The Companies Act 2013-changing India Inc....

Introduction

On August 30, 2013, the Companies Act 2013 ("**Act**") was finally notified thereby putting an end to a long wait for a comprehensive legislation that is expected to herald a new era in corporate governance and change the way India Inc. functions. The new Act is rule based since a large part of the Act is dependent upon the allied rules. All the sections have not been notified and in the first phase of its implementation, the Government has notified 98 sections on September 12, 2013. This newsletter provides a snapshot of some key, selective changes that are brought by the new Act.

1. Formation and Capital Structure

The legislation has introduced the concept of a one person company ("**OPC**") to the existing classes of companies, public and private, and has also envisaged additional/exclusive provisions for OPC, wherever necessary. The Act has made some notable changes with respect to incorporation as well as in the structure of its charter documents, Memorandum and Articles of Association[1]. The changes include penalty for facilitating incorporation by using wrong or incorrect information, additional formats of the charter documents for an unlimited company with and without a share capital. It also raised the maximum numbers of members allowed for private companies four times, from the prevailing 50 to 200, thereby paving way for an age of larger business houses, structured entirely on private participation.

There are some interesting amendments regarding companies' capital structure. One such modification is regarding the minimum subscription provisions. As a deviation from the old Act that prohibited allotment of shares to public unless minimum prescribed subscription in accordance with the prospectus was received, the new Act has extended this minimum subscription condition to all securities irrespective of whether shares or debentures. A blanket ban on issue of shares at a discount, barring sweat equity shares[2] is contemplated under section 53 of the legislation. Provisions for issue of global depository receipts by means of public offering or private placement have been added under section 41, which could have the potential to facilitate foreign investment.

2. Conduct of Meetings: Board and Shareholders

Certain pioneering changes have been introduced in the way meetings are conducted. Already, Directors can attend and participate through video conferencing or other audio visual means in the board meetings. This really obviates the need to travel, particularly for the foreign directors. Further, a class of companies, to be notified by the Central Government for this

[1] Tables A – J of the Companies Act 2013 contain formats of Memorandum and Articles to be followed by various types of companies.

[2] See Section 54 of the Act which states that sweat equity shares may be issued subject to the conditions laid down in this section irrespective of the prohibition on issue of shares at a discount as contained in Section 53.

purpose, will now be entitled to conduct voting electronically. But the Act is silent as to the different modes that can be adopted by the companies for the electronic voting system. The prescribed limit for quorum of public company's shareholders meetings has also been modified and will now be decided by the number of members of the company instead of 5, as earlier. An explanatory section, intended for giving additional clarity on the material facts to be included in the explanatory statement to be enclosed with the notice of general meetings and penalty for tampering with the minutes are other interesting additions.

Business hours are defined for conducting the Annual General Meetings ("**AGM**") and prohibitions are placed on conducting AGMs on national holidays instead of public holidays, a deviation from the 1956 Act. Another notable change concerns the first AGM which was to be held within 18 months from incorporation and was a privilege accorded to new companies under the 1956 Act. This provision has now been removed and the Act provides only 15 months for the conduct of the first AGM by newly incorporated companies. The alternate method for calculation of the limitation period for the first AGM based on the closing of the financial year has been retained.[3]

Since it will be difficult for OPCs to comply with procedural aspects regarding conduct of meetings due to its structuring, the Act has exempted them from the purview of majority of the applicable provisions.

3. The Board of Directors

The 1956 Act prescribed minimum 2 directors for a private and 3 for a public company respectively to constitute a Board. This criterion has been retained by the new Act, but the maximum limit of directors on the Board has now been raised from 12 to 15. The Act has also removed the stringent compliance of securing prior Central Government approval for raising the number of directors beyond the prescribed limit and, instead, a comparatively simpler method of approval by means of a special resolution of the shareholders has been introduced.

Additionally, new changes include mandatory presence of independent directors on the Board of listed public companies and minimum one woman director in the case of certain class of companies to be notified later, thereby bringing more transparency and gender equality into the Board rooms. The legislation clearly defines the role of such independent directors and has a detailed "Code for independent directors"[4] appended to it, which contains explicit guidelines for professional conduct, roles and responsibilities of such directors. They are bound by this Code to play a role in the appointments, determination of remuneration and removal of executive directors, managers and key managerial personnel. In view of the fiduciary position held by directors, explicit provisions prescribing directors duties have been added to the new Act. These include keeping away from situations in which they have conflicting interest with that of the company, duty to make good in monetary terms any undue gain/advantage on the part of the directors etc.

[3] As per the proviso to section 96 (1), the first AGM is to be held within nine months from the date of closing of the first financial year of the company.
[4] These are prescribed in Schedule IV of the new Act.

