



## Different perspectives of the Companies Act, 2013

- The new company law has been put in place by the Government with best intentions and it is now the turn of the corporate sector to demonstrate that it will play according to the Rules. The Government on its part must trust the corporate sector to function honestly and also keep a watch.

The new Companies Act, 2013 (the Act) that has already been made partially effective has been criticized by many for two main reasons; firstly, many provisions of the Act will get implemented through Rules to be prescribed (this is seen as excessive delegation that may lend itself to frequent change of Rules by the Ministry of Corporate Affairs) and secondly, companies would have to frequently approach shareholders by convening general meetings or adopting the postal ballot route to seek their approvals.

The first criticism may be unfair because the Ministry of Corporate Affairs (MCA) has already instituted a practice of consulting the stakeholders while drafting the Rules. Representatives of industry, industry bodies like chambers of commerce, investor protection organizations, the Institute of Company Secretaries, Company Secretaries, Chartered Accountants and Cost Accountants in practice, participated as a team in several meetings over a period of almost a year to review the draft Rules, consider suggestions based on experience and practical difficulties and tweak the Rules while ensuring they are aligned with the relevant provisions of the Act. It is reliably learnt that the Minister of Corporate Affairs, has strongly advocated and supported the initiative of the MCA in instituting the consultative process for Rules-making. The MCA is likely to constitute a formal Committee comprising of representatives of the stakeholders to discuss amendments or





modifications to the existing Rules or prescription of Rules before being notified.

The second criticism is unwarranted because in the company form of organization, the shareholders are supreme and the Boards of companies have to function within the powers and sanctions accorded by them. If a company needs to convene meetings in addition to the annual general meeting, why should one complain? Yes, it does involve costs but so do all activities that company executives and Board members undertake. For many years, companies have operated (and some of them unfairly) with the support of a few hundred shareholders who attend general meetings to pay obeisance to the Chairman and some of the eminent directors rather than to ask the management critical and relevant questions. We now have a generation of enlightened shareholders that is conscious of its rights and wishes to participate more actively. Postal ballot, e-voting, video-conferencing are new tools that are available to the present generation of companies to seek the mandate of their shareholders.

## Good governance

Several measures introduced in the Act are based on the tenets of good governance. The concept of independent directors introduced by SEBI has now been incorporated in the Act. Having one third of the strength of the Board comprising independent directors is no draconian provision. The candidates would still be people known to either the Chairman or some members of the Board or their friends. So what is there to complain? Prescribing a Code of Conduct (Schedule IV of the Act) is a step in the right direction. A written code and one mandated by law draws the lines for the conduct of independent directors.

The need to appoint a woman director on the Board is another welcome step. It is not 'reservation' for women. If this was not mandated, Boards of companies would rarely induct women because, by nature women, especially those educated, are independent and would not 'play along'. We have examples in renowned companies, banks and financial institutions of women directors, some even occupying the positions of Chairman and/or CEO, and their performances have been admirable and laudable.

The provisions enabling a company to have a small shareholders' director are currently not mandatory. This should not be mandated because we have seen many instances of how some shareholders with vested interests could 'gang up' and cause nuisance to the management. The Independent Directors and a Woman Director would bring about a balance in the policies and decisions of companies to advance and protect the interests of small shareholders among other stakeholders.

Increasing the scope of reporting in the annual directors' report including the assessment of the performance of the Board and

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the remuneration paid to directors and senior management are welcome measures. The common refrain that is heard is what would the shareholders do with all the information contained in the directors' report? It is not only the shareholders but a wide range of people including the government and its agencies that refer to the directors' reports of companies and several purposes could be served by providing comprehensive information in such reports.

## Shareholder supremacy

The Act upholds the supremacy of the shareholders of a company and, therefore, it has vested authority in the shareholders to approve significant transactions that the management wants to undertake. Investment of a company's funds or providing loans out of the company's funds and furnishing guarantees on behalf of others are all transactions that directly impact the fortunes of a company. The law recognizes that some leeway needs to be provided for the Boards of companies to operate based on opportunities that present themselves and this is reflected in the Act permitting companies to make investments, give loans or provide guarantees up to 60% of the net-worth of the company or up to 100% of its free reserves. It is beyond these limits that the prior approval of shareholders is mandated. A show-stopper is the removal of the exemption that was available in respect of wholly-owned subsidiaries but this is also not without justification. Companies are known to have created several wholly-owned subsidiaries and transferred funds to them using the exemption that was available under the old Act. Once the funds are thus transferred, the management could do anything with those funds using the wholly-owned subsidiary as a vehicle they were called 'special purpose vehicles'. The shareholders would only learn later about what transpired.

Related party transactions have also been entered into by companies many a times to allow related parties to enrich themselves at the cost of the company's larger interests. By mandating that some of the related party transactions cannot be



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What the Government wants the corporate sector to do is to give back a small portion of the wealth it has created with the help of the resources drawn from the society and its surroundings to provide succor and relief to the under-privileged sections of the society. Companies would in fact gain from such initiatives as they would enhance their reputation and image among all sections of people.

undertaken unless approved by the shareholders, the law has plugged a loophole. The measure is fortified by prescribing that if a shareholder is the related party, that shareholder would have to abstain from voting on the resolution. For example, a parent/holding company that draws out a significant amount from its subsidiary or other promoted companies in the guise of a royalty would now have to get the contract/agreement for payment of royalty approved by the shareholders. The parent/holding company cannot itself vote on the resolution for approving such a contract.

Managerial remuneration norms have been significantly liberalized and shareholders have been vested with power to sanction managerial remuneration. The Government has rightly reduced the need for companies to seek approvals in this regard from the government. Shareholders must satisfy themselves that the remuneration managerial personnel in their company wish to draw are in line with the market and they do not enrich themselves merely because they are serving prosperous companies.

## Auditors' responsibilities and tenure

The Act has introduced several requirements for determining the eligibility of a person or a firm to be appointed as an auditor. While it is true that actions of a few professionals who did not do a sincere job or colluded with managements to perpetrate wrong-doings that affected the interests of shareholders have turned the heat on chartered accountants working as auditors, the measures taken by law are in the best interests of all concerned. In the short run, the new requirements of rotating auditors may cause some discomfort to managements and auditors who have established a good rapport. However, we must not forget that auditors are professionals with responsibilities and are required to act in a professional manner and not merely in a friendly manner. Auditors would not be starved of assignments as the economy grows and more companies get established. They should be happy that they can gain as well as provide better professional knowledge working with diverse industries.

The provisions which require auditors to act as whistle-blowers are perhaps not entirely justifiable as the auditors are in any case required to report instances of fraud or potential fraud to the Audit Committee which is chaired by an independent director. The auditor is also required to report on frauds

committed by or against the company in his report. The requirement for auditors to report instances of fraud or potential fraud to the Central Government would lead to unwarranted consequences. The media which is news hungry and constantly wanting to 'break news', would get ready fodder from sources in the Central Government and even before someone is proved guilty his or their reputation would be tarnished. A person who is damned but found not guilty in due course has no means of redeeming his lost/tarred reputation.

## Corporate Social Responsibility

The provisions requiring certain class of companies to spend a certain amount each year on initiatives reflecting the Corporate Social Responsibility of the companies has been much criticized. Some say that what the government ought to do is being made a responsibility of the corporate sector. In addition to paying a huge amount of taxes to the government which are not spent entirely for the welfare of the people, the corporate sector now has to spend an additional amount on initiatives which the government should undertake. Such criticism is not entirely justified. What the Government wants the corporate sector to do is to give back a small portion of the wealth it has created with the help of the resources drawn from the society and its surroundings to provide succor and relief to the under-privileged sections of the society. Companies would in fact gain from such initiatives as they would enhance their reputation and image among all sections of people. There may be concerns and difficulties in the initial years but this measure would improve the lot of the under-privileged and backward sections of our population in the years to come. The corporate sector can then take credit for the transformation brought about by it.

## Raising of funds and utilization thereof

The Act has tightened the provisions relating to the raising of funds by companies through issue of capital either as a public issue or private placement and through public deposits. The measures have been the result of several companies which having raised monies from the public on the promise of fabulous returns have later vanished or lost all the money in their ventures. Similarly, if a company has raised money on a representation that the money would be utilized for a specific purpose, it cannot unilaterally change the purpose to which the money is to be applied. This would require prior approval of the shareholders and shareholders who do not wish to support such a change in object are entitled to be bought out at a fair price.



Fixed deposits or public deposits are invariably placed by individuals out of their savings or retirement benefits and, therefore, their monies need the greatest protection. The Act prescribes that deposits must henceforth be secured partly by assets of the borrowing company and partly by deposit insurance. This cannot be considered as an onerous measure introduced by the Act.

## National Company Law Tribunal

The creation of the National Company Law Tribunal and the National Company Law Appellate Tribunal are well-intentioned. They would reduce the burden on the Courts which have a huge backlog of other cases to deal with. The measure would be beneficial to the corporate sector and the Government if the Tribunals are staffed with persons having appropriate legal and commercial knowledge and experience. The Tribunals would also have to be housed in convenient locations in all metro cities and other cities if need be.

## Prohibition of Insider Trading and forward dealings

Provisions dealing with prohibition of insider trading and forward dealings in the securities of companies have been introduced in the Act. Earlier these provisions were contained in Regulations framed by SEBI as the capital markets regulator. By incorporating these provisions in the Act, the Government has given the subject legislative force. These provisions are generally relevant for companies whose shares are listed on stock exchanges.

## Cross-border mergers

The Act now permits cross-border mergers, both ways; a foreign company merging with an Indian company as well as an Indian company merging with a foreign company. However, there are several factors that need to be considered before such mergers are undertaken and it seems unlikely that there would be a flood of mergers happening merely because of the Act permitting it. The measure is therefore a forward looking one.

## Class action suits

A new tool called 'Class action suits' has been created which has been in existence in advanced countries like the US. With shareholders and other stakeholders becoming more informed, knowledgeable and conscious of their rights, it was inevitable that this concept would find roots in India as well.

## Miscellaneous

Several new concepts have been introduced such as 'total share capital' as the basis for determining the holding company which for all these years hinged on shareholding of the equity capital. The term 'control' has also been defined. 'Associate companies' and 'joint venture companies' are treated on par with subsidiaries causing practical difficulties as well as



accounting difficulties. 'Auditing standards' are being introduced and the National Financial Reporting Authority ("NFRA") is being created to take over several functions including the setting of accounting and auditing standards. 'Key Managerial Personnel' ("KMP") are identified and onus is on them to ensure various compliances required under the Act. The company secretary in employment is a KMP but the fear is that he/she would become an official with only responsibilities but no authority or power.

## Conclusion

The introduction of a new Companies Act, after the old Act has served all for over five decades, is a welcome and a significant step. The intentions of the Central Government, particularly the MCA, in drafting this law with several new provisions and concepts and prescribing extensive Rules to make the law dynamic and responsive to the needs of the corporate sector are greatly laudable. While the corporate sector would certainly be expected to conduct its affairs responsibly and transparently, the government would have to demonstrate that its intentions are to encourage the corporate sector and not to stifle or strangle it. If the corporate sector prospers, society and all its stakeholders will prosper. The Government and the corporate sector must work together to build mutual confidence and help advance the economic development of India. Each one of us may have a different perspective with regard to the new company law but let us believe for a moment that the new law has been introduced by the central government with the best intentions and that it is now the turn of the corporate sector to demonstrate that it will play according to the Rules. The government on its part must trust the corporate sector to function honestly but keep a watch!

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## Disclosure of interest by directors in contracts and arrangements: Provisions Not free from anomalies and absurdities

- Though the provisions of existing section 299 dealing with disclosure of interest by directors, have by and large, been incorporated in section 184 of the Companies Act, 2013 some significant changes made therein have unfortunately resulted in some absurdities and avoidable confusions. This article makes a critical analysis of the new provisions.



### INTRODUCTION

Section 299 of the Companies Act 1956 (1956 Act) has been retained by the Companies Act 2013 in section 184 with considerable similarity but a few significant changes. Overall, the recasting and changes are going to result in

more anomalies and absurdities in the working of this provision in reality. Candidly, section 299 is such a well drafted provision in the 1956 Act that there was hardly any need to recast it except one small change in sub-section (6). Unfortunately, this has happened in respect of many provisions of the 1956 Act included in the new Act; they have been unnecessarily tinkered with in an enthusiasm to create something new and different.



Section 184 of the new Act, reads as follows:

**“Disclosure of interest by director:** (1) Every director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed.

- (2) Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—
- (a) with a body corporate in which such director or such director in association with any other director, holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or
- (b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be, shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting:

Provided that where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

- (3) A contract or arrangement entered into by the company without disclosure under sub-section (2) or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company.
- (4) If a director of the company contravenes the provisions of sub-section (1) or sub-section (2), such director shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees, or with both.
- (5) Nothing in this section—
- (a) shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contract or arrangement

» A director will have to give a notice of disclosure at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change. This disclosure is the disclosure of the director’s interest by virtue of his connection.

with the company;

- (b) shall apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them together holds or hold not more than two per cent. of the paid-up share capital in the other company.”

## General disclosure of director’s connection with companies, etc.

According to section 184(1) of the new Act, every director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed.

This is similar to sub-section (3) section 299 of the 1956 Act but with some change. A director will have to give a notice of disclosure at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change. This disclosure is the disclosure of the director’s interest by virtue of his connection with any company, body corporate, firm, or other association of individuals. The interest may be by shareholding or otherwise. All these are cases of direct interest by reason of the director’s connection as a shareholder or in some other capacities with company, etc. The notice of this disclosure will be given by a director by a notice in the prescribed manner. Why interest through a relative has been excluded, is not clear.



## Specific disclosure of interest or concern

According to section 184(2) of the new Act, every director of a company must disclose the nature of his concern or interest if he is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—

- (a) with a body corporate in which such director or such director in association with any other director, holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or
- (b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be.

