1. FRAMEWORK OF THE BILL AND NEW DEFINITIONS

The Bill is divided into 29 Chapters with 470 Clauses and 7 Schedules as against 658 sections and 15 schedules under the Act. Unlike the Act, where the provisions pertaining to a particular subject matter were scattered across the Act, the Bill seeks to logically re-arrange and assimilate various provisions of law by categorizing all applicable provisions under one particular section/ chapter of the Bill.

The Bill has proposed certain new key definitions, some of which are described below:

a) **Control**: The new definition of the term 'control' has been brought in line with the definition of 'control' as prescribed under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011.

b) **Financial Year**: Under the provisions of the Act, companies were at a liberty to determine their own financial year, however the Bill seeks to curtail this liberty and requires the companies to have financial year ending as on the 31st day of March every year. The National Company Law Tribunal ("**NCLT**") shall have the power to allow a different financial year for companies which are either holding companies or subsidiaries of a company incorporated outside India so as to enable consolidation of accounts of such companies.

c) **Listed Company**: The term has been defined to include a company which has any of its securities listed on any recognized stock exchange. This definition could have a far reaching impact on the companies who hitherto have got their debentures etc. listed without actually falling within the ambit of the definition of 'listed company'.

d) **Private company**: The limit on maximum number of members constituting a private company has been increased from 50 to 200.This would allow the private companies for more funding avenues by offering securities to more than 50 members. However, Clause 42 restricts the offer to not more than 50 people or such higher number as may be prescribed. These contradictory provisions need to be reconciled.

e) **Promoter**: The term has been defined to mean (a) a person who has been named as such in the prospectus or is identified as such in the annual return; or (b) who has Control over the affairs of the company, other than in professional capacity, as a shareholder or a director or otherwise; or (c) in accordance with whose advice or directions the Board is accustomed to act. The definition of promoter is a new addition; it is not provided under the Act.

f) **Related Party**: The term, with reference to a company has been significantly broadened and it extends beyond the persons and entities covered under the existing provisions dealing with related party transactions.

g) **Subsidiary of a Public Company:** The Bill provides that, any private company which is a subsidiary of a public company shall be deemed to be a public company even where such subsidiary company continues to be a private company as per its articles of association. Currently, the Act doesn't provide as to whether such subsidiary company will have the articles of a public company or a private company. The Bill leaves no room for doubt by expressly mentioning that such subsidiary of a public company shall be considered as a public company.

© Nishith Desai Associates 2013

h) **Foreign Company:** The term has been defined to include any company or body corporate incorporated outside India which (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner. Currently under the Act, there is no specific provision for mandatory registration of foreign companies engaged in online business practices. However, keeping in view the present scenario with increasing e-commerce activities, the Bill has proposed to modify the definition of term 'foreign company' to provide for effective regulation of such entities.

i) **Officer in default:** The definition of the term has been expanded to include the following class of persons other than the ones already provided under Section 5 of the Act:

a. any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorizes, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;
b. every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same,
c. in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer.

j) **Subsidiary Company:** A company in which the holding company:

a. controls the composition of the board of directors; or
b. exercises or controls more than one half of the total share capital either at its own or together with one or more of its subsidiary companies. Under the extant provisions of the Act, it is more than one half of the total equity share capital, however the term used by the Bill is 'share capital' which may include all kinds of share capital including equity, preference or any other convertible securities.

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed. Thus, the Bill seeks to restrict the number of subsidiaries beyond a certain number, which may impact efficient planning of group operations.

2. DIRECTORS

The Bill elaborates upon the role of a director in a company by codifying specific provisions with respect to his/her powers, duties and liabilities. It also incorporates new concepts within its ambit, such as 'Key Managerial Personnel', 'Independent Directors', 'Whole time director', 'Woman Director', 'Resident Director', 'Non- Executive Director', etc. Some of the key amendments with respect to directors under the Bill are summarized below.

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
Directors	

© Nishith Desai Associates 2013

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
Section 252, 253, 259: Board composition • Minimum: 2 directors for private company, 3 for public company. • Maximum: 12 directors for public company. Any increase requires central government approval. No provision for private company.	**Clause 149 and 150: Board composition** • Minimum: 2 directors for private company, 3 for public company, 1 for OPC. • Maximum: 15 directors for public and private companies. Any increase requires special resolution. Thus privilege of a private company to have any number of directors has now been withdrawn.
No provision under the Act	**Clause 149 (2): Resident Director** 1 of the directors must stay in India for not less than 182 days during the calendar year.
No provision under the Act	**Clause 149 (1): Woman Director** 1 Woman Director required only in prescribed classes of company.
No provision under the Act	**Clause 168: Resignation of Director** • The effect of resignation is from the date, when company receives resignation letter or date as mentioned in the director's resignation letter, whichever is later. This could be a concern as earlier under common law principle as opined by various courts, resignation shall be effective from the date when directors want to resign irrespective of whether company receives or accepts the resignation. Thus, the director has to ensure that his/her resignation has reached and acknowledged by the company immediately. • An additional obligation has been casted on the director to send notice of his/her resignation to the Registrar of Companies ("**RoC**") with detailed reason for his or her resignation.
No provision under the Act	**Clause 149 and 150: Independent Directors** • Every listed public company to have at least one-third of the total number of directors as independent directors. • The term "Independent Directors" has been defined with certain prescribed qualifications and disqualifications. • Creation of mandatory nomination and remuneration committee to ensure

