of material transactions. This has created unprecedented complications for private companies which are unconnected with any promoter group.

The concept of related party could be validly applied in the context of companies where there are both related and unrelated directors / members. In public listed companies there are promoters' group shareholders and minority shareholders. There such a concept could properly be applied for listed companies. Thus, there is a need for grant of relief to private companies.

Earlier under section 300 (2) of the Companies Act, 1956, the Directors in Private Limited Company were not debarred from taking part in discussion and voting and not excluded for the purpose of quorum in respect of resolution in which they are interested. Now under Rule 15 of Chapter XII of Companies Act, 2013 the directors of Private Limited Company shall not be present at the meeting during the discussion on subject matter in which they are interested.

ORDINARY BUSINESS AT AGM

Under the 1956 Act, ordinary business was reserved for deliberation at the Annual General Meeting. Under the 2013 Act even ordinary business like adoption of accounts, retirement of directors, declaration of dividend and appointment of Auditors have been subjected to E-voting, thereby the seriousness of Annual General Meeting have been considerably reduced.

RETIREMENT OF DIRECTORS BY ROTATION

Under the 2013 Act, Independent Directors are not liable to retire by rotation. Further,Managing/ Whole time Directors are appointed for a term of 3-5 years. Therefore, in many instances confusion prevails in applying the rule of two thirds Directors retiring by rotation. In some critical cases, the managing / whole time director, who was appointed for a term of three years is required to be retired, which may tantamount to break in service. Thus there is an urgent need for clarification in this matter.

CONCLUSION

The Companies Act, 2013 appears to have been enforced in haste. Many provisions require review and reconsideration. Even the matter of general meeting, e-voting and deliberation at the meeting is full of controversy and pending before the Bombay High Court. In a short span of less than three months MCA has issued about 16 Circulars, 6 Notifications 4 removals of difficulties Order. Another area where difficulty is experienced relates to frequent revision of prescribed forms resulting in delay in submission / resubmission. The need of the hour is to urgently bring an end to controversial issues in consultation with professionals and corporates. CS

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The Companies Rules 2014: A Critique

Subordinate or delegated legislation lays out the road map for proper implementation of an enactment by a State or the Centre. The delegated legislation sub-serves the objectives behind the main legislation and remains within the broad framework of the main or parent Act. Else, it is liable to be struck down by courts as invalid. The new company rules notified by the Ministry of Corporate Affairs recently are subjected to a critical evaluation from the perspective of the company secretaryship profession.

Never before in the annals of the corporate sector has there been a more piquant situation than the recent one that followed the new legal regime in MCA with its notification of most of the sections of the Companies Act 2013 (the Act) and Final Rules there under in the last week of March 2014 which took effect from 1st day of April 2014 unleashing a spate of controversies with underlying discontent, disbelief and anxiety of certain sections of the society – especially the company secretaries who were hit harder.

Over 25000 company secretaries and over 3 to 4 lakh students of company secretaryship course became gloomy about their employment and public practice in particular and future prospects in general necessitating their professional body ICSI to make a number of representations to MCA and the Union Minister for Company Affairs for a review of the Rules with a view to allaying their fears and restoring their future prospects under the new law.

It is proposed to analyse and evaluate the vital issues involved in the record of compliance by MCA with the said Code of the Government of India for drafting and issuing subordinate legislation since much of the misery experienced by sections of society or the public due to hurried finalisation of the draft Rules without due consultation with the affected stakeholders with a view to hitting the self-imposed deadline of 1st April 2014.

SUBORDINATE OR DELEGATED LEGISLATION: VITAL STEPS AS PER GOI CODE

Subordinate or delegated legislation lays out the road map for proper implementation of an enactment by a State or the Centre. The delegated legislation sub-serves the objectives behind the main legislation and remains within the broad framework of the main or parent Act. Else, such legislation is liable to be struck down by courts as invalid.

Chapter 11 of the Government of India (GoI) Manual of Procedure details the steps to be followed by a Ministry in framing Rules under an enactment of Parliament a synopsis of which is given below:

(a) While publishing the draft Rules in the Gazette and newspapers, it shall send registered letters to all those likely to be affected by such Rules inviting their comments in order to ensure that the legitimate interests of any persons or section of the public are not unduly or adversely affected.

(b) If the suggestions or comments received are large, final rules may be notified by taking as much as six (6) months from the date of receiving the public comments. An extension of three (3) months has been provided for in special cases, with the permission of the Minister.

(c) Final draft rules are to be tabled in the Parliament for information and scrutiny of any member of the Parliament who may propose an amendment thereto. Such amendments made by members in one House of the Parliament are communicated to the other House by the LS/RS Secretariat.

(c) The Parliament's Committee on Subordinate Legislation scrutinizes all such amendments and submits a report of its recommendations to the Minister for Parliamentary Affairs who in turn examines the same and, after approval by the House, forwards them to the Department concerned for taking further action promptly and to submit an "Action taken report" to the Lok Sabha and Rajya Sabha Secretariats.

ADDITIONAL GENERAL TENETS

In addition to the above administrative steps, the delegated legislation has to satisfy the following general or basic principles to remain acceptable to one and all to become implementable by the users/compliers :

First and foremost, it should be a friendly guide to the users or compliers which requires the rules and forms to be simple, straight-forward, lucid, transparent and easily understandable. Accordingly, each Rule and Form should bear reference to the number of the source-Section or Sub-Section or the Proviso from which the Rule or the Form has emanated.

Second, the Rules must be confined to the ambit of the letter and spirit of the Section and no attempt should be made to transgress such boundary limits (like the proverbial lakshman rekha). The Rule or the Form should not become more onerous or rigorous or unhelpful than the parent Section itself. The Rule should not become new or additional legislation altogether.