Such disclosure must be made at the meeting of the Board in which the contract or arrangement is discussed and the concerned director shall not participate in such meeting. The words “in any way, whether directly or indirectly, concerned or interested in a contract or arrangement” underscore the wide scope of this provision. Interest of a director may be in any way, whether directly or indirectly, and it is not only interest but also concern and not only in a contract but also an arrangement, that would attract the requirement of disclosure. The disclosure required is a specific disclosure at a board meeting. This provision casts a duty on a director to disclose but also a duty on the company management to bring before the board every contract or arrangement that would attract the provision and it would not be justified to say that a contract or arrangement was not placed before the board (because it did not require to be placed either under the law or the company’s articles of association or its policy) director. The company management will have to place all contracts or arrangements before the board for its approval if any director is in any way, whether directly or indirectly, concerned or interested in such contract or arrangement.

This provision debars the concerned or interested director from participating in the board meeting. The words “shall not participate in such meeting” indicate the intention of the Legislature that the concerned or interested director should stay away from the meeting while the matter is being discussed and decided by the board and let the board do it in camera. In other words he should leave the board meeting room while the board discusses the matter.

## Becoming concerned or interested subsequently

According to the Proviso to section 184(2) of the new Act, if a director who is not concerned or interested in a contract or arrangement when it is entered into but becomes concerned or interested after it is entered into, he must disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned

or interested.

The words “he must disclose his concern or interest forthwith when he becomes concerned or interested” are going to create confusion because the following words (“at the first meeting of the Board held after he becomes so concerned or interested”) were enough to take care of the contingency contemplated by this proviso.

## Consequences of non-disclosure

According to section 184(3) of the new Act, a contract or arrangement entered into by the company without disclosure under sub-section (2) or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company. Thus, the contract or arrangement will not be void but only voidable at the option of the company and the board can ratify it so as to avoid its voidability.

According to section 184(4) of the new Act, a director who contravenes the provisions of sub-section (1) or sub-section (2) shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees, or with both. Then, according to section 167(c) of the new Act the office of a director failing to comply with the requirements of section 184 of the new Act shall become vacant. This provision is identical to section 283(1)(i) of the 1956 Act.

## Exclusion

Section 184(5) of the new Act reads thus:

“Nothing in this section—

- (a) shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contract or arrangement with the company;





(b) shall apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them together holds or hold not more than two per cent. of the paid-up share capital in the other company.

Sub-clause (b) is identical to sub-section (6) of section 299 of the 1956 Act, which provides that “Nothing in this section shall apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them together holds or hold not more than two per cent of the paid-up share capital in the other company.”

As in the case of sub-section (6), this provision is going to create (rather continue) a controversy as to its correct interpretation, which could have been avoided by simply introducing words appropriate to indicate that this exemption will be available only where interest of a director in another company is by reason of shareholder and not in any other manner and if a director has interest (direct or indirect) in any manner other than shareholding, such interest shall be excluded by this provision.

Such has to be the interpretation of the exemption under sub-clause (b) despite the use of the words “Nothing in this section shall apply”. It may be noted that these words were interpreted by the Supreme Court (in the context of some other law) to be having the effect of excluding the operation of the entire section [see Commissioner of Agricultural I. T., Kerala v. Plantation Corporation of Kerala Ltd. AIR 2000 SC 3714]. However, going by the principle of purposive interpretation, it is clear that the words “Nothing in this section shall apply” do not have the result of excluding the operation of the provisions of section 184 of the new Act (like section 299 of the 1956 Act) and they seek to exclude only director’s interest by virtue

of shareholding, the exemption has to be read in conjunction with the substantive provision in sub-sections (1) and (2). The intention of an analogous provision in the Indian Companies Act 1913 (section 86F) was thus explained by Chagla J. in *Walchandnagar Industries Ltd v Ratanchand Khimchand Motishaw* (1953) 23 Comp. Cas 343 (Bom): “It is clear that in enacting this provision, the Legislature wanted to suppress a particular mischief and had a particular object in mind. A director of a company occupies a responsible position and the Legislature wanted that while occupying that position he should not be placed in a situation where there would be a conflict between his interest and his duty. His duty would be to enter into a profitable contract with the company. It is also clear that a director holding the position that he does can obtain undue benefit by entering into profitable contracts with the company, and in order to suppress that mischief and to achieve the object which the Legislature had in mind, section 86F was enacted. It is a well settled canon of construction that when we are considering a remedial measure, we must give to the provision of law as wide an interpretation as possible, of course, consistently with the language used by the Legislature, and if section 86F is remedial in its nature, which it undoubtedly is, then it would be wrong to give it a restricted construction. On the contrary we should try and give it as wide an interpretation as possible.”

### Definition of “interested director”

Section 2(49) of the new Act defines the expression “interested director” as a director who is in any way, whether by himself or through any of his relatives or firm, body corporate or other association of individuals in which he or any of his relatives is a partner, director or a member, interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into by or on behalf of a company.

This definition is not the same as the concept of interest contemplated in section 184 of the new Act and there is a conflict between section 184 and the definition of “interested director”. The expression “interested director” as such has not been used in section 184.

The phrase “interested director” as such is used in only one provision throughout the new Act namely section 174, but, strangely enough, the Explanation appended to that section states that “For the purposes of this sub-section, “interested director” means a director within the meaning of sub-section (2) of section 184”. And, as noted, section 184 of the new Act doesn’t use precisely that expression. So, no purpose is served by the definition. Interestingly, this definition omits ‘concern’, which section 184 does include.

In short, a good amount of confusion has been created in drafting the provisions of the new Act in this regard. CS





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## Implications of the Notification issued by the Ministry of Corporate Affairs enforcing various provisions of the Companies Act, 2013

- Some of the provisions of the Companies Act, 2013 have already been brought into force with effect from 12 September 2013. The Companies Act, 1956 is still in force and has not been repealed in its entirety. The implications of the partial enforcement and the confusions that are likely to arise due to this are highlighted here.

### INTRODUCTION

The Companies Act, 2013 (the Act) received the Assent of the President of India on the 29th August 2013. Section 1(3), which empowers the Central Government (i.e. the Ministry of Corporate Affairs) to bring into force the remaining provisions of the Act from such date as the Central Government appoints, has come into force simultaneously with the issue of the notification notifying the receipt of Assent of the President of India in the Official Gazette (i.e. 30th August 2013). The said section further empowers the Central Government to appoint different dates for bringing into force different provisions of the Act. In exercise of its powers under the aforesaid section 1(3) of the Act the Ministry of Corporate Affairs has brought into force over 90 sections of the Act with effect from the 12th September 2013. The Companies Act, 1956 (the old Act) is still in force and has not been repealed. The Ministry of Corporate Affairs, for eliciting comments from the Public, has notified draft Rules in respect of certain Chapters of the Act. Thus on date the old Act and the notified sections

of the Act are in force. Because of this there is lot of confusion amongst those who are, in companies, required to comply with the requirements of various provisions of Company Legislation in India. The Central Government could have waited for some more time, say, till the finalisation of the Rules and then brought into force the Act as a whole and simultaneously repealed the old Act. Such a course could have avoided the present confusion existing in the minds of the professionals. Now that certain sections of the Act have been brought into force and the whole of the old Act has not been repealed, in order to avoid penal consequences it would be advisable for professionals to comply with the stricter requirements of the two legislations so that companies are not hauled up for unintended violations of either of the Acts. It may be of interest to note that even though not formally repealed by issue of specific notification in this regard the Ministry of Corporate Affairs has through its circular No.16/2013 dated the 18th Sept. 2013 has clarified that the corresponding sections in the old Act in respect of the aforesaid sections which have been enforced, would



cease to be effective. In the following paragraphs it is proposed to examine the implications of the Central Government's Notification putting into force certain provisions of the Act.

## Enforcement Notification

The Notification was issued on the 12th September 2013 in an Extra-ordinary Gazette of India bearing the same date. It has fifty-five clauses.

### Clause 1 - Definitions

Clause 1 relates to definition section (section 2) of the Act. Most of the definitions, which have been brought into force are similar or identical definitions contained in the definition section, or in the substantive sections of the Old Act. Wherever there are significant deviations the implications of the same are discussed hereunder:

**[a] Abridged prospectus:** In the old Act the power to prescribe the contents rested with the Ministry of Corporate Affairs. Under the new Act the power is with the Securities and Exchange Board of India and consequently companies have to follow the format of 'abridged prospectus' prescribed through its Regulations. Presently in the Issue of Capital & Disclosure Regulations of SEBI there is no specific format in this regard. It is hoped that SEBI would prescribe the format soon. Till it is prescribed, it would be prudent and advisable for companies to follow the format prescribed by the Ministry of Corporate Affairs, even though the said format cease to be current in view of the fact that the provisions of the Act which is latest in point of time would prevail.

**[b] Associate Company:** This is a new definition and has drawn its influence from the Accounting Standard No.18 issued by the Institute of Chartered Accountants of India relating to 'Related Party Disclosures'.

**[c] Board of Directors or Board:** The definition appropriately clarifies that the collective body of the directors will be known as 'Board of Directors or Board'.

**[d] Book and Paper:** This is on the lines of section 2(8) of the Old Act but the provisions of the said section 2 (8) is enlarged to include, 'minutes and registers maintained on paper or in electronic form'. The addition of the foregoing would formally enable companies to maintain registers in electronic form and make the Act self-contained. The word 'accounts' appearing in the definition of the old Act has been substituted by the words, 'books of account'. This enlargement is of a clarificatory in nature.

**[e] Control:** This is a new definition and is identical to the definition contained in Regulation 2(1)(e) of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011.

**[f] Court:** The whole of the definition excluding the one relating to special court has been brought into operation. Probably the whole of the definition would be brought into force when the Special Courts are constituted upon enforcement of all the provisions of the new Act.

**[g] Director:** The definition in the old Act has been revised to specifically mention that a person appointed as director to the Board of Directors would be a director of the company. In view of this revision the words, 'includes any person occupying the position of director, by whatever name called' have been deleted from the earlier definition.

**[h] Expert:** This is a new definition and will be of use in relation to section 26(5) of the Act. Largely in the absence of the definition the meaning of this term was in the realm of interpretation. By defining this term in the Act the word has been given a definite meaning.

**[i] Financial Institution:** This is a new inclusive definition. Schedule Banks and other institutions defined or notified under the Reserve Bank of India Act, 1934 are financial institutions in terms of the provisions of this section. Section 451(c) of the Reserve Bank of India Act, 1934 defines the expression 'Financial Institution' as under:

"financial institution" means any non-banking institution which carries on as its business or part of its business any of the following activities, namely: -

- (i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;
- (ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;
- (iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972 (26 of 1972);
- (iv) the carrying on of any class of insurance business;
- (v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;
- (vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, but does not include any institution, which carries on as its principal business,—
  - (a) agricultural operations; or
  - (aa) industrial activity; or
  - (b) the purchase, or sale of any goods (other than securities) or the providing of any services; or



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- (c) the purchase, construction or sale of immovable property, so, however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;

Explanation.—For the purposes of this clause, “industrial activity” means any activity specified in sub-clauses (i) to (xviii) of clause (c) of section 2 of the Industrial Development Bank of India Act, 1964 (18 of 1964);

It may be seen from the above that the Reserve Bank of India has not been empowered to notify institutions as ‘Financial institution’. In view of this position only institutions, which conform to the definition of ‘Financial Institution’ extracted above would, for the purposes of the Act, be Financial Institutions. Unless the Reserve Bank of India Act is amended the said Bank cannot notify institutions as Financial Institutions.

**[j] Financial Statement:** This is a new inclusive definition. Balance Sheet, Profit and Loss Account, Cash Flow Statement, where applicable a statement of changes in equity and notes in relation to the above would, inter alia, form part of the Financial Statement. In respect of an One Person Company and a Dormant Company this expression would exclude Cash Flow Statement. It may be noted that when section 129 of the Act is brought into force companies would be required to circulate to their members all the above documents for consideration at an Annual General Meeting.

**[k] Free Reserves:** This is a new definition. Earlier this expression was defined by way of Explanation to section 372A of the old Act. The said explanation in the old Act has been amplified to specifically spell out that

- (i) any amount representing un-realised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

It should be noted that credit balance in the securities premium account has not been included in the definition of free reserve.

**[l] Interested Director:** This is a new definition. It could be seen on a close reading of the definition of the term ‘interested director’ that it has enlarged the scope of interest in that even a contract with two public limited companies would come within the purview of the definition. But in relation to contracts with public limited companies a director would be deemed to be interested if in the public company with which the contract is entered into, any of the directors of the contracting company either by himself or along with other co-directors of the contracting company holds not less than 2% of its share capital. This would be evident from the



provisions of section 184 (5)(b) of the Act. As the reference in this section is to ‘share capital’ amount of the preference capital also would go into the computation of the aforesaid percentage. In order to simplify matters it would have been ideal if this had been provided so in the definition clause itself. It may be pertinent to point out that section 184 of the Act has not yet been brought into force and as such the aforesaid exemption would be available to companies only as and when the same is brought into force. Till such time the said section is made operational the definition of ‘interested director’, would have sway in relation to transactions with directors, etc. of a company and companies will have to live with it unless the Ministry of Corporate Affairs comes up with a clarification. Further even though a definition of this phrase has been included in the definition clause, this definition has been hardly made use of in the body of the Act as would be evident from the fact that wherever the interest of a director has been referred to the said section itself stipulate the details of interest thus making this definition redundant. Section 184(2), explanation to section 185(1), explanation to section 174(3), are instances in point.

**[m] Key managerial personnel :** This is a new definition. Even though the definition section has been brought into force, as section 203 of the Act has not been made effective, companies need not at present appoint key managerial personnel mandatorily. But if they so desire they can do so. But as section 21 of the Act has been brought into operation, a key managerial personnel of a company can authenticate documents requiring authentication on behalf of the company of which he is one of the key managerial personnel. Likewise he can sign contracts on behalf of the company. No delegation from the Board of Directors is required for this purpose.



**[n] Manager :** This conforms to the definition in the old Act. In terms of the definition a manager will have the management of the whole or substantially whole of the affairs of a company. The expression 'substantially whole' has not been defined. By way of explanation 'substantially the whole of the undertaking' has been defined by way of explanation to section 180 specifying, 'Restrictions on Powers of Board' to mean twenty percent or more of the value of the undertaking as per the audited balance-sheet of the preceding financial year. It would appear that the meaning assigned to 'substantially whole of the undertaking' in relation to section 180 of the Act could be made applicable to this definition. In that light a company could have more than one 'Manager' for the purposes of the Act. This requires clarification.