© Nishith Desai Associates 2013

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
	independence in selection of directors. • Apart from the sitting fee, directors are entitled to reimbursement of expenses for participation in the board and profit related commission as prescribed by the members. • Independent Directors are not entitled to any remuneration in form of stock option. • Such directors are insulated from liability unless the fraudulent act is done with consent, knowledge and connivance of the independent director or where the independent director has not acted diligently, thereby encouraging individuals to accept such posts sans any fright of being hauled up unnecessarily in this age of corporate frauds and scams.
Section 252: Small Shareholders Director Public companies having (i) paid up capital of INR 5 crores or more; or (ii) 100 or more small shareholders, may appoint one director elected by small shareholders.	**Clause 151: Small Shareholders Director** Listed companies may appoint one director elected by small shareholders
Section 275, 276, 277, 278, 279:Number of Directorship A person cannot be a director in more than 15 companies. In counting the above limit, directorships in private companies as well as alternate directorships are not counted. Thus, an individual could have any number of directorships in private companies and as an alternate director in more than 15 public companies	**Clause 165: Number of Directorship** A person cannot be a director including alternate director in more than 20 companies out of which he cannot be a director of more than 10 public companies. This will restrict the overall directorship held by any individual maximum up to 20 only.
Section 285, 286: Board Meeting • No specific provisions of timing for holding the first board meeting. • Minimum number of 4 meetings every year. One meeting every quarter. • No provisions as to how many days notice to be provided for calling a board meeting. • As per the circulars issued by the Ministry of Corporate Affairs in 2011, board meetings can be attended by directors through video conferencing or other audio-visual modes however such presence will not be counted	**Clause 173: Board Meeting** • Specific provision for holding first board meeting within 30 days of the date of its incorporation. • Minimum number of 4 meetings every year in such a manner that there should not be a gap of more than 120 days between two consecutive meetings of the board. • Minimum seven days' notice to be given for a board meeting either by hand delivery or by post or by electronic means. • Board meetings can be attended by directors

© Nishith Desai Associates 2013

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
towards the quorum for the meeting.	through video conferencing or other audio-visual modes, and such presence will be counted as quorum for the meeting, subject to the condition that they can be recorded and stored. The Central Government, however, has the power to specify such matters which cannot be discussed in a meeting through video conferencing and other electronic means prescribed.
Section 316, 383A, 386: Appointment of Key Managerial Personnel The Act did not specifically contain any provision on Key Managerial Personnel ("**KMP**") and who are KMP; however there was a requirement of appointing a managing director, whole time director, manager and a company secretary by certain companies in certain cases.	**Clause 203: Appointment of Key Managerial Personnel** • KMP has been specifically defined. • Every prescribed class of company shall be required to appoint (by way of a board resolution) a chief executive officer or managing director, company secretary, whole time director and a chief financial officer. • A KMP cannot be KMP of any other company other than the subsidiary.
Section 198, 269, 309: Appointment of managing or whole time director and Managerial Remuneration • Every public company or a subsidiary of a public company having paid up capital of Rs. 5 crores of more required to have managing or whole time director. • Private company is not required to appoint managing director or whole time director. • Overall remuneration to all directors not to exceed 11% of net profit. However, Central Government approval was required if the director was being paid remuneration (above the prescribed limit), in any other capacity. • No director who is in receipt of any commission from the company and who is a managing director or whole time director shall be entitled to receive any remuneration or commission from the holding or subsidiary company.	**Clause 196, and 197: Appointment and Remuneration of Managerial personal.** • Every company has to appoint managerial personnel. • Overall remuneration of 11% of net profits to all directors of a public company remains same as provided in the Act. • The Bill requires a private company to have one managerial personnel; however, there seems to be no restriction on a private company to pay any amount of remuneration to its managerial personnel. • No Central Government approval is required for the payment of any remuneration to any director for services rendered in any other capacity, provided such services are of a professional nature and when the nomination and remuneration committee or board of directors is of the opinion that the person possesses necessary qualifications. • Stock options, granted to directors, shall be included in the remuneration. • Insurance premium taken by the company on behalf of its directors or officers for indemnity for any liability arising out of a negligent act,

© Nishith Desai Associates 2013

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
	default, misfeasance, breach of duty or breach of trust for which they may be guilty, will not be considered as remuneration. • Any director who is in receipt of any commission from the company and who is a managing director or whole time director can also receive any remuneration or commission from the holding or the subsidiary company subject to requisite disclosures by the Company in its board report.
Section 283: Vacation of office of Director A director vacates the office, if he absents himself from 3 consecutive meetings of the board of directors or from all meetings of the board for a continuous period of 3 months, whichever is longer, without obtaining leave of absence from the board.	**Clause 167: Vacation of office of Director** • A director vacates the office, if he remains absent from all meetings of the board held during the preceding 12 months, whether with or without seeking leave of absence of the board. • A director vacates the office, if he ceases to hold any office or other employment in the holding, subsidiary or associate company, pursuant to which they were appointed as a director.
No provision under the Act	**Clause 166: Duties of Directors** Bill seeks to include a broad sweeping provision codifying the duties of directors, including but not limited to: act in good faith and in the best interest of the company, not to have any direct/indirect conflict of interest with the interest of the company and to exercise duties with diligence and reasonable care and declares that it would be a punishable offence to commit a breach of those duties.