Third, the Rules must conform to the principles of natural justice and underscore the overall Public good which, ultimately, any legislation should uphold. A humane touch is a must.

Fourth, the Rules must reflect the good faith that the Parliament has reposed in the Executive for issuing subordinate legislation. For example, Rules should have been well-thought out, well-discussed with the stakeholders which automatically means that thee shall be no hurry in finalizing the draft Rules until the views of all the stakeholders have been considered in depth and a satisfactory solution has been arrived at acceptable to all.

Fifth, the Rules should be consistent inter se and be in harmony, as far as possible, with other applicable Rules of the same and allied enactments applicable to the user.

Sixth, the Rules should pass the test of reason and relevance of the day at all times which means that they need to be kept updated periodically which is a basic purpose of subordinate legislation.

ADDED SIGNIFICANCE OF THE COMPANIES RULES, 2014

The Companies Rules 2014 have gathered additional significance due to certain special factors underscoring it, such as (a) a 'more-than-usual' part of the Companies Act 2013 including several sensitive subjects have been entrusted to the care of the Executive (MCA) to detail and prescribe judiciously by way of Rules, Forms, Notifications etc in order to keep the law abreast of developments over time without having to amend the law in the Parliament frequently. MCA has thus been charged with a trustee-like responsibility which MCA should discharge with great care and distinction winning the approbation of all concerned. This responsibility assumes a tad higher significance when it is realized that MCA shares the overall vision of the country to become a Developed Nation by 2020.

OBJECTIVE EVALUATION OF THE COMPANIES RULES 2014

MCA has no doubt bestowed great care and attention to detail in drafting and finalizing the Companies Rules & Forms but, perhaps due to its haste and hurry, some unintended but serious lapses and errors have crept into some of the Rules taking a heavy toll of MCA's image in the eyes of the public. Viewed against the combined criteria afore mentioned the Companies Rules 2014 (the

> The removal of the requirement of pre-certification of eforms has seriously clipped and curbed the growing public practice of young company secretaries who have been aiding the growth of good corporate governance in the country. MCA should take urgent steps to rectify these unintended or unforeseen hardships in consultation with the statutory bodies like ICSI. By and large the *status quo ante* should be restored soon.

Rules) may be said to suffer from some the following infirmities that have caused mental agony to some vulnerable sections of society, namely the company directors, industrialists, businessmen or the professionals in general and the company secretaries in particular.

The drafts initially released by MCA for public comment were well received and responded to by one and all. However, the revisions made in the rules were not made public in a similar way for public comments, especially since the revisions were very different from the earlier drafts. It is surmised that this may have resulted from MCA's hurry to meet their internal deadline of 1st April 2014.

Failure to interact with even a statutory body like the ICSI has caused widespread dismay, discontentment, displeasure, even anger among the company secretaries, justifiably. This article examines and analyses the issues involved with a view to finding a road map for MCA to consider and move forward.

HURRIED ENACTMENT OF FINAL RULES AND FORMS

Measures like the following, namely (a) the doubling of the threshold limits for mandatory appointment of CS (doubling the threshold of paid-up capital limit (for appointment of company secretaries) from the erstwhile Rs. 5 crore to Rs. 10 crore which of course has now been restored to Rs. 5 crore) (b) omission of Private Companies (which form a whopping 90 to 95 per cent of the company population from the scope of such mandatory requirement (this too has since been amended to restore the position that obtained prior to the Rules) and (c) removing the requirement of pre-certification of e-forms seriously affected the present and future prospects of over 30000 qualified Secretaries and over 4 lakh CS student population.

Careful consideration of such changes in consultation with the affected stakeholders (at least with bodies like ICSI, CII etc) would have had the twin benefits of avoiding the introduction of controversial rules but also enhanced the reputation of MCA as a responsible Ministry worthy of the trust placed by the Parliament.

The removal of the requirement of pre-certification of eforms has seriously clipped and curbed the growing public practice of young company secretaries who have been aiding the growth of good corporate governance in the country. MCA should take urgent steps to rectify these unintended or unforeseen hardships in consultation with the statutory bodies like ICSI. By and large the *status quo ante* should be restored soon.

The salutary introduction of gradual professionalism in the country's corporate management, (journey of which commenced as far back as in 1970 with the abolition of a century-old managing agency system and induction of qualified professionals) may be said to have been derailed with the above measures taken by MCA.

Some of the Rules have repeated the provisions of the section(s) pursuant to which they have been framed. For example, Rule 34 repeats the contents of section 17.

Rule 4 of Companies Appointment and Qualification of Directors) Rules requires vacancies among IDs to be filled up by the Board within 3 months while the Act requires the appointment of ID only by general meeting, within six months which is also in sync with the listing agreement. MCA must solve this riddle soon. MCA may also explain why the name of ID's spouse, her/his PAN, mobile numbers are required to be uploaded on the websites, causing erosion of privacy.

Rule 7 (vide Sec.151) regarding Small Shareholders' Director (SSD) does not clarify whether the deposit of Rs. one lakh prescribed in section 160 (1) needs to be deposited by the small shareholders proposing a person for appointment as SSD.

Rule 16 (vide section 168) requires the resigning director to file copy of his resignation with reasons for resignation. However, Rule 9 that requires intimation to RoC about appointment of director does not require reason for appointing him/her as a director. Either rule needs to be amended for a uniform rationale.

No guidance has been provided for the method to be followed for evaluation of the performance of IDs (sections 149 & 150) or for making self-evaluation of its performance by the Board (Sec.134)

Rule 3 of the Companies (Management & Administration) Rules should clarify/confirm that maintenance of the Register of Members by the RTA shall be in compliance with the said Rule and that no authentication is required of entries in the registers maintained in electronic form, since it is system-generated.