**[o] Net Worth:** The existing definition in the old Act has been amplified to make it self-contained. It would be significant to note that accumulations in securities premium would form part of the net worth as it is exclusively available to equity holders of a company.

**[p] Officer who is in default:** Provisions of section 5 of the Old Act have been incorporated in the definition clause. The said section has been amplified to include key managerial personnel as officers in default.

**[q] Promoter:** This is a new definition and exhaustively defines the promoter of a company. It is significant to note that a person, who is not merely acting in his professional capacity, but in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act is a promoter in terms of this definition. The definition is important in view of the fact that promoter is empowered to appoint directors, under section 168(3) of the Act, to the Board of Directors of a company in the event of all its directors resigning or vacating their office, to hold office till the directors are appointed by the general meeting. It would appear that once a person becomes a promoter of a company by his name being borne in the prospectus issued by the company he will continue to be promoter for life as there is no provision for resigning or otherwise vacating the office of promoter in the Act. That would not be the case if one becomes a promoter under other circumstances.

**[r] Public Financial Institution:** Provisions of section 4A of the old Act have been incorporated in the definition clause. This opportunity has been taken to prune the said section keeping in view the changes that have taken place subsequent to the enactment of the section. In terms of the definition, the Life Insurance Corporation of India, the Infrastructure Development Finance Company Limited, the specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002, the Institutions notified under section 4A of the old Act and such other institutions as may be notified by the Central Government (Ministry of Corporate Affairs) are Public Financial Institutions for the purposes of the Act.

**[s] Related Party:** This is a new definition and is similar to the definition contained in the Accounting Standard 18 issued by the Institute of Chartered Accountants of India with the addition to empower the Central Government to prescribe by notifications more person/s as related party. In exercise of this power the Central government has signified its intention through the draft Rules notified (Chapter I – 1.3) to include in the definition of 'related party' directors and KMP of subsidiaries and associate companies and personnel of the company, who are members of core management team excluding Board of Directors, comprising all members of management one level below the executive directors, including the functional heads. Under Section 188 of the Act, apart from entering into contracts, holding an office of profit by a related party will fall under the mischief of the said section. This requirement may lead to a miserable situation considering the wide coverage of the term 'related party'.

The provisions of Section 314 of the old Act have also been brought into Section 188 of the new Act. The provisions of Section 314 regulate only a relative of a director holding an office of profit. Of course 'Arm's length basis' transactions entered into in the ordinary course of business of the company have been excluded in the Act. It is now proposed, by intent or otherwise, to regulate the holding of office or place of profit by parties related to the senior management personnel (functional heads) of companies and its subsidiaries who normally are professionals without any other stake in the company. In a large company there may be number of such persons who are employed and related to the directors and other persons referred to above. The question, whether their appointments are on 'arm's length basis' or otherwise, is a subjective one. Any such appointment, the promotion and accelerated increments to such employees holding the appointment, etc. will require approval of the shareholders by special resolution in terms of the provisions of this section. This is definitely a retrograde provision and not simplification of the requirements, and, therefore, calls for review and revision so that the persons who are related to senior management persons, etc. are excluded from the restrictive provisions of section 188 of the Act.

**[t] Relative:** Provisions of Section 6 of the old Act have been transferred to the definition clause. Schedule 1A of the old Act has been deleted from the definition and in lieu there of the Central Government has been empowered to prescribe the manner in which one would be related to another. The definition section itself states that two persons would be related if they were husband and wife. In this context it is not understood why in the draft rules to be prescribed (Rule 1.4) spouse has been mentioned. Further the following relatives who found a place in Schedule 1A appended to the old Act are not mentioned in the List of Relatives: son's son's wife  
daughter's son  
daughter's daughter



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daughter's daughter's husband  
son's daughter's husband  
brother's wife  
sister's husband

It is also strange to note that wife's sister and wife's brother and husband's brother and husband's sister who enjoy considerable clout in the India context do not find a place in the list.

**(u) Remuneration:** This is a new definition inserted in the Act by shifting an inclusive definition given section 198 of the Old Act. The term has been given a definite meaning. Hitherto prerequisites were for the purpose of remuneration computed on 'cost to the company' or 'outgo' basis. In terms of the new definition remuneration would include prerequisites as defined in the Income-tax Act, 1961. In view of this change prerequisites would be valued on Income-tax basis.

**(v) Subsidiary company or subsidiary:** This is also a new definition inserted in the Act by shifting the provisions of section 4 of the old Act. The definition confers on the Central Government the power to prescribe the number of layers of subsidiaries a holding company can have. Of course, the clause in the definition in this regard has not been put into force. The deeming provision contained in section 4(7) of the old Act do not find a place in the definition.

**[w] Total voting power:** This is a new definition. This means the total votes that may be cast in regard to that matter on a poll at a meeting of the company. This definition will not be use in regard to matters decided on a show of hands, but would be relevant in relation to matters where certain interests are denied voting rights. For example in regard to election of small shareholder director, voting right is denied to members other than small shareholders (section 151).

**[x] Voting right:** This is a new definition and means the right of a member to vote in any meeting of the company or by means of postal ballot. This definition has to be read in conjunction with the provisions of section 47 of the Act in terms of which the holders of preference shares get the right to vote on certain matters and under certain circumstances.

## Clause 2 (Section 19):

This section relates to holding of shares in the holding company by its subsidiary. This is similar to the provisions of section 42 of the old Act. This section seeks to prohibit the allotment or transfer of shares by the holding company to its subsidiary and make such allotment or transfer void. A company registers a transfer and do not transfer its own shares to any one. It makes allotment of shares. Probably by referring to 'transfer of shares' the Legislature intends to prohibit the Registration of transfer of shares. This prohibition to be more effective in the case of listed companies should be extended to registration of transfer by Depository Participant also.

## Clause 3 (Section 21):

This section deals with authentication of documents and signing of contracts on behalf of a company. Now that the definition of 'Key managerial personnel' has been brought into force, if an existing company has a key managerial personnel he can authenticate documents and sign contracts on behalf of the company. No authorization would be required for that purpose. In addition to the key managerial personnel a document can be authenticated and contracts signed on behalf of a company by a person if he is so authorised in this behalf by its Board of Directors.

## Clause 4 (Section 22):

This section deals with signing of bill of exchange, etc. on behalf of a company and delegation of powers through a power of attorney. Provisions contained in sections 47 and 48 of the old Act have been combined and incorporated in this section.

## Clause 5 (section 23 except clause (b) of sub-section 1 and sub-section 2):

This section deals with public offer and private placement. It should be noted that the provisions relating to private placement by a public limited company and rights issue, bonus issue and issue by private placement by a private limited company have not yet been brought into force.

## Clause 6 (Section 24):

This section relates to distribution of powers with respect to share capital and debentures, and punishment for failure to distribute dividend, to be administered by the Securities and Exchange Board of India and the Central Government in the case of listed companies and other companies respectively. This is on the lines of section 55A of the old Act.

## Clause 7 [Section 25 except sub-section (3)]:

This section deals with and spells out that the documents containing offer of securities for sale would be deemed to be prospectus. However, sub-section (3) of section 25 has not been enforced. This section is similar to section 64 of the old Act.

## Clause 8 [sections 29 to 32 (both inclusive)]:

These sections specify that public offer of securities should be in dematerialized form (this is new in the case of companies whose shares are not listed and made mandatory in the case of listed companies irrespective of the amount of issue) and deals with shelf prospectus and red herring prospectus and advertisement of prospectus.

## Clause 9 [Section 33 except sub-section (3)]:

This section which is similar to sub-section (3) of section 56 spells out that no one can issue application for securities unless it is accompanied by abridged prospectus. In the definition of the



abridged prospectus, SEBI is required to notify the contents and till such time it is notified by SEBI it would be prudent to follow that the contents are in line with Form 2A prescribed under the Companies (Central Government's) General Rules and Forms, 1956.

**Clause 10 (Section 34):**

This deals with criminal liability for mis-statements in prospectus and is on the lines of section 63 of the old Act.

**Clause 11 [Section 35 except clause (e) of sub-section (1)]:**

This deals with civil liability for mis-statements in prospectus and is on the lines of section 62 of the old Act except that it seeks to specifically include the expert named in the prospectus. The liability in the case of an expert has been presently put on hold.

**Clause 12 [Sections 36 to 38 (both inclusive)]:**

These deals with fraudulent inducement to invest money and personation for acquisition of securities and corresponds to sections 68 and 68A of the old Act. Section 37, which is a new provision, provides for action by the affected person.

**Clause 13 [Section 39 except sub-section (4)]:**

This deals with allotment of shares and is on the lines of section 69 of the old Act.

**Clause 14 [Section 40 except sub-section (6)]:**

This deals with securities issued, to be dealt with in stock exchange and corresponds to section 73 of the old Act. Sub-section (6), which corresponds to section 76 of the Old Act, empowers the Central Government to prescribe the conditions subject to which such commission could be paid.

**Clause 15 (Sections 44 & 45):**

This deals with nature of shares and numbering of shares issued in physical form and corresponds to sections 82 and 83 of the old Act.

**Clause 16 (Sections 49 to 51):**

This relates to calls and payment of dividend in proportion to the amount paid up if so authorized by articles and is similar to sections 91 to 93 of the old Act.

**Clause 17 (Sections 57 to 60):**

Section 57 is new and deals with personation of shareholder. The other sections deal with registration of transfer of shares, rectification of register of members and publication of authorized capital. These sections correspond to section 111, 111A and 148 of the old Act.

**Clause 18 (Section 65):**

This requires an unlimited company to provide for reserve share capital on conversion into a limited liability company and is on the lines of section 98 of the old Act.

**Clause 19 (section 69):**

This requires a company purchasing its own shares out of free reserve and securities premium to create Capital Redemption Reserve Account. This is akin to section 77AA of the old Act.

**Clause 20 (section 70 except sub-section (2)):**

This section prohibits companies from buying back its shares under certain circumstances corresponds to section 77B of the old Act. Sub-section (2) of section 70, which has not been brought into force completely prohibits a company from buying its own shares if it had not filed the annual return, failed to pay the declared dividend, and circulate the financial statements amongst its members.

**Clause 21 (Section 86):**

This section prescribes penalties for contravention of the provisions relating to charges. It may be noted that the compliance provisions relating to charges have not been put into force. Therefore, in regard to compliances with the provisions relating to charges in the old Act will apply. It may further be noted that punishment for non-compliance with the provisions prescribed in this section would, in view of the provisions of Article 20 of the Constitution of India, apply only in relation to non-compliances arising on or after the 12th Sept. 2013 from which date this section was put into force. In relation to non-compliances relating to the period prior to Sept. 12, 2013, the provisions of the old Act would prevail.

**Clause 22 (Section 91):**

This relates to closure of Register of Members and is similar to provisions of section 154 of the old Act.

**Clause 23 (Section 100 except sub-section (6)):**

This deals with calling of extra-ordinary general meetings including on requisition by members. This is in line with section 169 of the old Act. The rationale for not putting into force sub-section 6 which deals with reimbursement of expenses incurred by the requisitionists and recovery there of from the directors concerned which is similar to the provisions of section 169 (9) of the old Act is not understood.

**Clause 24 (Section 102):**

This requires the explanatory statement to be attached with the notice in relation to each item of special business to be transacted at the meeting. The Ministry of Corporate Affairs, in its circular No.15 of 2003 dt. 13th Sept. 2013, has clarified that in regard to notice issued prior to 12th Sept. 2013 the requirements of this section need not be complied with. Further rules requiring additional disclosures have not yet been promulgated. This section applies to private limited companies also and as such notice of meetings of private limited companies should be accompanied by an explanatory statement.

**Clause 25 (section 103):**

This prescribes graded quorum of general meetings of companies.



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The requirements of this section have to be complied with in relation to general meetings held on or after the 12th September 2013 when the section was brought into operation. This corresponds to section 174 of the Act. It should be noted that there is no exemption from this requirement in regard to private limited companies.

## **Clause 26 (section 104):**

This deals with the Chairman of General Meetings of companies and is on the lines of section 175 of the old Act.

## **Clause 27 [Section 105 except the third and fourth proviso of sub-section (1) and sub-section (7)]:**

This section relates to proxies and is on the lines of section 176 of the old Act. Through the Third and Fourth Provisos referred to above the Central Government takes powers to prescribe that members of certain class of companies will not be entitled to appoint proxies and to prescribe a ceiling on number, for a person to be a proxy of the members of a company or on the number of shares in respect of which he can be a proxy. Sub-section (7) deals with the form of proxy.

## **Clause 28 (Section 106):**

The section 106 deals with restriction on voting rights and combines in itself provisions of sections 181 and 182 of the old Act.

## **Clause 29 (Section 107):**

This deals with voting by show of hands and is on the lines of section 177 and 178 of the old Act.

## **Clause 30 (Section 111):**

This deals with circulation of members' resolutions and is on the lines of section 188 of the old Act.

## **Clause 31 (Section 112):**

This deals with nomination of representatives by the President of India and Governors of States for attending meetings of companies in which they are members. This is on the lines of section 187A of the old Act.

## **Clause 32 [Section 113 except clause (b) of sub-section (1)]:**

This deals with the nomination of a representative by a company for the meeting of members and of creditors in which they are members and/or creditors, as the case may be. Clause (b) of sub-section (1) which deals with nomination to a meeting of creditors, which is a new provision in the Act, has not yet been put into force.

## **Clause 33 (Section 114):**

This deals with classification of resolutions and is similar to section 189 of the old Act.

## **Clause 34 (Section 116):**

This section deals with resolutions passed at adjourned general

meetings of a company and is in line with the provisions of section 191 of the old Act.

## **Clause 35 (section 127):**

This section spells out the punishment for failure to distribute declared dividend and is in line with the provisions of section 206 of the old Act. As indicated earlier in regard to punishment for non-compliance with the provisions relating to Registration of Charge, this section will be operative in respect of dividends declared on or after 12th September 2013.