Analysis

- Incorporation of provisions relating to independent directors furthers the notion of corporate governance by promoting board independence. Having a minimum number of independent directors on the board is said to enhance monitoring of the management and promoters, and thereby protect the interests of the stakeholders. By defining the term 'Independent Directors', the Bill has provided certain guidelines to determine if the concerned director is independent or not. However, it fails to identify the extent of providing greater participation by minority shareholders in their appointment process through methods such as cumulative voting or proportionate representation, which continue to be optional for companies to adopt rather than a mandatory requirement. The fixing of tenure of independent directors is a welcome step, as it will ensure independence of director in a true sense, without any fear of not being re-elected in general meeting upon retirement by rotation.

© Nishith Desai Associates 2013

- Post the famous Satyam controversy, most of the professional independent directors refused to accept appointments in companies due to overhang of liability. This is proposed to be corrected with making the independent directors liability proof, unless the fraudulent act is done with consent, knowledge and connivance of the independent director. Further, the act prohibits independent directors from being entitled to any stock options as part of the remuneration, thereby seeking to ensure the independence and impartiality of such directors.

- Another significant development under the Bill is the presence of the express provision providing for the directors duties and the liability of a director in case of breach of such duty. Accordingly, a higher degree of care and responsibility would have to be exercised by the directors to ensure that they fulfill their duties and continue to be in compliance with the statute. An important aspect which comes to fore in light of the higher degree of responsibility and liability imposed on the directors is the exclusion of the premium paid on a directors' liability insurance from the computation of managerial remuneration.

- Presently all directors can be stationed out of India and still control and manage the company. However, the Bill has changed the position by introducing the concept of resident director. The reason behind this provision is unclear. On one hand, the Bill claims that it is a step towards globalization and on the other; it wears down the globalization path. The condition of 182 days' stay in India during previous calendar year is self-defeating.

3. CORPORATE SOCIAL RESPONSIBILITY

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
No provision under the Act	**Clause 135: Corporate Social Responsibility** • Every company with a net worth of INR 500 crores or more or turnover of INR 1000 crores or more or net profit of INR 5 crores or more during any financial year is required to constitute a CSR Committee of the board. • The committee will consist of three or more directors of which at least one has to be an independent director. • The committee is required to formulate and monitor the CSR policy and recommend the expenditure to be incurred on such activities. • The CSR activities may comprise a number of activities listed in Schedule VII. • The board's report will require the disclosure of the CSR committee and the contents of the policy. • Further, the board is required to make endeavours to ensure that the activities provided under the CSR policy are undertaken and that the company spends at least 2% of the average net profits made by

© Nishith Desai Associates 2013

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
	the company in the preceding three financial years in accordance with the policy. • Where the board fails to spend such an amount, it is required to provide the reasons for the same in the board's report.

Analysis

With the aim of protecting the interests of employees and small investors while encouraging firms to undertake social responsibility voluntarily, the Bill has incorporated provisions on CSR. Previously the MCA had stipulated only guidelines which could have been voluntarily followed by the companies. However, Clause 135 of the Bill makes it mandatory for the specified companies to formulate a CSR committee and policy.

The Bill also casts obligations on the board to ensure that the activities provided under the policy are undertaken by the company and that the company spends 2% of the average net profits on such activities. However, the Bill does not specifically provide for any penalties in case a company fails to spend the required amount or undertake the activities as prescribed under the policy. The only requirement it seems is to provide an explanation under the director's report. Thus a "comply-or-explain" approach has been adopted as is normally the case for corporate governance measures.

4. **COMPROMISES, ARRANGEMENTS AND AMALGAMATIONS**

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
Section 391: Power to compromise or make arrangement with creditors and members. **Section 393: Information as to compromises or arrangements with creditors or members.** **Section 394A: Notice to be given to central government for application under Sections 391 to 394.**	**Clause 230: Power to compromise or make arrangement with creditors and members.**
Disclosure	
Section 391: An application for sanction of scheme of arrangement is required to be accompanied with an affidavit disclosing all material facts relating to the company, such as latest financial position, latest auditor's report on the accounts of the company and the status of any pending investigation against the company. Section 393: Every notice of meeting sent to shareholder/ creditor shall also be accompanied with a statement setting forth the terms of compromise and its effect, any material interests	In addition to the documents prescribed under the corresponding Sections of the Act, the Bill provides for the following additional disclosures to be made in relation to a scheme of arrangement: • Reduction of share capital, if any, included in the scheme of arrangement. • Any scheme of corporate debt restructuring consented to by not less than 75% in value of the secured creditors. • Every notice of meeting sent to shareholder/ creditor/ debenture holder of a company shall

© Nishith Desai Associates 2013

<table>
<tr><td>of the directors, managing director or manager in the scheme of arrangement.