Blanket prohibition in Rule 4 of Companies (meetings of Board and its powers) Rules for the items of business listed therein being transacted at board meetings held in video mode. This should be

> By framing the Rules Chapter-wise, instead of Section-wise as under the 1956 Act, references to the relevant Section or Sub-section etc. have been omitted to be given in the Rule or in the Form causing considerable confusion to the users or compliers. The provision of *non-obstante* clauses in many of the Sections have added to difficulties in understanding the rules and forms. The novel method followed by MCA under the Companies Act 2013 has rendered the present rules and the forms unclear and unfriendly to the users and compliers.

relaxed where there is physical presence of quorum at the main (physical) venue of the meeting. Video board meetings should be allowed to be held anywhere in the world to reap the benefits of such facility. Except very important items like consideration and approval of audited annual accounts, reviewing performance of directors and the board etc boards should be allowed to transact other business at video meetings to the extent advantageous to the company.

Rule (vide section 173) regarding video board meetings, requires the company to "record the proceedings and prepare the minutes of the meeting". MCA should clarify that the 'proceedings' here pertain only to the summary of decisions including the assent or dissent of the participating directors and not to the detailed proceedings of the meeting.

Rule 22(4) (vide section 110) re: postal ballot requires the notice of postal ballot to be placed on the website of the company, thus implying the maintenance of a mandatory website. This should be made optional.

Business transactions entered into by a company in its ordinary course of business and which do not carry any conflict of interest (being at arms-length) are exempt from the requirements of board resolution or special resolution mentioned in section 188 (1). However rule 15 of Companies (Meetings of Board and its powers) Rules has taken away this exemption for transactions in companies having a paid-up capital of Rs.10 crore and more which is clearly a breach of the section. This breach must be rectified soon. The paid-up capital limit also needs to be increased to, say, Rs.50 crore. Further, Private companies may be exempted from the requirements of the Rules. Furthermore, item 2 of Form AOC2 seeking details of transactions at arm's length basis is a negation of the third proviso to sub-section (1) of section 188.

Rule 3 (vide section 139) re: appointment of auditors: In the Explanation to Rule 3 it may be clarified that an auditor whose appointment has not been ratified by the AGM ceases to hold office as auditor *ipso facto* at that AGM and that the casual vacancy be filled by the Board on the lines provided in sub-section (8) of section 139.

In rule 3 of Companies (Declaration and Payment of Dividend) Rules the word 'adequacy' should be changed to 'inadequacy'.

INCONGRUITY OR INCOMPATIBILITY OF THE (FINAL) DRAFT RULES WITH THE FINAL RULE

Many of the measures mentioned above have also rendered the Final Rules to differ altogether from the immediately preceding final draft Rules, in many crucial areas. Examples include: (a) doubling the thresholds of capital detailed at Para 4.2 (a) above; and (b) wide variation in the threshold limits in the final Rule 4 of the Companies (Appointment and Qualification of directors) Rules in respect of the appointment of IDs – capital limit of Rs.100 crore or more and outstanding loans limit of Rs.200 crore or more in the draft Rules have been changed to Rs. 10 crore or more and Rs.50 crore or more respectively in the Final Rules.

SACRIFICE OF TRANSPARENCY/CLARITY

By framing the Rules Chapter-wise, instead of Section-wise as under the 1956 Act, references to the relevant Section or Sub-section etc. have been omitted to be given in the Rule or in the Form causing considerable confusion to the users or compliers. The provision of non-obstante clauses in many of the Sections have added to difficulties in understanding the rules and forms. The novel method followed by MCA under the Companies Act 2013 has rendered the present rules and the forms unclear and unfriendly to the users and compliers. This difficulty is likely to be felt even by the judiciary in following matters of cases before them.

For example, *non-obstante* clause in section 139 (6) does not require a return of appointment of first auditor to be filed with RoC since the requirement of appointment return under sub-section (1) of section 139 is not applicable to appointment of first auditor. This position is not however clear from the prescribed rules and forms. As a result, many companies have filed Form ADT 1 for appointment of first auditor (in the absence of reference to Sections and sub-sections on the form). This should be clarified soon.

Being aware that no clear procedure exists in section 139 to be followed by a company when an AGM does not ratify the appointment of an auditor as required by sub-section 139 (1), MCA states in Rule 3 (7) of Companies (Audit and Auditors) Rules 2014 that 'the procedure laid down in this behalf in the Act may be followed". If MCA considers that non-ratification results in a "Casual vacancy" in the position of the auditor, it should clearly

state so and guide the user to follow the procedure of filling the casual vacancy.

Expressions used in the Act and in the Rules like 'joint venture' (section 230), 'regulated' (section 230) 'other benefit' and 'effect of compromise' (section 232)'persons affected by the scheme'(section 233) 'other reason' (section 236), 'continuous experience', 'financial valuation', technical valuation', 'other professional bodies' (section 247) 'sick company' (section 253), 'financial asset' (section 254).

Rule 5 (1) of Companies (Management and Administration) Rules must clarify soon whether share transfers need to be considered and approved only by a committee of directors and not by a committee of senior company executives (and ratified by the Board) as was the case under the 1956 Act.

FORFEITURE OF FAITH IN THE EXECUTIVE

This is yet another fall-out from the adverse measures taken by MCA mentioned above which include sub-ordinate legislation going beyond the principal or main legislation, in letter and/or spirit.

Many of the measures including unauthorized creation of new multiple layers/classes of companies based on capital, turnover borrowings etc , seeking particulars in Rule 5 (1) of Companies (appointment and remuneration of managerial personnel) Rules to be given the Directors' Report beyond the scope of section 197 (12), unwarranted and unjustified restrictions on unlisted companies (with no public borrowings) to give loans to interested concerns for business purposes in section 185 have led to a sort of loss of confidence and faith of the corporate industry in the government as is evident from the lengthy memoranda submitted by apex bodies like the CII etc to the Government recently seeking large-scale changes both in the Act and in the Rules, at an early date.

