Companies Bill 2012- An introspection

Introduction

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The nuances in the Companies Bill 2012 after its passage through the lower house of parliament on December 18,2012 have been debated through the length and breadth of the country in professional forums .After the initial euphoria associated with its passage in the lower House, the bill seems to have gone off the radar, seemingly into an unchartered orbit, as little is now being heard about its movement. The draft Rules were supposed to be released by February 2013 for public debate and last heard, the bill was slated for discussion by the "elders'' of the House two months ago. All this has triggered off the apprehension that the Bill may crash land, meeting the same fate as its predecessors. We sincerely hope that this does not happen since the Bill,in many ways marks a watershed in that it seeks to replace the existing law which has gone past its "use by date" tag and was being seen as an anachronism especially against the backdrop of the paradigm shift that India Inc. has been a witness to in recent times. One conspicuous feature that comes out strongly in the Bill is that there is a thematic shift towards making the proposed law "Rule based" a la the laws governing levy of Excise Duty, Service Tax. A substantial portion of the Bill will be through the form of Rules which ought to have been prescribed by now. Administering the substantive law through delegated legislation is a double edged sword. On the one hand, changes can be made to the Rules as considered appropriate without seeking parliamentary sanction. The flip side is the spectre of a trigger happy Bureaucracy which may ring in the changes at the drop of a hat, as it were, thus injecting an element of adhocism to the Legislation which is best avoided. Be that as it may, it can be said at this juncture that no objective evaluation as to the appropriateness of the proposed law is possible unless it is read conjointly with the sub-ordinate legislation to be prescribed through Rules.

In many ways the bill provides a breath of fresh air. For one it has many a novel feature such as the concept of a "one Person company", it lists out the duties of directors, recognizes the importance of having independent Directors both in listed as also unlisted companies answering to a prescription to be laid down later. By the same breath it has several proposals which strike a discordant note suggesting a need for either revisiting them or to temper them through appropriate subordinate legislation before it receives the presidential nod. In this discussion we shall therefore focus on some of the proposals which do not appear to be in harmony with the objectives of the Bill and perhaps call for a review.

- **Clause 2(41)-Financial Year**

This clause provides that the financial year for a Company shall be the period ending March 31 each year. Where the company has been incorporated on or after January 1, of a year, the financial year will end on March 31 of the following year, in respect of which the financial statement of the company shall be made up. The above provision is in line with Section 3 in the Income Tax Act, 1961 which provides for a uniform previous year.

Where a Company is the subsidiary or Holding company of a Company incorporated outside India, and is required to follow a different financial year for consolidation of Accounts outside India, upon an application being made by the Company with the Tribunal, if the Tribunal is satisfied , the company may be allowed to follow any period as its financial year. In order to enable a company to fall in line with the above requirement, a transitional period of two years shall be allowed.

The above proposal will take away the flexibility companies hitherto had in the matter of choice of the financial period, albeit only for the purposes of the proposed Enactment. The ushering of a uniform financial year under the Income Tax law in the year 2000 was intended to facilitate, inter alia, fiscal consolidation. One fails to comprehend the need for bringing about uniformity in the financial year in a procedural statute such as the Companies Act. Companies engaged in seasonal industries such as sugar, Tea, normally would normally fix their financial years to end either in June or they would follow the calendar year to even out seasonal fluctuations in their activities.

- Clause 2(87)-Subsidiary Company

This Clause, inter alia ,contemplates that exercise or control over one half of the total Share Capital by one Company either on its own or with one or more of its subsidiaries would make the other Company a Subsidiary. The Clause does not draw any distinction between the class of shares held for the purpose of determining the Subsidiary relationship. Therefore it follows from the above, that preference shares held by a Company in another Company will come into reckoning in determining whether the latter is a subsidiary or not. The above proposal is somewhat intriguing when one considers that Preference Share Capital represents "mezzanine capital" and the holders thereof are not bestowed with voting powers except for those matters which impact their own rights. They are clothed with all the rights of equity holders only when the circumstances envisaged in Clause 47(1) of the bill which corresponds to Section 87 (2) in the present Act are visited.

The basic ingredient in a Holding-Subsidiary Company relationship is the capacity of the Holding company to control the other Company generally through the holding of 51% or more of the equity Capital of the latter. Under the proposed law, it may well be that, in a given situation, one Company may hold the entire preference capital of another Company without any Equity holding leading to a situation whereby more than one half of the total share capital of the other Company is controlled by the former. In such a scenario, the latter Company would become a Subsidiary. Assuming that Dividend in respect of the preference shares are not in arrears it may well be that the Holding Company cannot wield control over the other Company simply because it does not have any voting rights!.This would be a paradox and would simply cut across the grain of a Holding company-Subsidiary relationship.

