A New Wave In The Corporate Arena

Firm Overview

Kaushal Shah & Associates is a boutique law firm located in Mumbai, the commercial capital of India, which provides a unique service by focusing on effective discussion, careful listening, skilled and systematic planning process to approach our work. Based on our knowledge of key industry sectors and legal practice, the Law Firm provides holistic, innovative flexible commercial solutions to result in good transaction management.

The Law Firm is distinguished by its unsurpassed expertise in Corporate, Media Entertainment and Sport, Private Equity and Venture Capital Investment Funds, Intellectual Property, Human Resource, Life sciences, Technology and Real Estate. Each of our associates has expertise in specific area of law and is a leader in one's own field. Each of our specialist teams has a wealth of knowledge and practical experience.

At Kaushal Shah & Associates, we offer more than just law. We make it our business to understand your business and complex legal problems. We aim to be an integral part of your organization and place our emphasis on working closely with you to achieve your business goals through our sound, distinctive culture that puts people first. We believe that cultivating relationships is the key to our success.

Introduction

The Companies Act, 2013 replaces the near 60 year old Companies Act, 1956. The Companies Act, 2013 (the '2013 Act') received the assent of the President of India on 29 August 2013, and has now become law. The 2013 Act is the culmination of several years of effort to enact a new legislation governing companies to replace the Companies Act, 1956 (the '1956 Act'). Thereafter certain provisions of the new law have been notified by the Central Government, to ease the transition from the existing company law (Companies Act, 1956. This article is not meant to be legal advice or opinion, but is only meant to give a bird's eye view of the new law and its impact and consequences. The New Companies Act, 2013 which has replaced the old Companies Act, 1956 has "posed a lot of problems" to companies, chartered accountants and industries. The Ministry of Corporate Affairs has stated that efforts are being made to resolve difficulties faced by various professional entities, including chartered accountants, company secretaries and auditors, with regard to the new companies' law. The Companies Act, 1956 had 658 sections (XIII parts) and 15 Schedules and the new Companies Act, 2013 which is more concise has 470 sections (XXIX Chapters) and 7 schedules.

Why do we need a new company law?

The new act is intended to improve corporate governance, fight fraud, increase investor protection and simplify the process of creating and closing a business. Corporate lawyers said the new legislation recognizes the increased sophistication of business dealings and more clearly defines many aspects of corporate governance.
The old legislation that is the Companies Act, 1956 has often been criticized for being too cumbersome and outdated. It had been in the works for at least a decade but gained momentum after an accounting scandal at Satyam Computer Services in 2009. The law though amended 25 times, is perceived is perceived to be not in sync with the new corporate world. Hence the need for the new bill. The new act is intended to improve

<u>Some of the few important changes are</u>

- **Democracy of shareholders:**
  The Companies Act, 2013 has introduced a new concept of class action suits with a view of making shareholders and other stakeholders, more informed and knowledgeable about their rights.

- **Strengthening Women Contributions through Board Room:**

The Companies Act, 2013, stipulates appointment of at least one woman Director on the Board of the prescribed class of Companies so as to widen the talent pool enabling big Corporates to benefit from diversified backgrounds with different viewpoints.

- **National Company Law Tribunal:**
  The Companies Act, 2013 introduced National Company Law Tribunal and the National Company Law Appellate Tribunal to replace the Company Law Board and Board for Industrial and Financial Reconstruction. They would relieve the Courts of their burden while simultaneously providing specialized justice.

- **Prohibition on forward dealings and insider trading:**
  The Companies Act, 2013 prohibits directors and key managerial personnel from purchasing call and put options of shares of the company, its holding company and its subsidiary and associate companies as if such person is reasonably expected to have access to price-sensitive information (being information which, if published, is likely to affect the price of the company's securities). Earlier these provisions were contained in regulations framed by SEBI, as the capital market regulator. Now, it has also been informed that SEBI is expected to discuss changes in certain norms for listed firms so as to make them in line with the rules in the new Act.

- **Increase in number of Shareholders**:
  The Companies Act, 2013 increased the number of maximum shareholders in a private company from 50 to 200.

- **One Person Company**:
  The 2013 Act introduces a new type of entity to the existing list i.e. apart from forming a public or a private limited company, the 2013 Act enables the formation of a new entity a 'one-person company' (OPC). An OPC means a company with only one person as its member. The Companies Act 1956 requires minimum two shareholders and two directors in case of a private company.

- **Restriction on Composition**:
  Every company shall have at least one director who has stayed in India for a total period of not less than 182 (one hundred and eighty two) days in the previous calendar year.

- **Class action suits:**
  Perhaps the best new provision in the Companies Bill is the enabling of tort action and class action suits.

- **Independent Directors**:
  The Companies Act, 2013 provides that all listed companies should have

at least one-third of the Board as independent directors. Such other class or classes of public companies as may be prescribed by the Central Government shall also be required to appoint independent directors. No independent director shall hold office for more than two consecutive terms of five years.

- **Rotation of Auditors**:
  The Companies Act, 2013 provides for rotation of auditors and audit firms in case of publicly traded companies.