## **Clause 36 (section 133):**

This confers power on the Central Government to prescribe Accounting Standards, which are to be followed in the preparation of Financial Statements. Through its circular No.15/2013 dated the 13th September 2013 the Ministry of Corporate Affairs have stated that till the standards are prescribed, under the Act, the standards prescribed under the old Act would apply.

## **Clause 37 [Section 161 except sub-section 2]:**

This section confers powers on the Board of Directors to appoint, additional, alternate and casual directors. Sub-section (2) which deals with the appointment of alternate director and which has not yet been brought into force, stipulates that a person could be an alternate to only one director in a company. This section combines the provisions of section 260, 262 and 313 of the old Act.

## **Clause 38 (Sections 162 and 163):**

These sections deal with the appointment of directors and adoption of the principle of proportional representation in making such appointments and are similar to the provisions of sections 263 and 265 respectively of the old Act.

## **Clause 39 (section 176):**

This section provides that defect in the appointment of directors will not invalidate the acts done by them before the defect came to be noticed. This section corresponds to the provisions of section 290 of the old Act.

## **Clause 40 (sections 180 to 183 (both inclusive):**

These sections relate to the restrictions on the powers of directors, making of contribution to charitable purposes, political contributions and to National Defense Fund, etc. These correspond to 293, 293A and 293B of the old Act.

## **Clause 41 (section 185):**

This section regulates loan to directors and is similar to section 295 of the old Act. It is significant to note that loans to managing or whole-time directors as part of the terms of the service extended to all employees of the company pursuant to any scheme approved by the members by special resolution is exempt from the provisions of this section. Earlier such loans required the approval of the Central Government.

**Clause 42 (section 192):**

This is a new provision inserted into the Act and restricts the acquisition of assets and sale of assets other than for cash from or to the directors of the company from the directors of the holding and subsidiary of the company or from persons connected with him. As a corollary of this provision if assets are acquired from or sold to such persons for cash would be outside the purview of the restrictions imposed by this section.

**Clause 43 (Section 194):**

This is also a new provision built into the Act and prohibits forward dealings in securities of the company by its directors and key managerial personnel.

**Clause 44 (Section 195):**

This is also a new provision which prohibits any person including a director and a key managerial personnel indulging in insider trading. This section also defines the expression 'insider trading'. This applies to all companies, whether listed or not. In the case of listed companies these are regulated by Regulations promulgated by SEBI under the Securities and Exchange Board of India Act. Thus in their case, they are regulated both by the Ministry of Corporate Affairs and SEBI and there are bound to be differences in the course of implementation which may lead to avoidable difficulties to listed companies. It is hoped that in order to ensure simplicity such diarchy is avoided.

**Clause 45 (Section 202):**

This section regulates the compensation to managing, or whole-time director or manager for loss of office in line with section 318 of the old Act.

**Clause 46 (Section 379):**

This section is new and stipulates that if a company incorporated abroad in which an Indian citizen(s) or a company(ies) incorporated in India or a combination thereof holds 51% or more of its share capital, whether preference or equity, has a place of business in India, such business has to comply with the requirements of Chapter XXII of the Act and such other requirements as may be prescribed as if it is a company incorporated in India.

**Clause 47 (Sections 382 and 383):**

These stipulate the display the names, etc. outside the premises from where a foreign company transacts business in India and manner of service of documents and are on the lines of section sections 595 and 596 of the old Act.

**Clause 48 (Section 386 except clause (a)):**

This is an interpretation provision for Chapter XXII of the Act. The interpretation of the word, 'certified', has not yet been enforced because the Ministry of Corporate Affairs has not issued Rules in this regard. Till the Rules are promulgated, the provisions of section 602 of the old Act would interpret this word.

**Clause 49 (Section 394):**

This deal with the requirement of laying before Parliament of the annual report of Government companies and is in line with the provisions of 619A of the old Act.

**Clause 50 (Section 405):**

This empowers the Central Government to issue of orders to companies to furnish statistics and is in line with the provisions of section 615 of the old Act. It may be noted that the Central Government has not issued any order in this regard and pending the issue of such orders the old prescribed requirements in this regard would have to be complied with.

**Clause 51 [Section 407 to 414 (both inclusive)]:**

These relate to the constitution of National Company Law Tribunal and Appellate Tribunal and correspond to sections 10FB to 10GF of the old Act. It may be of interest to note that the aforesaid provisions in the old Act have not yet been brought into force but the provisions in this regard in the Act has been put into force. This is probably with a view to enable the Central Government to constitute the aforementioned Tribunals in time so that when the entire Act is put into force the Tribunals would be in place to attend to duties assigned to them under the Act.

**Clause 52 (section 439):**

This section states that offences under the Act are non-cognisable and is on the lines of section 624 of the old Act.

**Clause 53 [Sections 443 to 453 (both inclusive)]:**

These relate to various powers conferred by the Act on the Central Government and various other matters and correspond to sections 624A to 631 of the old Act.

**Clause 54 [Sections 456 to 463 (both inclusive)]:**

These relate to enactment of various provisions relating to administration of the Act by the Central Government, such as providing for consequences for action taken in good faith, condonation of delays, etc.

**Clause 55 [Sections 467 to 470 (both inclusive)]:**

These relate to conferment of power on the Central Government to amend the Schedules appended to the Act, to make Rules including for winding up of companies and to issue orders to remove any difficulty. In exercise of the power under section 470 of the Act the Ministry of Corporate Affairs has issued an order to clarify that 'that until a date is notified by the Central Government under sub-section (1) of section 434 of the Companies Act, 2013 (18 of 2013) for transfer of all matters, proceedings or cases to the Tribunal constituted under Chapter XXVII of the said Act, the Board of Company Law Administration shall exercise the powers of the Tribunal under sections 24, 58 and section 59 in pursuance of the second proviso to sub-section (1) of section 465 of the said Act.



## Special Court for Speedy Trial of Company Offences

- The setting up of the Special Courts will prompt the companies to scrupulously comply with the various provisions of the new Act and it will be dangerous if the companies become reckless or ignore the requirements of the newly introduced penal provisions of the Act. If they do so, it will be at their risk and peril.

Like many newly introduced provisions in the Companies Act, 2013 (hereafter referred to as 'the Act'), the provision for establishment of Special Courts is of special significance for speedy trial of 'all offences under the Act' and this will definitely help good corporate governance and stricter implementation of the new company law in India for the benefit of all the stakeholders. Section 435 of the Act stipulates that the Central Government by notification can establish or designate as many Special Courts as may be necessary. Added to this is the fact that the newly introduced Section 447 of the Act defines 'fraud' and prescribes the consequential stricter penal provisions for indulging in fraudulent activities. It is felt that the setting up of the Special Courts will prompt the companies to scrupulously comply with the various provisions of the new Act and it will be dangerous if the companies become reckless or ignore the requirements of the newly introduced penal provisions of the Act. If they do so, it will be at their risk and peril. Section 436(2) of the Act provides that while trying an offence under the Act, a Special Court may also try an offence other than an offence under the Act, with which the accused may, under the Criminal Procedure Code, 1973 (in short 'Cr PC) be charged at the same time.





Thus, not only trial of all offences under the Companies Act, 2013 but also offences in other Acts can be clubbed for trial by the Special Court. A perusal of the provisions of sections 435, 436 and 437 of the Act makes it clear that the Special Judge will exercise original jurisdiction in the criminal cases and he can even exercise jurisdictions akin to the one which are exercised by the Magistrate under the Cr PC.

Though it is too early to predict, simple analysis of the relevant provisions of the Act with regard to trial of offences indicate that just like the Central Bureau of Investigation ('CBI) which investigates bribery charges and corrupt practices by the Government officials enumerated in the provisions of the Prevention of Corruption Act, 1988 (in short 'PC Act') and subsequent trial of offenders by the special CBI Courts, in due course of time the Special Courts set up under the Companies Act, 2013 will assume a tremendous importance and are likely to usher in a regime of speedy justice delivery system by prosecuting the corporate offenders.

## What Section 447 Provides

Before we embark upon studying the provisions relating to setting up of the Special Courts and discussions on the 'cognizable' and 'non-cognizable' offences as per the Act, it is necessary to look at section 447 of the Act which has widened the scope of 'fraud' and clarifies that 'fraud' in relation to the affairs of the company or any body corporate, includes any act, omission or concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive or to gain undue advantage from, or to injure the interests of the company, or its shareholders, or its creditors or any other person (whether or not there is any wrongful gain or wrongful loss). Any such person, (including the company), who is found to be guilty of fraud shall be meted out with strict penalty going up to thrice the amount of the fraud and a minimum imprisonment term ranging from 6 (six) months up to 10 (ten) years. To deter the fraudulent acts affecting the "public interest", the Act clarifies that the minimum term of imprisonment shall not be less than 3 (three) years as against the minimum 6 months period in other cases. The said section also clarifies that 'wrongful gain' means the gain by unlawful means of property to which the person gaining is not legally entitled and that 'wrongful loss' means the loss by unlawful means of property to which the person losing is legally entitled.

## Composition of Special Court

Section 435 of the Act stipulates that a Special Court shall consist of a single Judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the Judge to be appointed is working and states that a person shall not be qualified for appointment as a Judge of a Special Court unless

he is, immediately before such appointment, holding office of a Sessions Judge or an Additional Sessions Judge. Thus, it becomes quite clear that the Central Government is very serious in punishing the corporate offenders and the Judge who will try corporate offences being not less than the rank of a Sessions Judge or Additional Sessions Judge will have sufficient experience, expertise and acumen to try such serious offences and render justice.

## Jurisdiction and Powers

Section 436 of the Act stipulates that notwithstanding anything contained in the Code of Criminal Procedure, 1973 (hereafter referred to as the 'Cr PC') 'all offences under the Act' shall be triable only by the Special Court established for the area in which the registered office of the company in relation to which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned. Regarding detention of accused person, Section 436(1)(b) of the Act stipulates that where a person accused of or suspected of the commissioning of an offence under the Act is forwarded to a Magistrate under Section 167(2A)(2) of the Cr PC, such Magistrate may authorise the detention of such person in such custody as he thinks fit for a period not exceeding 15(fifteen) days in the whole, where such Magistrate is a Judicial Magistrate and 7(seven) days in the whole, where such Magistrate is an Executive Magistrate, provided that where such Magistrate considers that the detention of such person upon or before the expiry of the period of detention is unnecessary, he shall order such person to be forwarded to the Special Court having jurisdiction. Since imminent arrest of the accused corporate officials is stipulated in the Act, it would hopefully deter fraudulent corporate practices.

Section 436(1)(c) of the Act stipulates that the Special Court may exercise, in relation to the person forwarded to it under clause (b) of Section 436(1) of the Act, the same power which a Magistrate having jurisdiction to try a case may exercise under Section 167 of the Cr PC in relation to an accused person who has been forwarded to him under that section; and a Special Court may, upon perusal of the Police Report of the facts constituting an offence under the Act or upon a complaint in that behalf, take cognizance of that offence without the accused being committed to it for trial. Section 436(2) states that when trying an offence under the Act, a Special Court may also 'try an offence other than an offence under the Act' with which the accused may under Cr PC be charged at the same trial. This also widens the jurisdiction and scope of trial at the Special Court and is a welcome move.

Section 436(3) of the Act stipulates that notwithstanding anything contained in the Cr PC, the Special Court may, if it thinks fit, try in a summary way any offence under the Act



# Article

Special Court for Speedy Trial of Company Offences

» Central Government is very serious in punishing the corporate offenders and the Judge who will try corporate offences being not less than the rank of a Sessions Judge or Additional Sessions Judge will have sufficient experience, expertise and acumen to try such serious offences and render justice.

which is punishable with imprisonment for a term not exceeding 3 (three) years, provided that in the case of any conviction in a Summary Trial, no sentence of imprisonment for a term exceeding 1 (one) year shall be passed. It is further provided that when at the commencement of, or in the course of, a summary trial, it appears to the Special Court that the nature of the case is such that the sentence of imprisonment for a term exceeding 1 (one) year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Special Court shall, after hearing the parties, record an order to that effect and thereafter recall any witnesses who may have been examined and proceed to hear or rehear the case in accordance with the procedure the regular trial.

Section 437 of the Act stipulates that the High Court within whose local jurisdiction the Special Court is functioning shall hear the appeals filed against the orders of the Special Court. Section 438 of the Act states that 'save as otherwise provided in this Act, the provisions of the Cr PC shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session and the person conducting a prosecution before a Special Court shall be deemed to be a Public Prosecutor. It is hoped that with the full functioning of the Special Courts under the Act, the maze of cases otherwise handled by a Magistrate would not come in the way of delivering speedier justice in cases pertaining to corporate fraud/corporate wrong doings.

Section 439 of the Act states that notwithstanding anything in the Cr PC, every offence under the Act, except the offences referred to in sub-section 6 of Section 212 of the Act shall be deemed to be non-cognizable within the meaning of Cr. PC and that no Court shall take cognizance of any offence under the Act which is alleged to have been committed by any Company or any officer thereof, except on the complaint in writing of the Registrar of Companies ('ROC'), a shareholder of the company or of a person authorized by the Central Government in that behalf. Thus a single shareholder can invoke the provisions of the law and initiate proceedings in the

Special Court. The law allows authorised SEBI officials to file cases relating to offence in issue and transfer of securities and for non payment of dividend. Prosecution by a company of any of its officers is not permitted in this section.

Section 439(3) of the Act, inter-alia, states that where the complainant is the ROC or a person authorized by the Central Government, the presence of such officer before the Court trying the offences shall not be necessary, unless the Court requires his personal attendance at the trial. Section 439(4) of the Act clarifies that the Official Liquidator of a company 'shall not be deemed to be an officer' of the company within the meaning of sub-section 2 of Section 439 and offences committed relating to winding up of companies will not be covered in this section.