NEW LAYERS/ADDITIONAL CATEGORIES OF COMPANIES CREATED BY MCA THROUGH THE RULES

The Companies Act has created enough number and categories and classes of companies, namely, (a) Limited and Unlimited by shares/guarantee(by nature and extent of liability), (b) Private, Public, OPC, Small (by size of capital or turnover and extent of public exposure) (c) Subsidiary, Holding, Government Company etc (by control) , (d) Investment company (by objective) (e) Foreign company (by location) (f) Listed and Unlisted companies (by liquidity or marketability of shares) etc. The authorization given to the Government "to prescribe rules" in section 139 (2) is limited to the Government prescribing one or more of the class or classes of companies already created by the principal statute and not to make new legislation by creating furthermore new classes or types of companies based on additional criteria of turnover, public deposits, borrowings etc as has been done by MCA in several rules including Rule 5 of the Companies (Audit & Auditors) Rules 2014.

Such drastic changes have violated the most important core principle of delegated legislation, namely the final draft being near-compatible with the Final Rules except to the extent of mutually agreed changes with stakeholders. Else, the Final rules may be open to judicial scrutiny, or even the Parliament's scrutiny.

CORRECTIVE MEASURES REQUIRED

The MCA may like to take steps to retract its steps (as has been done to restore the paid-up capital limit at Rs. 5 crore for appointment of company secretaries) and rectify the unintended faults or omissions in the Final Rules at an early date in order to restore public confidence in MCA.

The corrective measures to be taken by MCA include the following:-

(a) Reintroduction of pre-certification of e-forms.

(b) Certification for annual return under section 92(2) in respect of companies with at least Rs.5 crore paid up capital or Rs.25 crore turnover.

(c) Secretarial audit made applicable to all those companies which are subject to internal audit.

(d) Clarifying that, where an AGM has not ratified the appointment of an auditor, the vacancy will be a casual vacancy under section 139.

(e) A body corporate and a foreign citizen in India may also form an OPC.

(f) Permit shifting of registered office after completion of action pursuant to inquiry, inspection or investigation.

(g) Change of name to be permitted after rectification of defaults mentioned in Sec.13. In case of shift of registered office from one State to another, the affidavit required regarding 'no retrenchment of employees' should be confined to stating that the relevant provisions of the applicable labour legislation would be complied with.

(h) Rule 17 (vide section 17) should be dropped as the rule repeats the contents of section 17.

(i) Rule 3 (vide section 2) may be deleted since Sec.149 (6) (c) takes care of the independence of IDs.

Salutary measures as above, when taken by MCA, will ensure not only the achievement of the objectives of the Act but also gain the goodwill of the user-public. Such implementation will promote enlightened self-regulation by the companies contributing to better corporate governance. CS

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Rules relating to Loans, Guarantees & Security: Procedural aspects and Disclosures

The law relating to giving of loans and providing guarantees and security by companies in relation to loans as contained in the Companies Act, 2013 are substantially different from the provisions of the old Act. The procedure relating to the loans and guarantees/security as contained in the new Act and the new Rules are narrated here.

PREAMBLE

Post enactment of the Companies Act, 2013 ('the Act'), there were lot of deliberations around provisions dealing with loans, guarantees or providing security in connection with a loan made to any other body corporate or person. The law relating to loans, guarantees etc., is contained in Section 186 of the Act (corresponding to section 372A of the Companies Act, 1956) and the Companies (Meetings of Board and its Powers) Rules, 2014, which are effective from 1st April, 2014.

Earlier, the provisions relating to loans, guarantees etc., were not applicable to pure private companies. Further, as per the Companies Act, 1956, holding company was permitted to give interest free loan to its wholly owned subsidiary company ('WOS').

As there are substantial changes in the provisions dealing with

*The views expressed in this article are solely the views of the author and do not reflect in any way the views of the Company/or the Group where he is employed.

loans, guarantees etc., as contained in the new Act read with the Companies (Meetings of Board and its Powers) Rules, 2014 and other relevant Rules ('the Rules') vis-a-vis, the provisions of the Companies Act, 1956, it was felt apt to elaborate upon the major changes, procedural aspects and disclosure requirement through this article.

MAJOR CHANGES

Section 186 of the Act is applicable to both private and public companies, whereas section 372A of the Companies Act, 1956 was not applicable to:

- any loan made, guarantee given or security provided by a private company unless it was a subsidiary of a public company;
- any loan made by a holding company to its WOS.
- any guarantee given or security provided by a holding company in respect of any loan made to its WOS.

Additionally, the term 'any person' has been included in section 186(2)(a) of the Act. This means that for giving loan to 'any person', provisions of relevant Rules and section 186 of the Act also need to be complied with. It is pertinent to mention here that section 372A(1)(a) of the Companies Act, 1956 was restricted to loans to 'body corporate' only.