<u>Section 394A</u>: Tribunal to give notice of every application made to it under Section 391 or 394, to the Central Government.</td><td>also disclose the valuation report, if any, explaining its effect on creditors, KMP, promoters and non-promoter members and the debenture holders and the consequent effect of compromise or arrangement on any material interests of the directors of the company or the debenture trustees.

• The notice of meeting as aforesaid is required to be served on the Central Government, the income tax authorities, Reserve Bank of India (“RBI”), Securities and Exchange Board of India (“SEBI”), RoC, respective stock exchanges, the official liquidator, the Competition Commission of India (“CCI”) and such other authorities which are likely to be affected by the scheme of arrangement. Such notice, when served, shall require the concerned authorities to make their respective representations (if any) within a period of 30 days from the date of the receipt of such notice, failing which it shall be presumed that they have no representations to make on the scheme.</td></tr>
<tr><td colspan="2"><u>Meeting of shareholders/ creditors</u></td></tr>
<tr><td>No provision under the Act</td><td>A shareholder/ creditor, who holds not less than 10% of the shares or have an outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financials, shall be eligible to raise any objection to a scheme of arrangement or compromise.</td></tr>
<tr><td>If 3/4th in value of the creditors or members, present and voting, either in person or by proxy, at the meeting, agree to the scheme of arrangement, the scheme shall, if sanctioned by the court be binding on all creditors and members.</td><td>• Though the requirement of obtaining the approval of 3/4th of value of creditors and members, to the scheme of arrangement, still continues, the following exception has been added: NCLT may only dispense with the requirement of holding a meeting of creditors, where such creditors, having at least 90% value, agree by way of an affidavit, to the scheme of arrangement.
• Resolution for compromise or arrangement can now also be passed through postal ballot.</td></tr>
<tr><td colspan="2"><u>Penalties for non-compliance</u></td></tr>
<tr><td>Failure to comply with the provisions of Sections</td><td>No punishment prescribed for failure to comply</td></tr>
</table>

© Nishith Desai Associates 2013

<table>
<tr><td>391, 393 and 394A shall make the company and every officer in default punishable with fine.</td><td>with the disclosure requirements.</td></tr>
<tr><td>Section 394: Provision for facilitating reconstruction and amalgamation of companies</td><td>Clause 232: Merger and Amalgamation of companies</td></tr>
<tr><td colspan="2"><u>Powers of NCLT</u></td></tr>
<tr><td>While considering any scheme of arrangement, the tribunal may make provisions for any of the specified matters including but not limited to the transfer of the whole or part of the undertaking to the transferee company, dissolution of the transferor company, continuation by or against the transferee company of any pending legal proceedings etc.</td><td>In addition to the matters specified in the corresponding Sections of the Act, the NCLT can also make provisions for the following:

• Where the share capital is held by a non-resident under the foreign direct investment regime, the allotment of shares of the transferee company to such shareholder shall be in the manner prescribed under the NCLT order.
• The transfer of employees of the transferor company to the transferee company.</td></tr>
<tr><td colspan="2"><u>Order of the Tribunal</u></td></tr>
<tr><td>The tribunal shall not sanction a scheme of arrangement unless the court has received a report from the RoC that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.</td><td>The NCLT shall not sanction a scheme of arrangement unless a certificate by the company's auditor has been filed with the NCLT to the effect that the accounting treatment, as proposed in the scheme is in conformity with the accounting standards prescribed under Clause 133 of the Bill.</td></tr>
<tr><td>No provision under the Act</td><td>Clause 232: Merger and amalgamation of companies

• Treasury Stocks: The Bill prohibits creation of treasury stocks. Now a transferee company shall not, as a result of the arrangement, hold any shares in its own name or in the name of any trust whether on its behalf or on behalf of any of its subsidiary or associate companies and any such shares shall be cancelled or extinguished.
• In case of a merger of a listed company and an unlisted company, the NCLT can order that the unlisted transferee company shall continue to be unlisted. This will hamper reverse listing transactions which worked as an effective alternative for backdoor listing in comparison to listing of a company through an initial public offering.</td></tr>
</table>

© Nishith Desai Associates 2013

	• Two simplistic definitions of 'merger by absorption' and 'merger by formation of new company' have been introduced. • Any scheme of arrangement shall specify only one appointed date from which date the scheme shall be effective.
No provision under the Act	**Clause 233: Merger or amalgamation of certain companies** • Separate provisions have been provided for the merger or amalgamation between small companies or between holding companies and a wholly owned subsidiary or such other class of companies as may be prescribed. Such companies may now have an option to be governed by the specific provisions provided under Clause 233 or rules of a normal merger or amalgamation as provided elsewhere in Chapter XV of the Bill. • The proposed new process of merger/ amalgamation of small companies or group companies involves the approval of (i) shareholders holding at least 90% of the shares of the company, (ii) RoC, (iii) official liquidator and (iv) Central Government.
No provision under the Act	**Clause 234: Merger or amalgamation of company with foreign company** • New provision for cross border mergers or amalgamations between Indian companies and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government. The power of the Central Government to make rules under this Clause has been made subject to consultations with the RBI. • Prior approval of the RBI required before any foreign company merges with an Indian company or vice versa. As per the existing exchange control regulations, shares can be issued under automatic route to non-residents subject to satisfaction of certain conditions.
No provision under the Act	**Clause 240: Liability of officers in respect of offences committed prior to merger, amalgamation, etc.**

© Nishith Desai Associates 2013

	Any liability of any officer in default of the transferor company, who has committed any offence prior to the merger, shall continue after the merger or amalgamation as the case may be.