To investigate frauds committed by companies, the Serious Fraud Investigation Office ('SFIO') set up since July, 2003 had already been doing a good job. The newly introduced provisions of Section 211 of the Act has given legal effect to this in the Act itself. The SFIO set up by the Central Government shall, be deemed to be the SFIO for the purpose of the Act. Section 212 of the Act provides that on receipt of a report of the ROC or of the inspector under Section 208 of the Act or on intimation of a special resolution passed by a company that its affairs are required to be investigated or in the public interest or on request of any department of the Central Government or the State government, the Central Government may, by order, assign the investigation in to the affairs of the said company to the SFIO and its Director, who may designate such number of Inspectors as he may consider necessary for the purpose of such investigation. Since 'fraud' is now defined in the Act, SFIO can now get the offenders prosecuted at the Special Court.

## Cognizance of Offences

Though section 439 talks about non-cognisable offences, for knowing what type of offences are 'cognisable' notwithstanding anything otherwise contained in the Cr PC, an analysis of sub-section (6) of section 212 of the Act becomes necessary as it clearly states that no person accused of any offence under the following sections of the Act shall be released on bail or on his own bond, unless the Public Prosecutor has been given an opportunity to oppose the application of such release and where the Public Prosecutor opposes the application but the Court is satisfied that there are reasonable grounds for believing that the accused is not guilty of such offence and that the accused is not likely to commit any offence while on bail, the Court may order the accused to be released on bail. However, if the Special Court so directs, a person below age of 16 years or a woman or a sick or infirm may be released on bail. The Special Court shall not take cognizance of any offence referred to in sub-section (6) of Section 212 of the Act, except upon a complaint in writing



made by the Director, SFIO, or any officer of the Central Government authorized by a general or special order in writing in this behalf by that Government. Section 212 (6) of the Act relates to the following provisions, namely :-

- offences covered under sub-sections (5) & (6) of section 7 of the Act, which inter-alia, relate to furnishing of false or incorrect particulars or suppression of any material fact or information in relation to registration of a company or subsequent to its incorporation by such fraudulent actions;
- offences covered in Sections 34 and 36 of the Act, relating, inter-alia, to issue, circulation or distribution of any Prospectus containing any untrue or misleading statement or inclusion or omission of any matter likely to mislead any person, or making knowingly or recklessly any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, so as to induce another person to enter into or to offer to enter into any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities or any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities or any agreement for, or with a view to obtaining credit facilities from any bank or financial institution.

## Other Relevant Provisions

Section 38 (1) of the Act relates to offence committed by any person who makes or abets making of an application in a fictitious name to any company for acquiring or subscribing for, its securities.

Section 46 (5) of the Act stipulates that if a company, with intent to defraud, issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate, but which may extend to ten times the face value of such shares or rupees 10(ten) crores, whichever is higher and every officer of the company who is in default shall be liable for action under Section 447 of the Act.

Section 56 (7) of the Act relates to transfer and transmission of securities and prescribe that without prejudice to any liability under the Depositories Act, 1996, where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under Section 447 of the Act.

Section 66 (10) of the Act relates to reduction of share capital and it states that if any officer of the company knowingly conceals the names of any creditor entitled to object to the reduction; knowingly misrepresents the name or amount of the debt or claim of any creditor; or abets or is privy to any

such concealment or misrepresentation as aforesaid, he shall be liable under Section 447 of the Act.

Section 140 (5) of the Act relates to the removal, resignation of Auditor and giving of special notice and it stipulates that without prejudice to any action under the provisions of the Act or any other law for the time being in force, the National Company Law Tribunal (NCLT) either suo-moto or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the Auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to the company, or its directors or officers, it may, by order direct the company to change its Auditors. Where an auditor, whether individual or a firm, against whom final order has been passed by the NCLT shall not be appointed as an Auditor of any company for a period of 5 (five) years from the date of passing of the said NCLT order and the Auditor shall also be liable for action under Section 447.

Section 206 of the Act relates to ROC's power to call for information, inspect books and conduct enquiries against any company and sub-section (4) of Section 206 of the Act states, inter-alia, that if the ROC is satisfied that the business of a company is being carried on for a fraudulent or unlawful purpose or not in compliance with the provisions of the Act or if the grievances of the investors are not being addressed, the ROC may call for any information and may, in writing, direct carrying out of such inquiry as he deems fit after providing the company a reasonable opportunity of being heard. Where the business of a company has been or is being carried out for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud and liable under Section 447 of the Act.

Section 213 of the Act pertains to investigation into company's affairs by the Inspector or Inspectors as ordered by the NCLT, and it is stipulated that if after investigation, it is proved that the business of the company is being conducted with intent to defraud its creditors, members, or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, then every officer of the company who is in default and the person or persons concerned in the formation of the company or management of its affairs shall be punishable for fraud and liable under Section 447 of the Act.

Section 229 of the Act stipulates that where a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body



# Article

Special Court for Speedy Trial of Company Offences



The Special Court shall not take cognizance of any offence referred to in sub-section (6) of Section 212 of the Act, except upon a complaint in writing made by the Director, SFIO, or any officer of the Central Government authorized by a general or special order in writing in this behalf by that Government.

corporate which is also under investigation, destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorized removal of, documents relating to the property, assets or affairs of the company or the body corporate, makes or is a party to the making of, a false entry in any document concerning the company or body corporate or provides an explanation which is false or which he knows to be false, he shall be punishable for fraud in the manner as provided in Section 447 of the Act;

Section 251 (1) of the Act stipulates that where it is found that an application by a company under Section 248(2) has been made with the object of evading the liabilities of the company or with the intention to deceive the creditors or to defraud any other persons, the persons in-charge of the management of the company shall, notwithstanding that the company has been notified as dissolved, be jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved, be punishable for fraud in the manner as provided in Section 447 of the Act.

Section 339 (3) of the Act states that where any business of a company is carried on with fraudulent intent or for fraudulent purposes described in that section, every person who was knowingly a party to the carrying on of the business in the fraudulent manner shall be liable for action under Section 447 of the Act.

Section 448 of the Act stipulates that, save as otherwise provided in the Act, if in any return, report, certificate, financial statement, prospectus, statement or other document required by or for the purposes of any of the provisions of the Act or the rules made there under, any person makes a statement which is false in any material particulars, knowing it to be false; or which omits any material fact, knowing it to be material, he shall be liable under Section 447 of the Act.

## Power to Grant Relief

This article dealing with the setting up of Special Courts under the Act and trial of offences would be incomplete without mentioning the power of the Court to grant relief in certain cases as mentioned in Section 463 of the Act. Sub-section (1) of Section 463 states that if in any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against an officer of a company, it appears to the Court

hearing the case that he is or may be liable in respect of the negligence, default, breach of duty, misfeasance or breach of trust, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused, the Court may relieve him, either wholly or partly, from his liability on such term, as it may deem fit. Proviso to the said section stipulate that in a criminal proceeding under this section, the Court shall have no power to grant relief from any civil liability which may attach to an officer in respect of such negligence, default, breach of duty, misfeasance or breach. Sub-section (2) of Section 463 of the Act further states that where any such officer has reason to apprehend that any proceeding will or might be brought against him in respect of any negligence, default, breach of duty, misfeasance or breach of trust, he may apply to the High Court for relief and the High Court on such application shall have the same power to relieve him as it would have had if it had been a Court before which a proceeding against that officer for negligence, default, breach of duty, misfeasance or breach of trust had been brought under sub-section (1) of Section 463. However, before granting such relief to the officer, the Court would give notice to the ROC to show cause as to why such relief should not be granted. Section 2(59) of the Act states that 'officer' includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the Directors is or are accustomed to Act. Thus, company directors, in appropriate cases, can expect to get relief.

## CONCLUSION

From a discussion of the above mentioned legal provisions, it is felt that since the Special Courts under the Act would function in addition to the cases dealt with by the NCLT, the professionals associated with the corporate sector would be benefited if they not only keep themselves abreast with the changes in the Act, but they also appropriately guide the management of the corporate sector to take stock of the far reaching changes introduced in the new Act. Since the offences now cover cases pertaining to formation of companies, where the professionals readily lend their names, casual approach in this regard would be avoided. Moreover, since every person to be appointed as a Director in a company's Board is required to obtain 'Director's Identification Number' ('DIN'), escape route for the Company Directors to face trial could be curbed to a large extent. CS



# Corporate Social Responsibility in the Companies Act, 2013 - A boon for scientific research

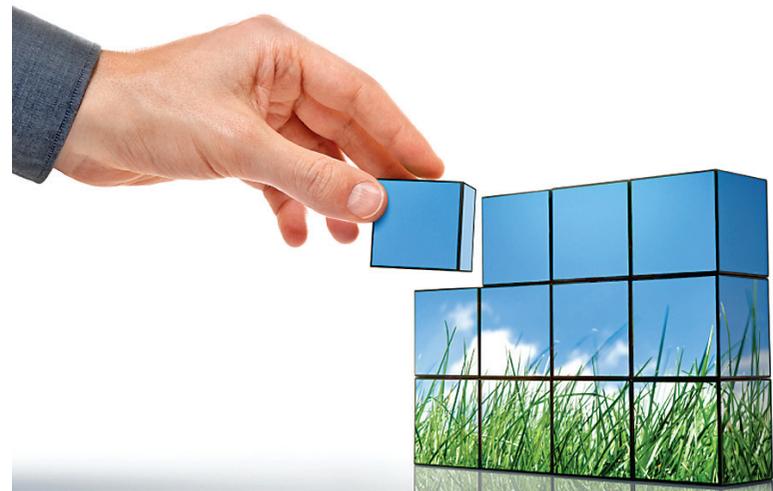
➤ 'Corporate social responsibility is a hard-edged business decision. Not because it is a nice thing to do or because people are forcing us to do it... because it is good for our business.'

*Niall Fitzgerald, Former CEO, Unilever*

## BACKGROUND

Corporate social responsibility has gained tremendous momentum in today's economic and social environment. The traditional approach of corporates that 'the business of business is to do business' has changed and now business goals are inseparable from the societies and environment within which business operate. Whilst short-term economic gain can be pursued through traditional approach, the failure to align the business goals with social and environmental factors will make those businesses unsustainable in the long term.

Corporate Social Responsibility (CSR) can be understood as a management concept and a process that integrates social and environmental concerns in business operations and a company's interactions with the full range of its stakeholders. Due to the world becoming a global village, companies are encouraged to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.



### Following are some of the approaches for defining CSR:

- CSR is a responsibility, beyond that required by the law, for a business to pursue long term goals that are good for society.
- CSR is a means by which a company manages its business to produce an overall positive impact on society.



# Article

Corporate Social Responsibility in the Companies Act, 2013 - A boon for scientific research

- CSR is coming out of the purview of 'doing social good' and is fast becoming a 'business necessity'.

## METHODS OF CSR

CSR activities can be conducted through the following methods:

### Charity and Donation:

Companies donate funds to charitable institutions e.g. donation to UNICEF, Red Cross, etc.

### Contract:

Companies hire agencies / Non-governmental Organizations which in turn carry out the activities/ projects for the companies and the companies bear the cost.

### Own initiatives:

Companies create a separate administrative machinery and staff of its own to perform the CSR activities e.g. large companies like Tata, Microsoft, IBM, GMR, Cairn India, Polarix Software etc have separate administrative department to deal with CSR activities.

## CSR Under the Companies Act, 2013

The Companies Act, 2013 (hereinafter referred to as the 'new Act'), which replaces nearly six decade old Companies Act, 1956, contains detailed provisions regarding CSR. The Act was passed by Lok Sabha and Rajya Sabha on 18th December 2012 and 8th August 2013 respectively and notified in the Gazette of India on 30th August 2013. CSR has been recognized for the first time through the said Act. Section 135 (under Chapter IX – Accounts of Companies) of the new Act deals with CSR while Schedule VII of the new Act lists out the CSR activities which may be undertaken by the companies.

## Who must comply?

According to Section 135(1) of the new Act, every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. Thus, every company registered under the Companies Act and having

- net worth of Rs. 500 crore or more, or
- turnover of Rs. 1000 crore or more, or
- net profit of Rs. 5 crore or more during any financial year will have to comply with the provisions of Section 135 of the new Act.

## Who will be accountable?

The Committee of the Board of Directors of the Company constituted under Section 135 of the new Act consisting of three or more directors shall be accountable for undertaking

the CSR activities.

## Duties of the CSR Committee

As per Section 135(3) of the new Act, the CSR Committee shall have the following duties and responsibilities:

- To 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.
- To recommend the amount of expenditure to be incurred on the CSR activities.
- To monitor the Corporate Social Responsibility Policy of the company from time to time.

## Role of Board of Directors

Section 135(4) & (5) of the new Act, specifies the role of the Board with respect to CSR as under:-

- review the recommendations made by the CSR Committee;
- approve the CSR Policy for the company;
- disclose contents of the Policy in the company's report/ website; and
- ensure that the company spends in every financial year, at least two percent of the average net profits made during the three immediately preceding financial years of the Company in CSR activities in pursuance of the CSR Policy of the Company.

Further, a company qualifying for CSR activities under section 135 of the new Act will have to explain if it fails to do so under section 134 of the new Act which states that any company that fails to spend prescribed amount and also fails to specify the reasons for not spending the amount in its Board report, shall be punishable with a fine not less than Rs. 50,000 but which may extend to Rs 25 lakh.

Although this appears to be more like a government levy on corporate profits, the Government has left the manner in





which the amount can be deployed in the various activities to the discretion of individual companies. Schedule VII of the new Act contains the activities, given below, which may be included in the CSR Policy:-

Eradicating extreme hunger and poverty  
 Promotion of education  
 Promoting gender equality and empowering women  
 Reducing child mortality and improving maternal health  
 Combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases  
 Ensuring environmental sustainability;  
 Employment-enhancing vocational skills;  
 Social business projects;  
 Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the state governments for socio-economic development, and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;  
 Such other matters as may be prescribed.

With the enactment of the Companies Act, 2013, companies would be required to spend at least 2% of their net profits on CSR activities, and hence it becomes imperative for corporate India to plan its spending on CSR activities and avail appropriate benefits/ deductions available under the Income Tax Act, 1961. Investments/ spending on scientific research appear to be one such area which apart from complying with the requirement of law is going to encourage scientific research hugely in India.