PROCEDURE ASPECTS

In respect of any proposal to give loan to any person/ body corporate or give guarantee or provide security in connection with the loan to any other body corporate or person the following procedural aspects are involved:

1. Calculate the paid-up capital, free reserves and security premium account of the company. The term'free reserve' is defined in section 2(43) of the Act whereas earlier itwas defined in the Explanation to section 372A of the Companies Act, 1956.
2. Fix the date of convening meeting to seek approval of the Board of Directors of the company.
3. Ensure to send notice convening the Board meeting to all directors by hand delivery or by post or by electronic means atleast 7 days before the meeting.
4. Finalise and send Agenda of Board meeting giving detailed background, rationale and draft resolution to all the directors.
5. In case some directors wish to attend the meeting through video conference or other audio visual mode, ensure to make arrangement for the same.
6. In case meeting of the Board is through video conferencing or other audio visual means, ensure to follow procedure prescribed to convene meeting in the Companies (Meetings of Board and its Powers) Rules, 2014.
7. File Form MGT 14 within 30 days from the date of approval of the Board of Directors with Ministry of Corporate Affairs ('MCA'). Also file Calendar of Event of Postal Ballot Process if the approval of shareholders is proposed to be sought through postal ballot.
8. Check whether terms of reference of Audit Committee, *inter-alia*, includes scrutiny of inter-corporate loans and investments (ICL). Further, ensure that matter relating ICL etc. are reviewed by the Audit Committee also.
9. Ensure to comply with Secretarial Standard relating to Board and General meeting as section 118(10) of the Act requires that every company shall observe Secretarial Standards with respect to Board and General meetings specified by the Institute of Company Secretaries of India.
10. Ensure minutes of the Board meeting are prepared, finalised and kept in minutes book within 30 days of conclusion of the Board meeting.
11. In case of Nidhi Company, the rate of interest to be charged on any loan given shall not exceed seven and half per cent. above the highest rate of interest offered on deposits by Nidhi and shall be calculated on reducing balance method. Further, ensure that Nidhi companies follow the Nidhi Rules, 2014 also.
12. If the proposed loan, guarantee or security in respect of loan exceed 60% of the its paid-up capital, free reserve and security premium account or 100% of free reserves and security premium account, ensure to seek approval of the Board for draft notice convening general meeting/ postal ballot notice also.
13. Print and despatch notice of general meeting to all the shareholders atleast 25 days before the meeting.
14. Ensure that documents referredto in general meeting notice are available for inspection at the Registered Office of the company.
15. Listed company or a company having 1,000 or more shareholders, shall provide to its members facility to exercise their right to vote at general meetings by electronic means.
16. Ensure to obtain approval of shareholders by means of voting through a postal ballot for matters relating to giving loan or extending guarantee or providing security in excess of the limits specified in section 186 of the Act if the members of the company exceed two hundred.
17. A company which opts to provide the facility to its members to exercise their votes at any general meeting by electronic voting system shall have to follow the procedure prescribed in the Companies (Management and Administration) Rules, 2014.
18. In case approval of shareholders is sought through postal ballot, ensure that Calendar of Events for the postal ballot process, consent of Scrutinizer is sent to the stock exchange(s) where shares of the company are listed.

19. Ensure that listed companies while sending notice of general meeting/ postal ballot to its shareholders also send the same to the stock exchange(s) where shares of the company are listed.
20. For e-voting, some of the important requirement are :-
    - Send notice through Registered Post or Speed Post or E-mail or Courier
    - Upload the notice of meeting in the website
    - Publish advertisement atleast five days before e-voting begins
    - e-voting to remain open for 1-3 days
    - e-voting need to be completed 3 days before the meeting
    - appointment of scrutinizer etc.
21. In case of listed company, a copy of the proposed special resolution be filed with MCA at least one day before the date of general meeting of the company in Form No.MGT.14.
22. In case of Listed companies, ensure to send the proceedings of general meeting/ postal ballot to the Stock Exchange(s) where the securities of the Company are listed.
23. File Form MGT 14 within 30 days from the date of approval of the shareholders with MCA alongwith notice convening meeting.
24. Ensurethat the minutes of the general meeting are prepared, finalised and kept in minutes book within 30 days of the general meeting.
25. Ensure to maintain Register of loan etc. in prescribed Form MBP 2.
26. Ensure to enter particulars of loan etc. in the Register within 7 days of making such loan or giving guarantee or providing security.
27. Ensure that each entry made in the Register is authenticated by the Company Secretary or any other person authorised by the Board.
28. The Register is to be kept at the Registered Office and preserved permanently.
29. The Register can be maintained either manfully or in electronic mode.
30. Ensure that pursuant to section 92(2) of the Companies Act, 2013 and rule 11(2) of Companies (Management and Administration) Rules, 2014, certificate given by Company Secretary in Practice in Form MGT 8 certify that during the financial year the Company has complied with provisions of the Act & Rules made there under in respect of :
    a. advances/ loans to its directors and/or persons or firms or companies referred in section 185 of the Act.
    b. loans or guarantees given or providing of securities to other bodies corporate or persons falling under the provisions of section 186 of the Act
31. Ensure that extract from the Register, on payment of fee which shall not exceed Rs.10 for each page, is made available to member of the Company.

DISCLOSURES

With regard to giving loans or guarantees or providing security in respect of loan, the following filings/ disclosures,(some of them may also be appearing above), are required to be observed:-

1. File resolutions passed by the Board of Directors relating to giving loan or guarantee or provide security in respect of loan with MCA in prescribed Form MGT 14.
2. Send notice of general meeting to the shareholders to obtain prior approval of the shareholder by way of special resolution if:-
    a. proposed loan, guarantee or security in respect of loan and acquisition of shares exceed 60% of the its paid-up capital, free reserve and security premium account; or
    b. 100% of free reserves and security premium account.
3. Notice of general meeting should contain disclosure of interest (financial or otherwise) of not only the directors but also of the Key Managerial Personnel and their relatives also.
4. If approval is sought through e-voting/ postal ballot, ensure to make disclosures relating to e-voting and postal ballot as prescribed in the Companies (Management and Administration), Rules, 2014.
5. In case of listed company, a copy of the proposed special resolution is required to be filed with MCA at least one day before the date of general meeting of the company in Form No.MGT.14.
6. Ensure to file MGT 14 within 30 days of seeking approval of the shareholders.
7. Listed companies are required to send the proceedings of general meeting/ postal ballot to the Stock Exchange(s) where the securities of the Company are listed.
8. Disclose in the financial statement, full particulars of the loans made, or guarantee given or security provided; and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.
9. The Board of Directors' report to shareholders shall contain particulars of loans, guarantees etc.
10. Upon giving loan or guarantee or providing security, update the same in the Register in prescribed form MBP 2.
11. The said Registers need to be updated within 7 days from the date of giving loan or guarantee or providing security as the case may.
12. Each entry in the Register (i.e., MBP 2) need to be authenticated by the Company Secretary or other person authorised by the Board.