Analysis

- Though additional disclosures have been included with a view to streamline the process of merger/ demerger and lend more transparency to the process; it is rather surprising to note that there are no corresponding penalties prescribed for non-compliance of the same.

- The Bill aims at enhancing the roles and responsibilities of various statutory authorities (including CCI, central government, RBI, SEBI etc.) in terms of providing their comments to the scheme of arrangement submitted to them by the companies under the provisions of Clauses 230-240. Though the Bill provides for a specific time limit within which the authorities are required to respond, it remains largely to be tested whether in practice the timelines will actually be adhered to. For instance, Section 6 (2A) of the Competition Act, 2002 permits 210 days to CCI for passing an order in case of a combination, however the Bill prescribes a timeline of 30 days within which CCI needs to provide its comments to the scheme of arrangement. To that extent, the Bill does not seem to be consistent with the extant provisions of the Competition Act, 2002 and therefore may need suitable modification for the purposes of CCI.

- Under the Act, any shareholder/ creditor, irrespective of his shareholding/ outstanding debt had the right to raise objections to the scheme of arrangement proposed by the company, as a result of which the process of seeking approval from the members/ creditors of the company at the court convened meeting witnessed futile objections from persons with miniscule shareholding/ outstanding debt. The Bill however seeks to resolve this issue by a new provision to the effect that only such persons who hold more than 10% of the shares or have an outstanding debt amounting to not less than 5% of the total outstanding debt shall be eligible to raise any objection to a scheme of arrangement.

- Under the Act, it was possible to seek approval of dispensation of the meeting of creditors, from the high court, based upon consent letters received from the creditors. The Bill now imposes a stringent obligation on the companies seeking such dispensation and provides that the NCLT may only dispense with the requirement of holding a meeting of creditors of class of creditors, where such creditors or class of creditors, having at least 90% value, agree and confirm, by way of an affidavit, to the scheme of compromise or arrangement. With the introduction of this new provision, it may now be difficult for companies to seek dispensation of the meeting of creditors if 90% in value of the creditors do not collectively agree on the filing of an affidavit.

- As a welcome step, the Bill specifically provides for arrangements between foreign companies and Indian companies and a separate process for arrangement between group companies. This amendment is likely to witness more group restructurings with boosted offshore participation, which route was otherwise not accessible.

5. <u>REVIVAL AND REHABILITATION OF SICK COMPANIES</u>

© Nishith Desai Associates 2013

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
Section 424A: Reference to Tribunal The Section only applies to an ‘industrial company’. The application under this Section must be accompanied by an auditor’s certificate indicating the reasons of the net worth of the company falling below 50%.	**Clause 253: Determination of sickness** Any company not only an ‘industrial company’ can be declared as a sick company. The criteria of erosion of 50% of the networth for filing an application with the board for financial & industrial reconstruction for declaring a company as sick has been dispensed with. The secured creditors of a company, representing 50% or more of the debt of the company and whose debt the company has failed to pay within 30 days of service of notice, can apply to the NCLT for declaring the company as sick or the company which fails to repay the debt of secured creditors representing 50% or more of the debt, may itself apply to the NCLT for declaring itself as sick.
Section 424D: Preparation and sanction of Scheme The creditors of a sick company may prepare a scheme for revival and rehabilitation for the company and submit the same to the tribunal after getting it approved by at least 3/4th in value of the creditors	**Clause 262: Sanction of scheme** The scheme of revival and rehabilitation prepared by the company administrator shall be approved by the unsecured creditors representing 1/4th in value of the amount and the secured creditors representing 3/4th in value of amount and thereafter shall be submitted to the NCLT for its sanction.
No provision under the Act	**Clause 256 and 257 of the Bill: Appointment of “interim administrator” and “committee of creditors”**
No provision under the Act	**Clause 265 of the Bill: Winding up of company on report of company administrator** If the scheme of revival and rehabilitation is not approved by the creditors in the prescribed manner, the company administrator shall submit a report to the NCLT within 15 days and the NCLT shall order for the winding up of the sick company.
No provision under the Act	**Clause 268 of the Bill: Bar on jurisdiction** No appeal shall lie in any court and no civil court shall have any jurisdiction in respect of any matter in respect of which the NCLT is empowered and no injunction shall be granted by any court in respect of any action taken or

© Nishith Desai Associates 2013

	proposed to be taken. Clause 268, however does not bar the jurisdiction of the Supreme Court under Article 136 or the jurisdiction of the High Court under Articles 226 and 227 of the Indian Constitution.

Analysis

The manner of declaring a company sick and process of its revival and rehabilitation has been completely rationalized. New authorities namely administrator, interim administrator and committee of creditors have been involved in the process. Instead of the 'operating agency' as provided under the Act, the company administrator shall prepare the final scheme of revival and rehabilitation after consideration of the draft scheme filed alongwith the application and shall perform such other functions as may be prescribed by NCLT from time to time.