## Relevant Provisions of Income Tax Act on Scientific Research

As per the provisions of Section 35 of the Income Tax Act, 1961 (IT Act), deduction is available of an amount

» According to Section 135(1) of the new Act, every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

- equal to any expenditure (not being in the nature of capital expenditure) laid out or expended on scientific research related to the business of the assessee. [Section 35(1)(i)]
- equal to one and three-fourth times (175%) of any sum paid to a research association which has as its object the undertaking of scientific research or to a approved university, college or other institution to be used for scientific research. [Section 35(1)(ii)]
- equal to one and one-fourth times (125%) of any sum paid to a company (registered in India and whose main object is scientific research) to be used by it for scientific research and approved by the prescribed authority and fulfill other conditions. [Section 35(1)(iia)]
- equal to one and one-fourth times (125%) any sum paid to a approved research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or statistical research. [Section 35(1)(iii)]

The above mentioned association, university, institution etc. should have been approved by the Income Tax Department of the Govt. of India for the purpose of scientific research. The scope of scientific research in the IT Act appears to be quite wide. Member (IT), CBDT on the recommendation of jurisdictional Commissioner or Director Income Tax is the approving authority for such matters.

There are many approved Institutions/ University/ Associations viz. AIIMS, IITs, BITS, ISM, IISc, ISI, ICAR, etc. and any contribution to them for scientific research would allow the contributor to avail appropriate benefits.

A reading of the provisions of the IT Act as above shows that expenditure incurred on scientific research was always the focus area of the Government. Nevertheless, mandatory





# Article

Corporate Social Responsibility in the Companies Act, 2013 - A boon for scientific research



The Companies Act does not specifically include spending on scientific research. However, if the companies spend/ contribute to the approved association(s) or university or institution(s) etc. engaged in scientific research pertaining to the activities mentioned under section (iv), (v), (vi) and (viii) of Schedule VII of the Act, then they would not only meet the requirement of the Companies Act, 2013 but also allow them to avail appropriate deductions under IT Act. Nevertheless, investments/ spending in scientific research have innumerable benefits.

spending on CSR will be the driving factor for the companies to look for the activities where they can avail appropriate benefits under IT Act.

The Companies Act does not specifically include spending on scientific research. However, if the companies spend/ contribute to the approved association(s) or university or institution(s) etc. engaged in scientific research pertaining to the activities mentioned under section (iv), (v), (vi) and (viii) of Schedule VII of the Act, then they would not only meet the requirement of the Companies Act, 2013 but also allow them to avail appropriate deductions under IT Act. Nevertheless, investments/ spending in scientific research have innumerable benefits.

## Benefits of Scientific Research

Scientific research is certainly a significant contributor to economic growth. R&D policies must be designed in such way which could respond to the complex societal issues within which scientific research can be applied. Scientific and technical research far outstrips our knowledge of the relationship between research and its outcome. There are countless benefits both direct and indirect that society and mankind obtain from scientific research. Some of them are as follows:

- Policy makers frequently frame discussions of the economic benefits from science in terms of job creation. This suggests that scientific research is the creator of various new employment opportunities.
- Companies would gain by having a stronghold in the Global market because of the innovations arising from scientific research within the country.
- Talent management and restricting talent drain will be possible as professionals and researchers would stop migrating to foreign lands in search of better career prospects.

## Way forward

A combined reading of the provision of CSR in the Companies Act, 2013 and provisions of IT Act, suggests that the corporates might take the following course of action to avail

the maximum benefits of spending in CSR activities as specified in Schedule VII:

- identify the existing approved association(s) or institution(s) or college or university etc. engaged in scientific research to whom contribution can be made; or
- seek the appropriate approval for the association(s) or institution(s)/ college/ university etc. engaged in scientific research

Schedule VII also states that the Government may include such other matters as may be prescribed under the said Schedule. Hence, it would be appropriate if the Ministry of Corporate Affairs include the spending on scientific research as one of the CSR activities.

## Conclusion

There are many companies and large corporate houses that are spending substantial amounts on CSR activities voluntarily. Primarily, such spending is on development of neighborhood, primary health care, education, safe drinking water etc. in the areas where the businesses are located. Nevertheless, CSR activities in the country suffer from a lack of understanding, inadequately trained personnel, non-availability of authentic data and specific information on the kinds of CSR activities that companies should be investing in.

The CSR Committee of the Board of Directors of the companies would strive to find avenues on focused areas where the allocated funds for CSR activities can be deployed. The Companies Act, 2013 has already provided relatively huge avenues where the CSR Committee can strategize their spending. Spending on scientific research appears to be one such area which would give the companies dual benefits of complying with the requirement of law and availing appropriate benefit under IT Act. Hence, companies would tend to allocate and contribute certain part of its CSR spending on scientific research which can become a boon for the specified Institutions/ Universities / Associations engaged in scientific research. Finally, spending on scientific research would also immensely benefit Indian companies and they will have competitive edge globally. 



A

## Relief to Directors/Officers of a Company against Criminal Prosecution

- It would be inappropriate to prosecute and punish all the officers of a company but only those who are actually involved in the offences and hence it is necessary to provide adequate protection to safeguard those who acted honestly and reasonably by exonerating them particularly from criminal liability.

### INTRODUCTION

**C** In the modern corporate era, officers of a company play a significant role in complying with the various provisions of law including new Companies Act, 2013 and any non-compliance would result in prosecution and punishment not only to the company but also to the officers of the company and if convicted the punishment could either be imprisonment and/or fine and the amount of fine could even run in lakhs which depends on the offence committed but whether all the officers of a company can be held liable for any offence committed under the Companies Act is an issue which requires detailed consideration. Though de facto (in fact) one or more persons in a company are entrusted with the responsibility of complying with the provisions of law, de jure (in law) towards non-compliance, it is the 'officer who is in default' as defined under section. 5 of the 1956 Act and section 2(60) of the new Act is held liable and must face prosecution and punishment. A company cannot function on its own, being an artificial person hence it is being managed by the Board of directors and it is the collective responsibility of the Board to comply with the various provisions of law but at the same time a person just because being a member of the board cannot be held liable for the offences under the Act unless proven guilty.

A director may hold the position as a nominee director, independent director, professional director, non-whole time director, non-executive director etc. in such cases the role of those directors would not be as similar as that of the Managing Director/Whole-time director or any other director who is in-charge of the day to day affairs of the company hence even for the purpose of conviction and punishment for the offences committed under the law is concerned they cannot be held liable merely because of the fact that they are part of the Board unless and otherwise their actual participation is established. Though the nomenclature is 'director', still they stand in a different footing as compared to regular directors and therefore they cannot be treated on par with those who discharge their functions in managing the day to day affairs of a company is concerned. This article discusses the immunity available to an officer/director of a company if he has acted honestly or reasonably while discharging his duties despite the company or the officer having committed a default or an offence. The legal provisions applicable to the present discussion are contained in section 633 of the Companies Act, 1956 and corresponding section. 463 of the Companies Act, 2013. Similarly the provisions relating to compounding of offences contained in section 621A of the Companies Act, 1956 are covered under section 441 of the



➤ Normally the High Court while exercising its powers under section 633 (section 463 of the new Act) will approach very cautiously before exercising its discretion in favour of an officer and the discretion will be a judicial one. At the most it can relieve the officer from the liability but cannot order the company or the officer to comply with the statutory requirements.

Companies Act, 2013. The term 'composition' used in section 621A of the 1956 Act has been replaced by the word 'compounding' in section 441 of the new Act. The Regional Director is vested with the power to compound offences carrying punishment upto a fine of Rs. 5 lakhs and as per section 441(1) the offences under the new Act can be compounded only if the punishment for such offence is fine only which means after the new Act comes into force no more an offence punishable with imprisonment or fine would be compoundable but as per section 441(6) of the new Act, the Special court is empowered to compound all offences committed under the Companies Act, 2013 in accordance with the procedures laid down under Cr.P.C. except those offences which are punishable with imprisonment only or imprisonment and fine. As per section 92(1)(h) of the new Act it is also mandatory for every company to disclose in the Annual Return about the penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment.

## Who is an 'Officer'?

Section. 633/463 uses the term 'Officer' and not 'officer who is in default' and hence for the purpose of invoking this right it is to be understood going by the definition of the term 'Officer' as defined in section 2(30) / 2(59) which includes any director, manager or secretary or any person in accordance with whose directions or instructions the Board of directors or any one or more of the directors is or are accustomed to act. Therefore the relief covered by section 633/463 is applicable not only to directors/ex-directors but every person who falls within the said definition against whom any criminal proceeding is initiated or likely to be initiated for negligence, default, breach of duty, misfeasance or breach of trust resulting in committing an offence under the Act.



A director being an officer as per the definition under section 2(30) / 2(59) can also file an application under section 633/463 for relief upon receipt of show cause notice from RoC if he has an apprehension that any proceeding will or might be initiated against him for negligence, default, breach of duty, misfeasance or breach of trust and the court would come to his rescue only when there is a benefit of doubt and that he has acted honestly and reasonably while performing his duties and the High Court while exercising its powers under section 633/463 would have the same power in relieving him from the criminal liability as the Criminal Court would have had before which any criminal proceedings against the director had been initiated. Naturally, it must be proved beyond doubt that the officer has acted honestly, bona fide or reasonably or with due care and diligence expected of a person holding a responsible office. Similarly, the Court while exercising its powers under section 633/463 is empowered to relieve the director either in whole or in part from his liability as he may incur in respect of the offence committed. The relief under section 633(1)/463(1) would not entitle a director from discharge against any civil liability that he would attract by virtue of his acts of negligence etc. under the Act since the Proviso under Sub-section (1) protects a director only against a criminal liability and not against any civil liability however that is not the case under sub-section (2) where an High Court can exonerate an officer even from the civil liability. The relief if granted under section 633/463 would discharge from criminal liability the officer/director concerned for that offence and it would amount to an acquittal from the charges levelled against him and subsequent to the relief being granted no prosecution would lie against the officer/director concerned for the said offence.

## When section 633/463 is applicable?

The section is applicable under two different contexts, one is prior to initiation of prosecution and the other is post initiation of prosecution. In the former case it is the High Court which can



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grant relief and in the later case it is the criminal court concerned where the prosecution is initiated alone can grant relief. Therefore this power can be exercised under section 633(1) of the Companies Act, 1956 by the Magistrate Court [whereas as per section 436(1)(a) of the new Act it is the Special Court constituted under section 435 which is competent to try all offences under the new Companies Act] before whom the criminal proceedings are already initiated against the officers concerned by the RoC or any other person and under section 633(2) / 463(2) by the High Court as a preventive relief if there is an apprehension on the part of the officer that it is likely that the RoC or any other person might initiate criminal proceedings against them and the entitlement for the relief is subject to proving that the officer had acted honestly and reasonably in exercise of his powers and therefore he deserves to be excused. The High Court can even grant an interim relief before ordering notice to the RoC. . Once the proceedings are initiated before the criminal court it is that court which can exercise the right and grant relief under section 633(1) / 463(1) and the High Court cannot intervene under section 633(2) / 463(2). The requirements for the applicability of the said section are (a) there must be a statutory default on the part of an individual while acting on behalf of the company and the individual happens to be an 'officer' (b) the court must come to a conclusion that the applicant had acted honestly and fairly and even after his honest and fair act the default was committed for some unavoidable circumstances (c) non-compliance with such statutory requirements by the applicant was caused due to incidents beyond his control.

## Comparison between Sections 441 and 463 of the new Act (Sections 621A and 633 of the 1956 Act)

Under section 441 of the new Act before or after the initiation of prosecution, a company or an officer who has committed an offence under the Companies Act can file a petition before the RoC for compounding the offence which will be compounded by the Central Govt. (i.e. Regional Director) or the Tribunal depending upon the quantum of fine imposed for the said offence under the Act and upon payment of the compounding fee imposed, the offence is said to be compounded. Therefore the compounding power under section 441 is vested with the Central Government/Tribunal whereas under section 463(1) the power is vested with the Special court and with the High Court under section 463(2). The burden under section 463(2) is to prove that the officer had acted honestly and reasonably while exercising his duties which is the criteria for granting the relief by the High Court and unlike section 441, it is not necessary to admit the offence in a petition under section 463(2) since if it is admitted but ultimately the petition fails (as it is a discretionary relief) the said admission would have an impact on the outcome in the criminal proceedings if any initiated later. Further a company which is entitled to invoke section 441 is not entitled to invoke section 463 since this right is available only to individuals. The limitation which is prescribed



under sub-section (2) of section 441 is not applicable for a petition under section 463 and section 463 covers all offences whereas the right under section 441 cannot be exercised in respect of the offences which are not compoundable. Under section 441(4) the Tribunal/Regional Director while compounding can direct compliance of the default whereas the court while exercising its limited powers under section 463 cannot order such compliance of the statutory requirements. Reference is drawn to page 636 of the Judgment in Tapan Kumar Chowdhury v. RoC (2003) 114Comp.cas. 631 (Cal.) where the High Court dealing with section 633(2) of the Companies Act, 1956 observed that "the court is neither empowered to extend the time to hold annual general meeting or to comply with the statutory requirements nor empowered to relieve the company from such responsibility and/or liability."

## NOTICE UNDER SECTION 463(3)

It is mandatory to serve notice on the Registrar and such other person as the case may be, before the Court grants relief either under section 463(1) or (2). This is one of the principles of natural justice which is to be adhered in order to give an opportunity of being heard to the other side (audi alteram partem). The term 'such other person' mentioned under sub-section (3) would include a shareholder of the company or a person authorised by the Central Govt. or a person authorized by SEBI if the offence relates to issue and transfer of securities and non-payment of dividend. As per section 439(2), no court shall take cognizance of any offence under the Companies Act, 2013 unless a complaint in writing is made by the person(s) aforementioned. Therefore the term 'other person' in section 463(3) must be read with reference to persons mentioned in section 439(2). Therefore the right under section 463(1) or (2) can be invoked if the proceedings are



initiated or likely to be initiated by any person who is entitled to do so as per section 439(2) and therefore not restricted to complaint by the RoC only .