13. The Registers in prescribed Forms need to be kept at the Registered Office in the custody of Company Secretary or other person authorised by the Board.
14. The register should be made available for inspection at the Registered Office of the Company.
15. All transactions with related parties with respect to giving of loans or, guarantees, providing securities in connection with loans made during last five financial year should be stated in the prospectus.
16. The Private placement offer letter should disclose related party transactions entered during the last three financial years immediately preceding the year of circulation of offer letter including with regard to loans made or, guarantees given or securities provided.

CONCLUSION

The applicability of the provisions of section 186 of the Act for giving loans etc., by private companies and holding companies to its WOS are certainly significant and welcome change. These companies are also now not allowed to give loans at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan. This will increase the revenue of the company who had given loan and consequently the revenue of the Government also. The provisions of section 186 of the Act are not applicable to companies executing'infrastructural projects' or providing 'infrastructural facilities'. A question may arise as to when a single entity is executing one or more project(s) as mentioned in the Schedule VI of the Act and also manufacturing/ producing other product(s) such as cement, paper, tyre, steel, chemicals, medicine, car etc., whether it would be considered to be one providing 'infrastructure facility'. As the Rules and the Act do not state any criteria for being considered as providing 'infrastructure facility', the MCA should clarify, when the company could be considered as providing 'infrastructure facility' or executing 'infrastructure project(s)'. Primarily, the percentage of revenue generated and/ or capital employed from such project(s) could be the criteria to determine the said contentious matter. CS

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Appointment of Functional Directors in Unlisted Central Public Sector Enterprises(CPSEs): Provisions of The Companies Act, 2013

Government companies have not been given any exemption or special treatment with regard to appointment of managerial personnel under the Companies Act, 2013. These companies will have to follow provisions of section 196 of Companies Act, 2013, which are applicable for appointment of managerial personnel pursuant to section 152(2) which provides that every director shall be appointed by the company in general meeting.

THE DEPARTMENT OF PUBLIC ENTERPRISES (DPE)

The Department of Public Enterprises (DPE) in the Ministry of Heavy Industries and Public Enterprises, Government of India acts as a nodal agency for all Public Sector Enterprises (PSEs) and assists in policy formulation pertaining to the role of PSEs in the economy as also in laying down policy guidelines on performance improvement and evaluation, financial accounting, personnel management and in related areas. It also collects, evaluates and maintains information on several areas in respect of PSEs. DPE also provides an interface between the Administrative Ministries and the PSEs. In fulfilling its role, it associates itself with other Ministries and organisations as also premier management institutes in the country.

CENTRAL PUBLIC SECTOR ENTERPRISES (CPSEs)

The term "Central Public Sector Enterprises(CPSEs)" has, probably, been coined by theDPE as in the Preface of Public EnterprisesSurvey (2012-13) issued by the DPE, it is stated that besides Statutory Corporations, CPSEs comprise those Government Companies (defined under Section 617 of Companies Act, 1956) wherein more than 50% equity is held by the Central Government. Here, use of the term "CPSEs" for Statutory Corporations is not understood. It is further gathered from Public Enterprises Survey (2012-13) that there were as many as 277 CPSEs out of which 229 were operating CPSEs as on 31st March,2013 and that 46 CPSEs were listed on Stock exchanges of India as on 31.03.2013. It means as on 31.3.2013, out of 229 operating CPSEs, 173 were unlisted CPSEs.

STATUS OF UNLISTED CENTRAL PUBLIC SECTOR ENTERPRISES (CPSEs)

Unlisted CPSEs are either Private Limited Companies or public Limited Companies. Government Companies and Private Limited Companies were granted certain exemptions under the Companies Act 1956, which were enjoyed by them till coming into force of Companies Act, 2013. 98 Sections of this new Act came into force on 13.9.2013 and 183 sections came into effect from 1.4.2014, which include sections relating to Appointment and Qualifications of Directors. The exemptions to Government Companies and Private Limited Companies no longer exist in the Companies Act, 2013.

FUNCTIONAL DIRECTORS

The DPEs Guidelines on Corporate Governance ,2010 for CPSEs provide that the Board of Directors of the company shall have an optimum combination of Functional, Nominee and Independent Directors. The term "Functional Directors" is used by the DPE for those directors, who are full time operational Directors responsible for day to day functioning of the enterprise. The DPEs Guidelines provide that every Board should have some full time Functional Directors. The number of such Directors on a Board should not exceed 50% of the actual strength of the Board.

The policy of Government is to appoint through a fair and objective selection procedure outstanding professional managers to Level-I and Level-II posts and posts at any other level, as may be decided by the Government from time to time. Government has also recognised the need to develop a cadre of professional managers within the public sector. This is being done through Public Enterprises Selection Board (PESB).

PUBLIC ENTERPRISES SELECTION BOARD (PESB)

The Public Enterprises Selection Board (PESB) is a high powered body constituted by Government of India Resolution dated 3.3.1987 which was subsequently amended from time-to-time, the latest being on 11.11.2008. The PESB has been set up with the objective of evolving a sound managerial policy for the Central Public Sector Enterprises (CPSEs) and, in particular, to advise Government on appointments to their top management posts.