In light of the amendments carried out in this provision and Chapter XX (*Winding Up*), it is pertinent to take into account the wide powers bestowed upon the creditors of the company under the Bill. Whilst on the one hand, the creditors of a company can call for a winding up of the company under Chapter XX of the Bill, on the other hand the creditors representing 50% of the total outstanding debt of the company may also apply for declaration of a company as sick. Though Clause 253 of the Bill provides that the creditor who has filed an application for declaration of a company as sick, may also make an application for the stay of winding up proceedings (if any) in relation to the company, it remains to be seen how judiciously will the creditors exercise such varied powers.

6. WINDING UP

Both under the Act and the Bill the relevant provision provides that the company could be wound up either by the tribunal/NCLT (as the case may be) or on a voluntary application made by the company.

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
Section 433: Circumstances in which company may be wound up by the tribunal A company may be wound up by the tribunal in cases where the: • Company has, by special resolution, resolved that the company be wound up by the tribunal. • Default is made in delivering the statutory report to the RoC or in holding the statutory meeting. • Company does not commence business within a year from its incorporation. • In the case of a public company number of members is reduced, below seven, and in the case of a private company, below two. • Company is unable to pay its debts.	**Clause 271: Circumstances in which company may be wound up by the Tribunal** A company may, be wound up by the NCLT where the: • Company is unable to pay its debts. • Company has, by special resolution, resolved that the company be wound up by the NCLT. • Company has acted against the interests of the sovereignty and integrity of India. • if the NCLT has ordered the winding up of the company under the provision relating to the revival and rehabilitation of sick companies. • if on an application made by the RoC or any other person authorized by the central government by notification under the Act, the NCLT is of the opinion that the affairs of the

© Nishith Desai Associates 2013

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
• Tribunal is of opinion that it is just and equitable that the company should be wound up. • Company has made a default in filing with the RoC its accounts or annual return for any five consecutive financial years ; • Company has acted against the interests of the sovereignty and integrity of India. • if the tribunal has ordered the winding up of the company under the provision relating to the revival and rehabilitation of sick companies.	company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose. • if the company has made a default in filing with the RoC its financial statements or annual returns for immediately preceding five consecutive financial years. • if the NCLT is of the opinion that it is just and equitable that the company should be wound up.
Section 484: Circumstances in which company may be wound up voluntarily A company may be wound up voluntarily: • when the period or the event, if any, fixed for the duration of the company by the articles has expired. • if the company passes a special resolution that the company be wound up voluntarily.	**Clause 304: Circumstances in which company may be wound up voluntarily** A company may be wound up voluntarily: • when the period or the event, if any, fixed for the duration of the company by the articles has expired. • if the company passes a special resolution that the company be wound up voluntarily.

Analysis

The Bill seeks to include 'fraud' as one of the grounds for winding up of a company. It is provided that NCLT may wind up the company if the NCLT, on the basis of application made by the RoC or the Central Government, is of the opinion that the affairs of the company are being carried out in a fraudulent manner; or if the company was formed for any fraudulent and unlawful purpose; or if the persons concerned in formation or management of the affairs of the company have been guilty of fraud, misfeasance or misconduct. Even in the cases of voluntary winding up, the companies will be required to give a declaration that company is not being wound up to defraud any person or persons. The provisions such as non-commencement of business within one year of its incorporation, default in delivering statutory report, reduction in the number of the members of the company below the prescribed limit, which provisions found place under the Act, have not been included under the Bill. The Bill also provides a definite time frame within which the NCLT, liquidator and other concerned will be required to discharge their obligation in relation to the winding up of the company.

7. LOAN AND INVESTMENT BY THE COMPANY

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
Section 372A: Inter-Corporate Loans and Investment This Section *inter-alia* covers: • Loans given by one company to another company.	**Clause 186: Loan and Investment by the Company** Structurally the provisions of Clause 186 are similar to the provisions of Section 372A. However the Bill has introduced certain significant

© Nishith Desai Associates 2013

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
• Guarantees and securities in favour of a person who has given any loan to the company. • Acquiring by subscription or otherwise, securities of a company by other company.	changes under this provision which are as follows: • The exemption available under the Act for loans, investments and guarantees given by a holding company to its wholly-owned subsidiaries is withdrawn. • The exemption available under the Act to infrastructure companies continues for loans, provision of security and guarantee but not for investments. • The company shall not provide loans at a rate lower than the prevailing yield of the 1, 3, 5 or 10 years government security closest to the tenor of the loan instead of bank rate as currently provided in the Act. • The exemption available under the Act to private companies is also withdrawn, which is likely to place significant burden of compliance on the loans and investments of private companies.

Analysis

Clause 186 brings major changes to inter-corporate investment/loan provisions under the Act. It significantly changes the manner in which the companies were conducting their routine inter-corporate transactions. Under the Act, the private companies were totally exempt from the provisions of Section 372A. However, by virtue of Clause 186 of the Bill, even the private companies will be subject to strict compliance. The exemption available in respect of loan, investment and guarantee given by a holding company to its wholly owned subsidiary company is proposed to be withdrawn. Under the provisions of the Act, while calculating loans and guarantees etc. such loans and guarantees furnished to wholly-owned subsidiaries were exempted and hence not included in computing the limit of higher of 60% of net worth or 100% of reserves. However under Clause 186 of the Bill, if such holding company seeks to go beyond the prescribed limit, then the holding company will have to seek prior approval of shareholders by way of special resolution. This amendment is expected to affect M&A activity because the acquiring companies especially in case of overseas acquisitions often tend to use their wholly-owned subsidiaries as a vehicle to avoid the need for seeking prior shareholder approval.