## POWERS OF HIGH COURT

Normally the High Court while exercising its powers under section 633 (section 463 of the new Act) will approach very cautiously before exercising its discretion in favour of an officer and the discretion will be a judicial one. At the most it can relieve the officer from the liability but cannot order the company or the officer to comply with the statutory requirements.

In the case of Kenji Tamiya & Another (1990) 68 Comp.Cas 142 (Bom.), two Japanese directors of Orson Electronics Ltd. (OE Ltd.) filed a petition under section 633(2) for being relieved from any criminal proceedings and/or liability that might be launched or brought or action taken against the petitioners in respect of default in complying with the provisions of sections 210 and 220 of the Companies Act 1956. The petitioners were officers of Sony Corporation which incorporated a company called Somtron in Hongkong which held 76% shares in the Indian company OE Ltd. The petitioners were directors of the Indian company who realising manipulation of accounts by a director who resigned from the Board appointed Price Waterhouse and Co. to audit the accounts. The petitioners realised that the balance-sheet and profit and loss account cannot be laid before the company at the AGM and it could not be filed with the RoC within 30 days from the date of the AGM hence it would lead to breach of provisions of sections 210 and 220 of the Companies Act, 1956 and it may further lead to the RoC initiating criminal prosecutions against them hence they tendered their resignations as directors of OE Ltd. and filed the petition under section 633.

It was argued that the petitioners were residents abroad and were not connected with the day-to-day management of the company and they were nominee directors appointed by Sony Corporation and the petitioners took reasonable precautions to appoint Price Waterhouse to investigate into the affairs of the Co. the petitioners never acted mala fide or dishonestly or unreasonably hence they need to be relieved from any intended prosecution in respect of violation of provisions of sections 210 and 220 of the Companies Act, 1956. The High Court allowed their petitions under section 633 by exonerating them from any criminal proceedings and the order made it clear that the order would have no effect on the similar applications made by the Indian directors which will be examined independently.

Similarly, in Orissa Jute and Cotton Mills Ltd. & Others AIR 1956 Orissa 205 where the directors of the company filed an application under sections 281(2) of the Indian Companies Act, 1913 which corresponded to section 633 of the Companies Act, 1956 for relieving them from their liabilities in respect of defaults such as holding the AGM and filing the balance sheet of the year 1951 in 1954. The only difference in this case as compared to the earlier case is that the RoC had already filed a criminal complaint before the Magistrate Court, Cuttack and the petitioners were being tried in the said court for such offences. Though the High Court initially granted an interim stay of the criminal proceedings before the Magistrate Court, it finally held that " the petitioners having filed this application after institution of the prosecution, though I am satisfied that the default was due to unavoidable circumstances and grant them the relief, this relief will be confined only as far as the future liabilities for the default are concerned. Under the express provisions of Clause (1) of section 281, it is only the Court which is in seisin of the matter complained of that can grant relief regarding the subject matter of the prosecution. In this case, the Magistrate, before whom the proceedings are pending, can if he is so satisfied grant the relief.'

In Om Prakash Khaitan v. Shree Keshariya Investment Ltd (1978) 48 Comp.Cas. 85 (Del.) while dealing with a petition of a professional director, the High Court held : "Judicial moderation was necessary in the administration of section 633 of the Act so as to ensure that such categories of directors were not subjected to the harassment of legal proceedings for breach and defaults of the company, which might at times be rather protracted. It would be proper in such cases to relieve such directors of consequences of the defaults and the breaches unless they were directly involved in the act or omission complained of or had otherwise not acted honestly or reasonably or had financial involvement in the company."

In another interesting case [Hindusthan Wire & Metal Products (1983) 54 Comp.Cas 104 (Cal.)] a director filed an application under section 633 for relieving him from the default committed u/s. 295 in granting loan to another co. The application was presented



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Relief to Directors/Officers of a Company against Criminal Prosecution



The relief under section 633 of the 1956 Act / section 463 of the 2013 Act is confined to offences under the Companies Act, 1956/2013 and not under any other law and therefore an officer cannot seek relief under this section for an offence committed under other laws.

on 28.06.1980 and on 02.07.1980 there was an interim order of injunction passed by the High Court restraining the RoC from commencing any prosecution against the applicant director for the default. Later it appeared from the affidavit filed by the RoC that a complaint was filed as early on 12.06.1980 with a petition to condone the delay under section 473 of Cr.P.C. but the said petition was taken up and allowed on 04.11.1980 i.e. after the interim order of injunction passed by the High Court. The directors while appearing on 23.12.1980 before the Magistrate pleaded that the violation u/s. 295 has been made good as the loan has been repaid by the Co. and there should be an injunction against the RoC from taking any criminal proceedings against the petitioners. The issue that arose was whether the application under section 633(2) was maintainable after the said complaint had been filed and cognizance of the same taken by the Metropolitan Magistrate. Though the High Court was inclined to relieve the directors since the offence has been made good and their resignation has been accepted by the Board and the offence was no longer a continuing one, in the facts and circumstances of the case, the court held that it will not hesitate to relieve the petitioners from the consequence of such default.

The point for consideration is whether filing the complaint and making an application for condoning the delay under section 473 of Cr.P.C. can be said to be the institution of a criminal proceeding or initiation of a proceeding before the delay is condoned and the offence is taken cognizance of by the criminal court where the proceeding has been filed. The High Court in order to ascertain when a criminal court shall take cognizance of an offence went through various sections such as sections 2(d), 190, 192, 200, 204, 468, 469 and 473 of the Cr.P.C. and arrived at the conclusion that in the facts and circumstances of the case the magistrate had taken cognizance of the offence only after the delay was condoned on 04.11.1980 which was much after the High Court admitted the petition under section 633 and granted an interim injunction on 02.07.1980. Therefore on 12.06.1980, it cannot be said that cognizance of the said offence was taken of or any proceeding was initiated against the accused in respect of the alleged offence under section 295 of the Companies Act, 1956, as, unless the bar of limitation was lifted by condonation of delay by an order of the Magistrate, there cannot be any question of taking cognizance of the offence or filing of the complaint against the accused. Therefore the complaint itself was filed before the Magistrate during the period when the injunction order against the RoC was in force and operative and therefore the complaint was in violation of the injunction order and the said proceeding was

bad and a null and had no effect and non est. Reference was also drawn to the decision in E. Pedda Subba Reddy v. State, AIR 1969 AP 281, where the meaning of the word "cognizance" occurring in section 190 of the Cr.P.C. has been interpreted as indicating the point of time when a criminal court first takes notice of an offence. Therefore the court allowed the petition under section 633(2) since on the date of granting interim injunction there was no proceeding pending before a criminal court hence there is no bar to entertain and relieve the petitioners in the petition under section 633.

In Progressive Aluminium Ltd. and Others v. RoC (1997) 89 Comp.Cas. 147 (AP) the High Court while allowing a petition under section 633 held that the petitioners had not acted with a mala fide intention of luring the public to subscribing to the shares of the company under a false representation that the company had experience of two and a half decades. The only default, if any, was the omission on the part of the promoters to clarify that the experience of two and half decades in the field was of the persons who were manning the earlier partnership firm and not the partnership firm itself. However, such omission could not be treated as a deliberate omission with a mala fide intention of suppressing any truth from the public. Moreover, the company had been successfully launched on the strength of the experience of the directors. It is a matter of ordinary prudence that the experience of a body corporate is always that of the persons manning the body corporate and not of the body corporate itself. The explanation tendered by the petitioners for the delay in commencing production was reasonable. Subsequent developments and the progress made by the company in the direction of fructifying the objects for which the company was incorporated, discharged or acquitted the promoters of any allegation that the misstatements in the prospectus were made with any dishonest intention of practising fraud upon the subscribers of the company.

There are also instances of courts dismissing petition under section 633. Some such cases are briefly dealt with hereunder.

In T.G. Venkatesh v. RoC (2008) 145 Comp. Cas. 662 (AP), the RoC issued a show cause notice for violation of sections. 63, 68, 628 for failure of the company to comply with the specified schedule in the prospectus. One of the directors filed a petition under section 633(2) and sought relief from prosecution contending that there was inevitable delay in project implementation due to unforeseen circumstances and he was not liable for non-



declaration of dividends by the company since he became aware of it only after his resignation from the Board. Moreover, the company could not declare dividends as stated in the prospectus due to unforeseen decline in the company's business. In turn the RoC contended that the petitioner should not be relieved of his obligation as he was one of the signatories to the prospectus of the company. The High Court while dismissing the petition, held that the resignation of the petitioner would not absolve him of his obligations and liabilities since he was a signatory to the prospectus and the explanation provided for non-implementation of the project in accordance with the schedule specified in the prospectus failed to elaborate the inevitable circumstances. The explanation for non-declaration of dividend was vague and was not substantiated by any facts and figures. The petitioner having failed to produce material explaining the circumstances for non-compliance with the terms declared in the prospectus and to prove that the statements made in the prospectus were not false, deceptive or misleading, he was not entitled for the relief under section 633 of the Act.

In *Satish Batra and Another v. RoC and Another*, (2010) 154 Comp. Cas.. 453 (Del.)(DB) an inspection was carried out under section 209 and it was found that the company had accepted huge amounts from the directors, shareholders, corporate bodies and from public since 1999; that the MD/WTD received application money from directors, shareholders, public and body corporates without any board resolution and allotment of shares were done by MD/WTD and not by the Board. The RoC issued a show cause notice under section 628 to which the company replied that the amount shown as share application money was a current account transaction and as there is no provision in the Companies Act, or in Schedule VI to reflect the current account balances it was reflected under the head share application money. The RoC came to the conclusion that the company had violated the provisions of section 628 of the Companies Act, 1956. The directors filed a petition under section 633 before the Single Judge for relieving them from any liability for the alleged default and a defence was taken that unsecured loans were in fact friendly and temporary loans based on the oral agreements and therefore no interest was payable thereon. The Single judge dismissed the petition and on an appeal the Division Bench finding no default dismissed the appeal thereby upholding the order of the Single Judge and even extracting the observation made by the Single Judge that "from the averments made and considering the facts and totality of circumstances, it is difficult to infer that the petitioners have acted reasonably and that considering all the circumstances, it will be appropriate to excuse the petitioners. Merely on the basis of the bald averments made by the petitioners, it will be difficult to infer that the amounts received were temporary loans based on oral agreements and no interest was payable thereon and in the totality of the facts and circumstances, it will not be appropriate to excuse the petitioners. The petitioners are also unable to show prima facie that they have acted in good faith and they have justifiable reasons to escape from the liability".

## CAN RELIEF BE GRANTED FOR OFFENCES UNDER OTHER LAWS?

The relief under section 633 of the 1956 Act / section 463 of the 2013 Act is confined to offences under the Companies Act, 1956/2013 and not under any other law and therefore an officer cannot seek relief under this section for an offence committed under other laws. This is supported by a judgment of the Supreme Court in the case of *Rabindra Chamria & Others s. RoC* AIR 1992 SC 398, wherein the Supreme Court while dealing with the issue as to whether relief under section. 633 would cover proceedings only under the Companies Act, 1956 or under other Acts also, held that 'any proceeding' under section 633(2) would mean both civil and criminal proceedings but does not apply to proceedings instituted against the officer of the company to enforce the liability arising out of violation of provisions of other statutes since the notice contemplated under section 633(3) is mandatory and required to be given to the RoC or other person hence the power under sub-section (2) must be restricted in respect of the proceedings arising out of the violation of the Companies Act only. On the other hand, the authority to take action under Provident Funds Act as seen from section of 14 of the EPF Act is the Commissioner; if notice is given to RoC for the offences committed under the said Act without giving notice to the authority concerned who alone is competent to prosecute in respect of liabilities under the respective law the purpose of giving notice itself would be defeated.

## CONCLUSION

In the administration of a company irrespective of its nature and size it is natural that occasionally the persons involved are likely to breach or fail to comply with any of the provisions of law. The objective of penal provisions in a law is not to punish an innocent person but to punish those who are negligent and acted contrary to law with a mala fide intention and at the same time the law always protects those who are vigilant. It would be inappropriate to prosecute and punish all the officers of a company but those who are actually involved and hence under such circumstances it is necessary to provide adequate protection to safeguard those who acted honestly and reasonably by exonerating them particularly from criminal liability. No person can claim relief under 633/463 as a matter of right unless he deserves to be discharged from the liability and he owes a duty to explain and convince the court that he was not responsible for the offence charged or he was diligent in exercising his duties. The Court while entertaining a petition will also be extra cautious while granting relief under section 633/463 in order to prevent any delinquent officer from escaping the clutches of law irrespective of the consequences of the offence. The object of section 633/463 is only to prevent any harassment or injustice caused to innocent officers who played no role in the offence charged. An officer who approaches with clean hands stands to deserve a relief subject to fulfillment of proving his innocence.

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## Promoters : Role Under The Companies Act, 2013

- The Companies Act, 2013 has made substantive provisions to cover the role of promoters. It is only hoped that action under the Act does not come in the way of actions against promoters under the Security Regulations.

### PRELIMINARY

Company is a creation of law. Like a living person, a company has its own 'parents'- the promoters through whose vision the company comes into existence to carry on an enterprise. The role of a 'promoter' is neither that of an agent nor a trustee of the company but is like the 'Settlor' of a trust, though there is no cestui que trust. The concept of 'ratification' of acts by a 'promoter', after incorporation of a company, is akin to the persons agreeing to act as trustees of the 'Settlement' giving their consent to act as such.

The role of a 'promoter' of a company is often compared to that of a promoter of a charitable institution under the Los Angeles Municipal Code. Section 44.01 of the said Code defines the term to mean "any person who for pecuniary compensation or consideration received or to be received, solicits or is engaged in the business of or holds himself out to the public as engaged in the business of soliciting contributions for or on behalf of any other person or any charitable association, corporation, or institution, or conducts, manages or carries on or agrees to conduct, manage or carry on or is engaged in the business of or holds himself out as engaged in the business of conducting, managing or carrying

on any drive or campaign for any such purpose.<sup>1</sup>"

The Companies Act, 1956 did not spell out the importance of the role of promoters of a company nor had a general definition of this expression as applicable to the whole of the Companies Act, 1956, except for a definition, limited to a specific section, contained in clause (a) of sub-section (6) of section 62 which states that for the purposes of that section "the expression 'promoter' means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company".