PROCEDURE FOR APPOINTMENT OF FUNCTIONAL DIRECTORS IN UNLISTED CPSEs TILL 31.3.2014

Before the coming into effect of relevant provisions of Companies Act, 2013 from 1.4.2014, appointment of directors in unlisted CPSEs were governed as per provisions of Companies Act, 1956 as well as Articles of Association of the respective such CPSEs. Provisions of the following Sections of the Companies were exempt in the case of wholly owned government companies:

Section 255 - Appointment of directors and proportion of those who are to retire by rotation - Exempt vide Government of India's Notification G.S.R No. 234 dated 31-1-1978

Section 256 - Ascertainment of directors retiring by rotation and filling of vacancies - Exempt vide Government of India's Notification G.S.R No. 234 dated 31-1-1978

Section 257 - Right of persons other than retiring directors to stand for directorship – Exempt vide Government of India's Notification G.S.R No. 234 dated 31-1-1988

Section 264 - Consent of candidate for directorship to be filed with the company and consent to act as director to be filed with the Registrar - Exempt vide Government of India's Notification. G.S.R No. 577(E) dated 16-7-1985

Appointments of Directors in unlisted CPSEs, where exemptions were applicable, were governed by the Articles of Association of the Company, which have similar provision as that the President may appoint Chairman, Managing Director, Chairman cum Managing Director and shall appoint other Directors in consultation with the Chairman or Chairman cum Managing Director provided that no such consultation is necessary in respect of Government representatives on the Board of Directors of the Company. Accordingly, Functional Directors including Chief Executives of CPSEs were appointed by the Concerned Administrative Ministries/Departments on the basis of recommendations of Public Enterprises Selection Board (PESB) and with the approval of Appointments Committee of the Cabinet (ACC). The Terms and Conditions of their appointment were standard Terms and Conditions issued by the DPE vide their O.M.No. 2(30)/09-DPE(WC) dated 30.12.2009 in respect of Board Level Executives and clarifications issued thereafter.

POSITION UNDER COMPANIES ACT, 2013

The Companies Act, 2013 was enacted to replace Companies Act 1956 and while its 98 sections came into effect from 12.9.2013, 183 sections of it, which include Section 152 regarding appointments of directors, along with other related sections, have become effective from 1.4.2014. Further, Companies (Directors Appointment and Qualifications) Rules, 2014 have come into force w.e.f. 1.4.2014.

Interpretation clause of the Articles of Association of unlisted CPSEs generally provides, inter alia, as follows:

"The Act" means the Companies Act, 1956 (1 of 1956) and includes, where the context so admits, any re-enactment or statutory modification thereof for the time being in force…"

Section 6 of the Companies Act, 2013 captioned"Act to override memorandum, articles, etc" provides as follows: -

Save as otherwise expressly provided in this Act—

a. the provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and

b. any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be."

Section 152 of Companies Act, 2013 provides, inter alia, as follows:

"152. (1) ……..

(2) Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting."

This Section starts with the wordings "Save as otherwise expressly provided in this Act" and it is observed that the Act expressly provides for appointments of managerial in CHAPTER XIII with the Heading "APPOINTMENT AND REMUNERATION OF MANAGERIAL PERSONNEL" and Section196 provides for Appointment of managing director, whole-time director or manager. Managing Director or whole-time directors are termed as 'Functional Directors' by the DPE. In the absence of any exemption to Government Companies, appointment of Functional Directors of such Companies is governed by the provisions of Section 196(4) of the Companies Act, 2013, which provides as follows:

"(4) Subject to the provisions of section 197 and Schedule V, a managing director, whole-time director or manager shall be appointed and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting which shall be subject to approval by a resolution at the next general meeting of the company and by the Central Government in case such appointment is at variance to the conditions specified in that Schedule:

Provided that a notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or directors in such appointments, if any:

Provided further that a return in the prescribed form shall be filed within sixty days of such appointment with the Registrar."

Section 197, subject to which such appointments are to be made, relates to Overall Maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits. The relevant portion of this Section is quoted below:

"197. (1) The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed …

(2)……

(3)……

(4) The remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of 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 and the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity…"

Sub-section (1) of this Section specifies the limits and states that"The total managerial remuneration payable by a public company…", which means this sub-section is not applicable to unlisted CPSEs, which have been incorporated as Private companies.

SCHEDULE V referred to in Section 196 of the Companies Act, 2013 has following parts"

PART I contains conditions to be fulfilled for the appointment of a managing or whole-time director or a manager without the approval of the central Government.

PART II relates to Remuneration under five sections with the following Headings:

"Section I - Remuneration payable by companies having profits:

Section II - Remuneration payable by companies having no profit or inadequate profit without Central Government

Section III -Remuneration payable by companies having no profit or inadequate profit without Central Government approval in certain special circumstances:

Section IV- Perquisites not included in managerial remuneration:

Section V - Remuneration payable to a managerial person in two companies:"

PART III contains following Provisions applicable to Parts I and II of this Schedule:

1. "The appointment and remuneration referred to in Part I and Part II of this Schedule shall be subject to approval by a resolution of the shareholders in general meeting.

2. The auditor or the Secretary of the company or where the company is not required to appointed a Secretary, a Secretary in whole-time practice shall certify that the requirement of this Schedule have been complied with and such certificate shall be incorporated in the return filed with the Registrar under sub-section (4) of section 196."

PART IV provides that the Central Government may, by notification, exempt any class or classes of companies from any of the requirements contained in this Schedule.

So far no notification regarding exemption to Government Companies has been issued pursuant to PART IV.

From the foregoing it is clear that government companies have not been given any exemption or special treatment with regard to appointment of managerial personnel in the Companies Act, 2013. These companies will have to follow provisions of section 196 of Companies Act, 2013, which are applicable for appointment of managerial personnel pursuant to section 152(2) which provides "Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting."