Considering the above, it is earnestly submitted that the status quo ante on the subject is restored and only voting shares namely ,Equity shares be taken into consideration for the purposes of clause 2(87) above.

- **Clause 8-Formation of Companies with Charitable objectives**

The above clause facilitates the setting up of Companies for "nonprofit "purposes. The basic ingredients in the said clause are substantially identical to Section 25 of the present Act save and except for clause 8(11)which speaks about the levy of penalties for contravention of the provision. The said Clause envisages the imposition of a fine which shall not be less than Rs 10 lacs but which may extend to Rs 1 Crore . In addition, the errant Directors and officers shall be liable to imprisonment for a term which may extend to three years or a fine which may be as much as Rs 25 lacs or to both.

We have looked at other punitive provisions of the Bill and it is found that under no other provision is the quantum of penalty as much as in clause 8(11).Unless the intention of the powers that be, is to clamp down completely on the formation of non-profit entities , it is submitted that the above punitive provision be moderated as it is exemplary in nature.

- **Mode of redemption of Preference shares-Clause 55(2)(d)**

Clause 55(2) in the bill envisages that the Securities premium Account could be used, inter alia, to provide the premium payable on the redemption of Redeemable preference shares. This is consistent with the existing provisions in Section 78 of the present Act. The above facility of using the Securities premium Account for redemption purposes is sought to be taken away by clause 55(d) (i) which proposes that in the case of such class of companies , as may be prescribed and whose financial statements comply with the Accounting Standards as applicable to it in clause 133,the premium on redemption shall be provided out of the profits of the company. It is not clear as to what is the trigger point for denying the benefit of using the Securities premium Account and we shall have to wait for the Rules to be prescribed to appreciate the justification for the above proposal. The immediate fall out of the above proposal would be that the distributable profits of companies which would be covered under the Rules would be impacted if redemption premium has to be met out of their profits.

- **Registration of charges-Clause 77**

This clause envisages that charges created either in India or outside India by a Company on its properties or Assets both tangible and intangible shall be liable to registration with the ROC. We are aware that u/s 125(4) of the present Act , only certain types of charge are liable for registration with the ROC. It is observed that the bill does not contain a list similar to the one contained in the present Act with the result that all kinds of encumbrances created by a company on its assets shall come within the ambit of registration.

- **Postal ballot-Clause 110**

A plain reading of this Clause suggests that the requirement of a postal ballot will not only apply to listed companies but also to unlisted companies as well. Further any business other than ordinary business in respect of which the Directors or the Auditor have a right to be heard shall be transacted by a postal ballot. The Central Government shall by notification be empowered to declare the items to be transacted by postal ballot.

As the cost associated with a postal ballot is substantial especially where there is a large investor base, ,it is hoped that the Central Govt will while issuing the required notification, consider the ground realities and make the above requirement applicable only to companies of a reasonable size and prescribe appropriate thresholds.

- **Consolidation of Accounts-Clause 129(3)**

The above clause provides that where a company has one or more subsidiaries, it shall , in addition to its stand alone financial results, prepare consolidated financial statements of itself along with its subsidiaries and these statements will have to be placed at the Annual General Meeting of the Company. Explanation to the above clause clarifies that for the purposes of this clause, the term "Subsidiary "shall include an Associate company and Joint ventures. The Central Government has been empowered in terms of the above clause to prescribe the manner of consolidation .

It follows from the above that presentation of consolidated Accounts will not be a requirement which will be restricted to listed companies alone. As consolidation of Accounts entail additional costs, it will turn out to be an expensive proposition. It is therefore expected that while laying down the modalities for consolidation, the Central govt. shall ensure that no undue hardship is created to marginal and small sized companies which have Subsidiaries.

- **Board's Report-clause 134(1)**

A slew of new items are proposed to be added to the Board's Report some of which overlap with the requirements of clause 49 where it come to listed companies. In order to avoid tedium and redundancy in compliance, it is imperative that the provisions of clause 49 are aligned with the bill. For the sake of brevity we are not reproducing in this exposition the additional items which need to be included in the Board's Report.

- **Appointment of Auditors-clause 139(1)**

The above clause envisages that the statutory Auditors shall be appointed at the first Annual General Meeting (AGM) to hold office from the conclusion of that meeting till the conclusion of its sixth AGM. In effect the appointment shall be for a period of five years. Proviso to the said Clause states , however, that the Company shall place the matter relating to such appointment for ratification of members at every AGM. It is not clear from the proviso whether the ratification of the members is to be secured by an appropriate resolution or merely by way of a noting in the minutes of the Meeting. Logically it should be through a resolution. If this is so, we see a dichotomy in the proposals based on a conjoint reading of the above Clause with Clause 102 (2) which sets out the items of ordinary business to be transacted at the AGM. Sub-clause (iv) to Clause 102 (2) provides that the appointment of and the fixing of the remuneration of the auditors would be an item of ordinary business. As the Auditors' term is to be for a period of five years, obviously it would not be necessary to propose their re-appointment at each

AGM during the above tenure of five years. What would be necessary , however, would be to seek the ratification of members at each AGM of the appointment as envisaged by the proviso to clause 139(1) as referred to above. Seeking ratification of the members to the appointment of the Auditor does not figure in the list of items to be transacted as "ordinary business". Ratification of members cannot obviously be part of "special business".