The Expert Committee on Company Law under the Chairmanship of Dr. Jamshed J. Irani, had recommended that 'the terms 'Promoters' and 'control' should be clearly defined for avoiding any doubts' and that 'The process of incorporation through registration should be based on correct information to be disclosed by the promoters of the company with full liability towards its correctness'.

Before the Standing Committee on Finance which considered the Companies Bill, 2009, it was, ignoring the provisions

<sup>1</sup> U. S. Supreme Court *Rescue Army v. Municipal Court of City of Los Angeles* 33a US 549 (1947) quoted in the dissenting judgment by Mr. Justice Murphy.



## » There is a provision to grant relief, subject to acceptance by the company after its incorporation, in cases where the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by the terms of the incorporation under the Specific Relief Act, 1963.

already contained in section 62(6)(a) referred to earlier, averred that “The expression ‘promoter’, is not justified in the Companies Act and should be deleted. It is more a capital market terminology, but extensively used in the media to create a separate ‘class’. The purpose for which ‘Promoter’ is sought to be defined in Law (as distinct from Regulations) is unclear, more so since the ‘control sequence’ which is Shareholder - Boards - Management is well defined in existing law. ....To define a nebulous and extra constitutional authority who in law ‘has control over affairs of Company’ is wrong in fact, as well as holding potential to severely compromise the accountability of the Board and Management.”<sup>2</sup> Notwithstanding such observations, the Companies Bill, 2011, did contain definition of expressions ‘promoter’ as well as ‘control’.

Before considering the provisions relating to ‘promoter’ under the Companies Act, 2013, one may enumerate some of the instances of the use of the expression ‘promoter’ under the Companies Act, 1956:

- (a) Section 62 dealing with civil liability for mis-statements in prospectus – where a prospectus invites persons to subscribe for shares in or debentures of a company, every person who is a ‘promoter’ of the company shall be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have sustained by reason of any untrue statement included therein.
- (b) Section 69 dealing with prohibition of allotment unless minimum subscription is received – it provides for levy of fine on ‘every promoter’ contravening the provisions of sub-section (4) of section 69.
- (c) Section 75 dealing with return as to allotments – contravention of proviso to clause (a) of sub-section 1 (not to show allotment made against cash if cash is not received).
- (d) Section 322 dealing with unlimited company – giving of

notice by a promoter to a person who is proposed to be a director or manager and failing this levy of fine on the promoter.

- (e) Section 478 dealing with power to order public examination of promoters by the Tribunal in case of winding up of a company.
- (f) Section 519 dealing with application of liquidator to Tribunal for public examination of promoters if in his opinion a fraud has been committed by a promoter in the promotion or formation of the company.
- (g) Schedule II dealing with matters to be specified in prospectus in terms of sections 43(2)(a) and 56 Promoters and their background, short particulars of every transaction relating to the property completed within the two preceding years with promoter, contribution of promoters towards means of financing and benefit paid or given within the two preceding years or intended to be paid or given to any promoter.

Apart from the above there is a provision to grant relief, subject to acceptance by the company after its incorporation, in cases where the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by the terms of the incorporation under the Specific Relief Act, 1963 [sections 15(h) and 19(e)].

With these preliminary observations, we now proceed to consider the provisions of the Companies Act, 2013 relating to ‘promoter’.

### DEFINITION

For the first time, based on the recommendations of the Expert Committee under the Chairmanship of Dr. J.J. Irani, the Companies Bill 2008 and 2009 contained a definition of the expression in clause (zzq) of sub-section (1) of section 2, which read as under:

*“promoter” means a person –*

- (a) *who has been named as such in a prospectus*
- (b) *who has control over the affairs of the company, directly*

<sup>2</sup> Para 1.96(ii) of the 21st Report of the Standing Committee on Finance on Companies Bill, 2009.



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*or indirectly whether as a shareholder, director or otherwise*

**Provided** that nothing in sub-clause (b) shall apply to a person who is acting merely in a professional capacity.

On the basis of recommendations of the Standing Committee on Finance on the Companies Bill, 2009 (Companies Bill 2011; and later amended to read as Companies Bill 2013), the Companies Act, 2013 contains the definition under sub-section (69) of section 2, which read as under:

*“promoter” means a person—*

- (a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or*
- (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or*
- (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:*

**Provided** that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity *(emphasis supplied)*

One can note that the differences between the earlier Bills and the final provision is the modification of clause ‘a’ by insertion of an additional criteria, the insertion of clause (c) and the application of proviso to clause (c) instead of to clause (b). The proviso to clause (b) under the Companies Bill, 2009, was removed due to the observations of the Standing Committee on Finance 57th Report that “the proviso

reference to sub-clause (b) is erroneous since it gives rise to a meaning that if a person is acting in a professional capacity he can still have control over the affairs of the company, directly or indirectly, whether as a shareholder, director, or otherwise and such a person would not be a promoter. This is a very easy gateway and would not be justified in public interest”.

The additional criteria may have been inserted in clause (a) to ensure changes in the status of a ‘promoter’ are reflected on the basis of disclosures made in the Annual Return of the company filed with the Registrar viz. particulars regarding ‘promoters’ as it stood on the close of the financial year **along with changes therein since the close of the previous financial year**. In this regard one may also refer to the reply given by the Ministry to the Standing Committee on Finance viz. “... It is not the intention that in the likelihood of change in the ‘promoter’ of a company over a period of time, the promoter initially indicated in the offer document should continue to remain liable even for the actions of the company after the change in promoter have taken place.” Thus both the initial promoters as well as promoters indicated in the Annual Return are covered under the definition.

The insertion of clause (c) is to bring within the meaning of the expression ‘promoter’ any person who is ‘acting from behind’ and is ‘shadow boxing’ but is in fact controls the operations of a company. The insertion ignores the objections raised before the Standing Committee on Finance that “To define a nebulous and extra constitutional authority who in law ‘has control over affairs of Company’ is wrong in fact, as well as holding potential to severely compromise the accountability of the Board and Management”.

Thus the following four categories of persons fall within the definition of the expression ‘promoter’ –

- a person who has been named as such in a prospectus or
- a person identified by the company in the annual return referred to in section 92 or
- a person who has control over the affairs of the company or
- a person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

While identifying persons under items (i) and (ii) is easy, the other two categories, if a person does not fall in the first two categories, may have to be established by facts and thus may lead to litigation.

It will be of interest to note that the definition clause under the Companies Act, 2013, uses the word ‘means’ i.e. more specific, while the definition contained in the Securities and



Exchange Board of India (Substantial Acquisitions of Shares and Takeovers) Regulations, 2011 (SAST) which refers to section 2(1)(za) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, is an **inclusive definition** as it uses the word **'includes'**. Thus the definition of 'promoter' under the above said Regulations have a wider meaning than that as contained in the Companies Act, 2013. Readers must note this difference. In addition since the definition does not mention whether it applies only to a listed company it will have application to all unlisted companies whether they are public limited companies or private limited companies.

There are two other expressions used in this definition which have been defined in the legislation viz. 'control' and 'prospectus'. These expressions are defined in sub-section (27) and sub-section (70) of section 2 respectively as under: 2(27) "control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

2(70) "prospectus" means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

The Standing Committee on Finance observed on Companies Bill 2009, that "Since the term 'controlling interest' has been defined in clause 2(1)(za) but has not been used in the Bill anywhere it may be considered for omission; and that the suggestion to define the term 'control' in the Bill, particularly in context of the definition of the term 'promoter' may be considered." Based on this observation the definition of the expression 'control' is inserted in the Companies Act, 2013.

It may be of interest to note that the definition of 'control' is similar to the definition contained in Regulation 2(1)(e) of the Securities and Exchange Board of India (Substantial Acquisitions of Shares and Takeovers) Regulations, 2011,(SAST) excluding the proviso in the said Regulation.

The definition of 'Control' is an inclusive definition as it uses the word **'include'** and thus wide enough to cover 'control' as generally understood and specifically covers –

- (a) the right to appoint majority of the directors or
- (b) right to control the management exercisable by a person or persons acting individually or in concert, directly or indirectly, including

- i. by virtue of their shareholding or
  - ii. management rights or
  - iii. shareholders agreements or
  - iv. voting agreements or
  - v. in any other manner
- (c) right to control policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including
- i. by virtue of their shareholding or
  - ii. management rights or
  - iii. shareholders agreements or
  - iv. voting agreements or
  - v. in any other manner

The absence of the proviso as contained in SAST viz. **"Provided** that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position" is absent in the Companies Act, 2013. This together with the use of the words 'in any other manner' is likely to be open for dispute and hence likely to lead to litigation.

## PENAL PROVISIONS

The Companies Act, 2013, has several sections providing for penal actions against the 'promoter'. We briefly narrate some of the provisions:

### A. Section 7(6)

Where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters shall each be liable for action under section 447.

### B. Section 35(1)

Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the promoter of the company, without prejudice to any punishment to which he may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

### C. Section 42(10)

If a company makes an offer or accepts monies in contravention of section 42 i.e. making an offer or invitation of securities to a section of the public otherwise than through issue of a prospectus by way of private



# Article

Promoters : Role Under The Companies Act, 2013



The insertion of clause (c) is to bring within the meaning of the expression 'promoter' any person who is 'acting from behind' and is 'shadow boxing' but is in fact controls the operations of a company. The insertion ignores the objections raised before the Standing Committee on Finance that "To define a nebulous and extra constitutional authority who in law 'has control over affairs of Company' is wrong in fact, as well as holding potential to severely compromise the accountability of the Board and Management".

placement basis without complying with the requisites under the said section, inter alia its promoters shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher.

## D. Section 102(5)

Failure to make full disclosure or non-disclosure concerning each item of special business to be transacted at a general meeting will entail inter alia the promoter a fine which may extend to fifty thousand rupees or five times the amount of benefit accruing inter alia to the promoter or any of his relatives, whichever is more. Section 173 of the Companies Act, 1956 did not provide for such fine, except for the general provision under section 629A.

## E. Section 266(2)

If the Tribunal is satisfied on the basis of the information and evidence in its possession with respect to any person who is or was a director or an officer or other employee of the sick company, that such person by himself or along with others had diverted the funds or other property of such company for any purpose other than the purposes of the company or had managed the affairs of the company in a manner highly detrimental to the interests of the company, the Tribunal shall, by order, disqualify inter alia the said promoter from being appointed as a director in any company registered under this Act for a maximum period of six years.

## F. Section 284(2)

The promoters, inter alia, who are or have been in employment of the company or acting or associated with the company who did not, without reasonable cause, extend full cooperation to the Company Liquidator in discharge of his functions and duties shall be punishable with imprisonment which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.

## DISCLOSURES

### A. Section 26(1)(a)(xi)

Every prospectus issued by or on behalf of a public company either with reference to its formation or

subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company shall state the particulars relating to any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company.

### B. Section 26(1)(a)(xiv)

Every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company shall give disclosures in such manner as may be prescribed about sources of promoter's contribution. [Para 3.16 of the Report of Standing Committee on Finance]

### C. Section 92(1)(e)

Every company shall prepare a return (hereinafter referred to as the annual return) in the prescribed form containing the particulars as they stood on the close of the financial year regarding inter alia its promoters, along with changes therein since the close of the previous financial year.

### D. Section 93

Every listed company shall file a return in the prescribed form with the Registrar with respect to change in the number of shares held by promoters and top ten shareholders of such company, within fifteen days of such change. This is a new clause. [Para 7.12 of the Report of Standing Committee on Finance]

### E. Section 102(2)

Where any item of special business to be transacted at a meeting of the company relates to or affects any other company, the extent of shareholding interest in that other company of inter alia every promoter shall, if the extent of such shareholding is not less than two per cent. of the paid-up share capital of that company, also be set out in the statement to be sent to all members.

### F. Section 230(3)

In a statement required to be sent to all the creditors or class of creditors and to all the members or class of



members and the debenture-holders of the company disclosing the details of the compromise or arrangement, explanation should be given as to the effect of such proposal to promoters.

#### G. Section 232(2)

Where an order has been made by the Tribunal in respect of merging companies or the companies in respect of which a division is proposed, the companies required to circulate the for the meeting so ordered by the Tribunal a report adopted by the directors of the merging companies explaining effect of compromise on inter alia promoters laying out in particular the share exchange ratio, specifying any special valuation difficulties.

## 5. Prohibition to act as an Independent director

### Section 149 (6)

A person –

- (a) who is or was a promoter of the company or its holding, subsidiary or associate company; or
- (b) who is related to promoters of the company or
- (c) who has or had any pecuniary relationship with the promoters during the two immediately preceding years or during the current financial year; or
- (d) or his relatives is a Chief executive or director of a non profit organisation which receives 25% or more of its receipts from a promoter of the company cannot be an independent director of that company.

## 6. Right to appoint directors on the Board of the company

### Section 167(3)

Where all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1) of section 167, inter alia the promoter has a right to appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting (No such provision in the 1956 Act)

## 7. Opportunity to exit for shareholders

### (a) Section 13(8)(ii)

A company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and apart from such resolution published in newspapers the dissenting shareholders are given an opportunity to exit by the



promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

### (b) Section 27(2)

A company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except subject to the approval of, or except subject to an authority given by the company in general meeting by way of special resolution, and The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.

It may be pointed out that notwithstanding the provision for Class Action under section 245 of the Companies Act, 2013, there is absence of action against a promoter, though the Expert Committee had observed "A situation may arise whereby the interest of the company may need to be protected from the actions of the persons in control of the company. At the same time, the interests of the larger body of investors/ shareholders may have to be provided legal avenues to protect the company in their interest. For this purpose, the law should provide for 'class action/derivative suits on behalf of depositors/shareholders. The promoters, managers held guilty of misfeasance / fraud should be asked to pay the legal costs, if proven guilty."

It would be seen from the above analysis that the Companies Act, 2013 has made substantive provisions to cover the role of promoters. It is only hoped that action under the Act does not come in the way of actions against promoters under the Security Regulations.