8. CLASS ACTION SUITS

SECTIONS OF THE ACT	CORRESPONDING CLAUSES OF THE BILL
No provision under the Act	**Clause 245 of the Bill: Class Action** The Bill introduces the concept of class action whereby:

© Nishith Desai Associates 2013

	• Action may be initiated by the members or depositors against the company, its directors, auditors and/or other experts or consultants or advisors before the NCLT if they are of the opinion that the management or the conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors. • Such action may be initiated by certain percentage of total number of members or depositors or members holding such percentage of share capital as prescribed, on behalf of the other aggrieved or prejudiced members or depositors, provided that such applicants have paid all calls and other sums due on their shares. • A wide variety of reliefs can be sought by the applicants under such proceedings including damages, compensation, restriction against passing any resolution or declaration of a resolution to be void etc. • The Clause stipulates various factors which the NCLT would have to take into account at the time of admitting such class action proceedings. Such factors include: 1. Whether the applicant is acting in good faith; 2. Whether the cause of action is one which the applicant could pursue in his own right rather than through a class action; 3. Views of members, directors or depositors who have no personal interest. An action may also be brought under the provisions pertaining to class action by any person or group of persons or association of persons representing the persons affected.

Analysis

As part of the overhaul, the Bill now incorporates within its fold provision pertaining to class actions and thereby giving statutory sanction to such class action proceedings. With the expansion of commerce a wide variety of persons are affected by the acts of the companies and by fraudulent conduct of such the employees, investors, shareholders, creditors etc. Such proceedings have now been allowed keeping in mind the interests of the stock holders and situations where it may be prudent to allow for such class action instead of claims being raised by the affected parties

© Nishith Desai Associates 2013

individually. Thus, while the Bill on one hand improves the corporate governance measures, it on the other hand provides for greater variety of remedies to the affected parties to protect their interests.

9. OTHER IMPORTANT PROVISIONS

a) **One Person Company:** The option of incorporating a one person company is a paradigm shift in the Indian corporate regime bringing it at par with global standards and could provide significant fillip to the micro and small scale industries and business. The earlier requirement of minimum two members for a private company distinguished between a sole-proprietorship and a company, and individuals used to mostly run their business as sole proprietorship which itself is not a legal entity. Accordingly, a one person company alleviates the risk associated in running a business as a sole proprietorship which has unlimited liability where the personal assets of the business owner could also be attached.

b) **Entrenchment:** In another significant development, Clause 5 of the Bill allows for articles of a company to include entrenchment provisions, according to which the articles may contain provisions to the effect that specific provisions of the articles may be altered only if conditions or procedures that are more restrictive than those applicable in the case of a special resolution, are complied with. Such provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

   Accordingly, if any particular provision of the articles is required to be amended as per the provisions of the Bill, then such amendment shall require the consent of 80% of the shareholders as opposed to 75% which would have been otherwise required to pass the special resolution under the Act. Although such provisions were previously allowed and enforced by the courts, the Bill now specifically recognizes such provisions.

c) **Issuance of share with differential voting rights:** Clause 43 of the Bill provides that companies shall be allowed to issue shares with differential voting rights. India Inc was concerned about the provision under Companies Bill 2009 restricting issuance of shares with differential voting rights which could have been a huge dampener for Indian companies proposing to raise funds. Fortunately, the Bill allows issuance of such shares providing the much needed flexibility to India Inc to structure deals.

d) **Prohibition against issue of Shares at discount:** Clause 53 of the Bill now imposes an absolute prohibition on issue of shares at discount. The only exception which has been carved out is the issues of sweat equity shares, which may be issued at a discount in accordance with Clause 54 of the Bill.

e) **Exit Option to Investors:** Clause 13 of the Bill provides that a company, which has raised money from public through prospectus and still has any unutilized 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 the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the SEBI.

© Nishith Desai Associates 2013

The change is critical in protecting the rights of minority investors and would be of great benefit to the retail investors, foreign institutional investments and other high network individuals and investment funds who invest based on object for fund raising and the consequent expected growth.

f) **Voluntary restriction on transfer of shares:** Section 111A of the Act which dealt with free transferability of the shares of a public company was one of the most debated provisions of the Act especially in light of the recent rulings of the high courts in India. The debate over the scope of applicability of Section 111A had loomed large over the validity of pre-emptive provisions agreed inter-se amongst shareholders such as lock-in period, right of first refusal, tag-along right, drag- along right, etc. and gained momentum in recent years. The Bill seeks to rest the discussion by specifically providing under the proviso to Clause 58(2) that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as contract.