4. Auditors

Limited liability partnerships are now included within the gamut of audit firms and entitled to be appointed as auditors. The auditors of a company are now bound to report on the efficiency and adequacy of the internal financial control system as well as the effectiveness of its operations. The Act stipulates mandatory rotation of statutory auditors. Instead of an annual appointment, individual auditors can hold office for a maximum period of 5 years whereas audit firms are allowed to retain the post for up to 10 years. A cooling period of 5 years is prescribed for reappointment of auditors who complete one term i.e., 5 years or 10 years as the case may be, of their office. This means that such auditors or audit firms cannot be reappointed by the same company for the next 5 years after termination.

The recommendation of the Audit committee will also play a significant role in the appointment of auditors including filling up of casual vacancies due to resignation. The retiring auditors are to file within the statutory period of thirty days a statement about the termination of their office with the company and Registrar of Companies and if the auditor is appointed by the Comptroller and Auditor-General of India ("**CAG**"), then to CAG also. A power to order removal of auditors of a company is now bestowed upon the new regulator National Company Law Tribunal ("**Tribunal**"). This is a significant departure from the 1956 Act.

Unlike the 1956 Act, the auditors will now compulsorily need to attend the AGMs. The accountability of the auditors is enhanced significantly by having the onus of reporting fraud noticed by them, during the performance of their duties, to Central Government. They are also prohibited from rendering certain service to the company such as accounting and book keeping services, internal audit, management services, actuarial services and, investment advisory services.

5. Other key provisions

(a) Corporate restructuring[5] and winding-up[6]

Section 234 of the new Act permits cross-border mergers i.e., merger of Indian and foreign companies. India's central bank, Reserve Bank of India ("**RBI**") will play a significant role in such mergers as the approving authority along with Central Government. Likewise, provisions for mergers/amalgamations between small companies, holding and subsidiary companies and other prescribed class of companies are also separately provided for.

The statute has provisions for only two methods of liquidation i.e., voluntary winding-up and winding-up by the Tribunal. Further categorisation of voluntary winding-up into members and creditors based upon the declaration of solvency from the Board is removed by the Act.

A couple of other new provisions expected to bring radical changes to corporate governance include:

[5] These are covered under Sections 230-240.
[6] Sections 270-365.

(i) Deep focus on Corporate Social Responsibility ("CSR"): An increased CSR responsibility is cast upon companies having net worth of INR 500 crores *(US$ 80 million)* or more, or turnover of INR 1,000 crores *(US$ 160 million)* or more or a net profit of INR 5 crores *(US$ 0.8 million)* or more during any financial year, to promote social, environmental and ethical conduct. Effective from April 2014, they will have to spend at least 2% of their three-year average profit annually on CSR activities. They are bound to constitute a CSR committee for the formulation and monitoring of a CSR policy that will envisage promotion of a wide range of activities including eradication of hunger and poverty, promotion of education, gender equality and empowering women, ensuring environmental sustainability and vocational skill enhancement. These provisions are introduced with an intention of making the companies responsible to the society in which they function. The general perception is that this will not only boost corporate charitable activity in India but also gives companies a range of varying tax benefits. Clearly, the advisers will need to devise a tax-efficient CSR strategy for India Inc.

(ii) Class action suits: Any group or association of persons who are affected by any misleading statements or inclusion/omission of any matter in the prospectus of a company is entitled to initiate action. Likewise, individual members/depositors or any class of them who form an opinion that the affairs of the company are conducted in a prejudicial manner to them or to the company can approach the Tribunal for appropriate remedies in the form of damages or compensation or demand of other suitable action. These provisions enhance the minority shareholders power to protect their interests.

(iii) Corporate Fraud: Unlike its predecessor, the new law has defined "fraud" and dealt extensively with it. With an increase in corporate misconduct and frauds in India, this may be the right approach as this law empowers an agency, Serious Fraud Investigation Office ("**SFIO**"), to tackle corporate scams. The SFIO will have a statutory status and will be mandated to investigate corporate frauds, coupled with an authority to impose punitive measures and in specific instances, even arrest persons found guilty of corporate crimes.

Conclusion

The hope is that the new contemporary and pragmatic legislation will bring radical changes to the way corporate India functions. It has all the right elements. Although it is more comprehensive and appears to be uncomplicated than its predecessor, it is still in its initial stage of implementation and will need many more clarifications and subsidiary rules from the law makers to make it fully operational. A more complete picture may emerge after the publications of the supporting rules that are still on the anvil. Until then, the situation of having two legislations in force on the same subject matter is certainly peculiar and could possibly create administrative burden. For instance, the definition of a "foreign company" has not been made effective under the new Act, yet the provisions applicable to foreign companies are in effect. In such a situation, it is unclear whether it would be essential to rely on the old Act for the definition while relying on the provisions of the new law. So, the company and its advisers will have to be mindful of both legislations, as well as the draft rules to ensure compliance with the law.

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