Thus, as per section 196(4) of the Companies Act, 2013, a managerial personnel shall, subject to the provisions of section 197 and Schedule V, be appointed and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting which shall be subject to approval by a resolution at the next general meeting of the company and by the Central Government in case such appointment is at variance to the conditions specified in that Schedule. After the appointment, e.Form MR-1 is to be filed pursuant to Section 196, 197, and Schedule V of the Companies Act, 2013 and Rule 3 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014…" It is stated in the kit of this Form under the heading "Purpose of the e.Form" that 'The provisions of section 196 are applicable to all the companies whether public or private…'

Here a question arises, from where choices will be available to the unlisted CPSE for appointment of managerial personnel. In this connection, an unlisted CPSE may have two alternatives viz. each CPSE should either create its own method to select the managerial personnel or appoint the person selected by PESB and approved by the Competent Authority, which is ACC. In the former case, each CPSE will have to create its own infrastructure for selection of competent managerial personnel and leaving the PESB without its core work. The latter case would mean shifting of or transferring the role of the President to the Board/General Meeting, which will unnecessarily lengthen the procedure for the Company with no choice left with the Company.

Similarly, the DPE, vide their O.M.No. 2(30)/09-DPE(WC) dated 30.12.2009 issued standard Terms and Conditions in respect of Board Level Executives. In case, the Board/General meeting appointing Functional Directors adopt different terms and conditions than those provided in the DPEs O.M. differential in remuneration and other terms and conditions may arise, which may have its own problems. Further, there could be requirement of Government's approval in cases which do not conform to applicable provisions of Companies Act, 2013 and rules made thereunder.

It is hoped that concerned authorities are seized of these issues.

INCONSONANCE BETWEEN SECTION 196 AND SECTION 203 OF COMPANIES ACT, 2013 RELATING TO APPOINTMENTS OF FUNCTIONAL DIRECTORS

Appointments of Functional Directors in unlisted CPSEs have been discussed above. Such Directors are also included in the Definition of "Key Managerial personnel". As per Section 2(51) 0f Companies Act, 2013, "key managerial personnel", in relation to a company, means:

i. the Chief Executive Officer or the managing director or the manager;
ii. the company secretary;
iii. the whole-time director;
iv. the Chief Financial Officer; and
v. such other officer as may be prescribed;

Section 203(1) of Companies provides as follows:

"Every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel:

i. managing director, or Chief Executive Officer or manager and

> In the case of appointment as Key Managerial Personnel of any Functional Director, whose appointment as a managerial personnel and terms and conditions including remuneration are governed by express provisions, a simple resolution by the Board would have been made sufficient in Section 203(2).

in their absence, a whole-time director;

ii. company secretary; and

iii. Chief Financial Officer :

Provided that…

(2) Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration"

Besides, listed CPSEs, unlisted CPSEs, incorporated as Public Limited Companies with paid up capital of Rs.10 crore or more are required to appoint "key managerial personnel". For the purpose, the paid up share capital as existing on the last date of latest audited financial statements shall be taken into account.

In case provisions of sub-section (2) of above Section are followed, Functional Directors i.e. Managing Director or whole-time Director as whole-time key managerial personnel are required to be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.

Here, it is interesting that in case Functional Directors viz. Managing Director or Whole-time Director are otherwise appointed, they are to be appointed as per provisions of Section 196(4), where such appointments are subject to the provisions of section 197 and Schedule V. However, in case they are to be appointed as "Key Managerial Personnel", as per Section 203(2), they can be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration".

Thus, there is inconsonance, which needs to be addressed by the concerned authorities. It appears that intention of the Legislature was that appointments of officials as Key managerial Personnel be made by means of a resolution of the Board, who may not be members of the Board as the definition of the term. 'Key Managerial Personnel' includes posts like Chief Executive Officer (CEO), Company Secretary and Chief Financial Officer as also such other officer, as may be prescribed. In the case of appointment as Key Managerial Personnel of any Functional Director, whose appointment as a managerial personnel and terms and conditions including remuneration are governed by express provisions, a simple resolution by the Board would have been made sufficient in Section 203(2).

Moreover, while there is no mention of posts like Chief Executive Officer (CEO), Company Secretary and Chief Financial Officer in Section 196(4). Rule 3 (2) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that for the purposes of second proviso to sub-section (4) of section 196, a company shall file a return of appointment of a Managing Director, Whole Time Director or Manager, Chief Executive Officer (CEO), Company Secretary and Chief Financial Officer (CFO) within sixty days, with the Registrar in Form No. MR-1 along with such fee. Further, the Heading of Form MR-1 is (Return of appointment of key managerial personnel) However, in the Instruction Kit for eForm MR-1, in Part I – Laws Governing the eForm under the heading "Section and Rule Numbers, it is stated that eForm MR-1 is filed in pursuant to Section 196, 197, and Schedule V of the Companies Act, 2013 and Rule 3 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014…" Further, it is also stated in the kit under the heading "Purpose of the e.Form" that 'The provisions of section 196 are applicable to all the companies whether public or private…"

It will be observed that the Heading of form MR-1 is (Return of appointment of key managerial personnel) and appointment of key managerial personnel is required to be made under Section 203 of the Companies, 2013 but, interestingly, this section finds place neither in the form MR-1 nor in the instruction kit for this e.form. Similarly, no return is stated to be filed under this section. This aspect thus also needs to be addressed by the concerned authorities. CS

QUERIES ON COMPANIES ACT, 2013

- Members may send the queries relating to operation and practical difficulties in implementation of Companies Act, 2013 at companiesact2013@icsi.edu

and

- Any query relating to filing of e-forms under the new Act may be sent at efiling@icsi.edu