In view of the above, perhaps it would have been better if Sub-clause (iv)to Clause 102(2) were reframed to read as under:

"the appointment and /or ratification of the appointment of ....the Auditors". Alternatively , the law will have to be "read down" in a manner that the term "appointment" shall include ratification as well.

- **Corporate Social Responsibility-Clause 135(1)**

In our view, the proposal that every Company satisfying the prescribed criteria should ensure that there should be CSR spends for at least 2% of the average net profits of the Company during the last three years calls for a review as it will impact the distributable profits of companies. 2% of Net Profits for large Corporations represents a substantial amount. It would have been better to prescribe an appropriate threshold for CSR spends for a period of say five years as opposed to insisting on yearly spends. It is also necessary to ensure that Companies get tax breaks against the CSR spends through the introduction of appropriate provisions in the Income Tax Act, 1961.

- **Remuneration of Auditors-Clause 142(1)**

The remuneration of the Auditors shall be fixed at the Company's General Meeting or in such manner as may be determined therein. The proviso to the above Clause stipulates that the Board may fix the remuneration of the first auditor appointed by it. A plain reading of the above suggests that the Board shall be authorized to fix the remuneration of the First auditors only as they are appointed by it. Given the fact that the Bill provides for the appointment of the Auditors for a five year period, it would not be proper if the Shareholders were made to decide on the remuneration of the Auditors for a five year horizon at the time when they approve of their appointment . It is necessary that the decision as regards the remuneration payable to the Auditor should be delegated to the Board and the Rules to be laid down on this should facilitate the continuance of such procedure.

- **Resignation of Director-Clause 168**

Proviso to the above clause stipulates that the Director demitting his office , should forward a copy of his resignation along with the detailed reasons for his resignation to the ROC within 30 days of his resignation.

In our view the onus of informing the ROC about the resignation should continue to be that of the Company and the requirement of the Director sending a copy of his resignation to the ROC should be dispensed with.

The fact that sub-clause (2) to clause 168 clarifies that the resignation shall take effect from the date on which notice is received by the Company or on the date specified by the director in the notice whichever is later suggests that the resignation of the Director would take effect regardless of whether he has sent to the ROC a copy of his resignation.

- **Loans and Investment by Company- Clause 186**

The above Clause corresponds to Section 372A in the present Act. The bill proposes to make the provision applicable to private companies as well. Further loans, investments, guarantees extended by a Holding Company in favour of its wholly owned subsidiaries will not be exempt from the purview of the above clause. This proposal may cause hardships to Companies big and small alike.

- **Related Party Transactions-Clause 188**

Related party transactions including those involving lease/transfer of property of any kind will be subject to approval by the Board , subject to such conditions as may be prescribed. In order that fetter proposed to be imposed through this clause may be meaningful it is necessary that the sub-ordinate legislation to be prescribed should be such as to provide for realistic thresholds in terms of value so that every transaction with a related party is not subjected to the rigmarole of a Board sanction.

- **Class Action-Clause 245**

An application for class action against the company can be preferred with the Tribunal by members or deposit holders in case the Company is being managed or the conduct of its affairs are being conducted in a manner which is prejudicial to the interests of the company ,its members or its depositors. Such action can be resorted to by not less than 100 members or not less than such percentage of members as may be prescribed or by members holding such percentage of the issued capital as may be prescribed. A similar criteria would apply where such action is preferred by Depositors. Lest the provision should be perpetrated to abuse by stakeholders who may have an axe to grind, it is imperative that realistic thresholds are prescribed for determining the eligibility to class action so that the remedy is resorted only in compelling circumstances.

Conclusion

We have cherry picked on some of the provisions in the bill to drive home the need for a possible review primarily with a view to eliminate the possibility of any hardship being caused to the companies and the stakeholders alike. The bill does contain quite a few laudable features which will go towards enhancing the levels of governance and transparency. We can debate as they say, until the cows come home on the appropriateness of the changes proposed in the new legislation. Law can never be a panacea for social ills, much less a procedural law which seeks to regulate the functioning of corporations. We will therefore leave it for posterity to pass judgement on the suitability or otherwise of the proposed law which seeks to replace an antiquated piece of legislation which has stood the test of time.