g) **Private Placement:** Though the Bill provides a revised definition of the term "Private Company" by increasing the minimum number of members from 50 to 200, any private placement of securities by a company continues to be limited to 50 persons, unless a higher number is separately prescribed. This may give rise to number of difficulties especially in light of the fact that now a private company itself can have up to 200 members. Thus accordingly a higher number should be prescribed for private placement of securities.

h) **Requirement of a Debenture Trustee:** Under the Act, if a company is offering debentures to the public, a debenture trustee is required to be appointed. However, the Bill under Clause 71 stipulates that a debenture trustee would be required to be appointed only where an offer is made to more than 500 persons. Thus accordingly if an offer is made to less than 500 persons, a debenture trustee may not be required.

i) **Related party transactions:** Unlike the provisions of the Act, where any company proposing to enter into related party transactions was required to seek prior approval from the Central Government, the Bill provides that any related party transactions proposed to be entered into between a company (having paid up capital in excess of prescribed limits) with its related parties, which is beyond certain specified limits, shall require the prior approval of the shareholders by way of special resolution. Hence going forward, no Central Government approval is required for such transactions.

j) **Investment Companies:** Clause 186 of the Bill provides that a company can make investment through not more than two layers of investment companies, unless otherwise prescribed. However this provision shall not affect a company from acquiring any other company incorporated in a country outside India if such company has investment subsidiaries beyond two layers according to the laws of such country. This may significantly hamper the flexibility of Indian companies proposing to set up greenfield operations outside India since its quite common for them to use multiple layers of companies outside India to make the entire structure tax efficient.

k) **New instruments:** The Bill introduces new definitions of security instruments called Global Depository Receipts and Indian Depository Receipts. These instruments are not a new kind of security, sought to be created by the Bill. Clause 43 of the Bill continues to maintain the present

© Nishith Desai Associates 2013

provision of the Act under Section 85 that the share capital of the company limited by shares shall be of two kinds, namely (a) equity share capital; and (b) preference share capital.

l) **Fraud:** In the backdrop of the various corporate frauds that have come to light in the recent times, the Bill now incorporates within its fold stringent provisions addressing fraudulent conduct and provides for significantly higher penalties in situations where a fraud is proved. The Bill under Clause 447 now defines fraud as:

""fraud" in relation to affairs of a company or any Body Corporate, includes any act, omission, 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, 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"

The Clause further provides for a minimum six month imprisonment in case a fraud is proved and if in such cases of fraud if public interest is involved then the minimum imprisonment goes up to three years. Thus, under the Bill wherever a violation of a provision takes place and fraud is proved in relation to the same then the penalty as prescribed under clause 447 becomes applicable. A major apprehension in this regard is the ambiguity or the vagueness surrounding the term public interest and what would be a scenario which would be deemed to involve public interest.

Another cause of concern is Clause 212(6), which provides cases which attract punishment of fraud provided in Section 447 would be considered to be a cognizable offence and bail would not be provided unless the public prosecutor is given an opportunity to oppose the application. Though in light of the recent increase in cases of fraud, the provision would indeed be helpful, but given the state of the judicial system and the public prosecution system it should be ensured that the opportunity to oppose as provided under the Clause is interpreted strictly and that a person is no unduly kept under arrest for want of opportunity.

m) **Serious Fraud Investigation Office ("SFIO")**: The SFIO is an expert body which was established in 2003 as a special organization to investigate into serious cases of fraud received by the Department of Company Affairs. The body was formed to carry out investigations under the provisions of the Act and was formed in light of the rise in white collar crimes, stock market scams, failure of non-banking financial companies, phenomenon of vanishing companies and plantation companies. SFIO normally investigates into complex matters, matters involving multi-disciplinary ramifications or where substantial public interest is involved.

The Bill now itself incorporates within the folds the mandate for setting up an investigative body and recognizes the already existing SFIO as the investigative body. Clause 212 of the Bill provides the details of when a matter could be referred to SFIO for investigation and the powers of the body. A major apprehension that remains is with regard to the use of the wide powers granted to SFIO, for example SFIO has been granted the power to arrest a person. Thus a cautious approach is required to be adopted by the central government while referring an investigation to SFIO and the quintessential fact that the body has been formulated to investigate only serious cases of fraud should not be forgotten or diluted.

© Nishith Desai Associates 2013

n) **Insider trading**: New clause has been introduced with respect to prohibition of insider trading of securities. The definition of price sensitive information and insider trading has also been included. Clause 195 makes insider trading by a director or a KMP, a criminal offence. However, communication in the ordinary course of business, profession or employment will not be treated as insider trading.

o) **Use of share premium account**: The Bill introduces a new provision Clause 52 (3) according to which certain prescribed classes of companies can use their share premium account only for certain specific purposes including but not limited to issue of unissued 'equity shares', as fully paid up bonus shares, writing off expenses and the like.. Unlike the position under the Act, where the share premium account could also be used for the (i) issue of unissued 'preference shares'; and (ii) payment of premium on the redemption of redeemable preference shares/ debentures, the Bill seeks to disallow certain specified companies from doing so.

p) **Penalties:** The penalties for non-compliance of provisions of the Bill has increased manifold as compared to the Act. It is imperative that compliance of the provisions of the Bill is ensured on timely basis as per the compliance calendar, rather than facing costly penal provisions.

© Nishith Desai Associates 2013