- **Auditors performing Non-Audit Services**:
  The Companies Act, 2013 prohibits Auditors from performing non-audit services to the company where they are auditor to ensure independence and accountability of auditor.

- **Corporate Social Responsibility:**
  The ministry has already notified 98 sections of the new legislation along with the rules governing the Corporate Social Responsibility, which will make it mandatory for a certain class of companies to spend 2% of their average net profit of last three years on social welfare activities. There may be difficulties in implementing in the initial years but this measure would help in improving the Under-privileged & backward sections of Society and the Corporate would in fact gain in terms of their reputation and image in the Society.

- **Multi-layer subsidiaries:**
  Companies can have only two layers of subsidiaries for investment

And its consequences

- **Strengthening Women Contributions through Board Room:**
  The Companies Act, 2013, stipulates appointment of at least one woman Director on the Board of the prescribed class of Companies so as to widen the talent pool enabling big Corporates to benefit from diversified backgrounds with different viewpoints. It is important for corporate boards to ensure gender diversity, but before that happens, a supply of women eligible for board positions needs to be created. According to GMI Ratings' Women on Boards Survey 2013, even on the world's best-known companies, women account for only 11% of total directorships. In India, a sample of 89 companies with more than $ I billion in market valuation, the women percentage is less than 7%. And we are talking only about the biggest companies here. Clearly, major efforts will have to be made to create more women directors, but before that there have to be more women reaching the top of the corporate hierarchy. The legislation should act as a spur to women's

empowerment, but compliance could be years away.

- **Class action suits:**

Perhaps the best new provision in the Companies Bill is the enabling of tort action and class action suits. If this provision had been on the statute book in 2008, Satyam's Indian shareholders could have filed a class action suit against the Rajus, or even the Mahindra-run company that took over Satyam's assets. Mahindra Satyam settled lawsuits in the US and UK since these countries enable class action suits, but in India shareholders were left twiddling their thumbs while foreign shareholders were paid off. This can't happen in future, but the moot point is whether shareholders of government- owned companies can sue the government for squashing minority interests. It is worth recalling the Coal India has been sued by a minority shareholder (The Children's Investment Fund) for following the government's diktat to lower coal prices in 2012. There is ample scope for class action suits against ONGC, Oil India and GAIL which are subsidizing losses in the oil marketing companies. Class action suits have to be filed before the National Company Law Tribunal first, but banking companies are excluded from such action. In the weeks ahead, as companies pore over the fine print of the Companies Bill, more issues will surface. But for now the best sum-up is this: it's a great start, but, as always, the proof of the pudding is in the eating.

- **Independent Directors:**

The provision to make companies have one-third of their board members as independent directors is fine in principle. Independent Directors (IDs) are also more stringently defined, and their tenures will be limited to two terms adding up to 10 years. IDs can also hold a maximum of 20 directorships. Sounds good? But there are pitfalls. For three reasons, First how independent can IDs be when they are appointed and paid for by the promoters? Will promoters appoint truly independent people on boards? Second, are there enough persons available to be appointed as IDs? In theory, yes, because there are no qualifications for becoming an ID, But, in practice, once you tell the prospective person the responsibilities he will bear, the actual number of competent and willing IDs diminishes. Most IDs, in fact, end up adorning corporate boards without the time or commitment to work in the interests of shareholders. Third, if eligible IDs end up taking 20 directorships each, how can they really serve each of those companies' shareholders diligently? According to a CNBC TV18 report. Analjit Singh of Max India, for example, attended only one out of 14 board meeting of Dabur in three years, before he resigned. How did he really help protect Dabur's shareholder interests by remaining absent?

- ## Corporate Social Responsibility:

  The ministry has already notified 98 sections of the new legislation along with the rules governing the Corporate Social Responsibility, which will make it mandatory for a certain class of companies to spend 2% of their average net profits of last three years on social welfare activities. There may be difficulties in implementing in the initial years but this measure would help in improving the Under-privileged & backward sections of Society and the Corporate would in fact gain in terms of their reputation and image in the Society.

  - **<u>What is the Concern</u>:**

    The CSR clause covers all companies that have either net worth in excess of Rs 500 crore, or turnover of Rs 1,000 crore or more, or net profit of Rs 5 crore or more. They have to set aside 2% of the average net profit of the preceding three years for CSR activities. That is a lot of money. It won't pinch much during the good times. But what happens when the economy slows or during recession? The Companies Bill 2011 makes no exception, though an 'errant' company can explain the reason for not spending the amount in its annual report..

  - **<u>What Can Go Wrong</u>:**

    Industry fears hefty fines for non-compliance, though there is no mention of penalty in the Bill. They also fear political extortion. Politicians can force companies contribute to their "trusts". They can even demand that a company develops their constituencies.

- ## Multi-layer subsidiaries:

  Companies can have only two layers of subsidiaries for investment.

  - **<u>What is the Concern:</u>**

    Companies have traditionally created multiple investment subsidiaries. These offshoots can come up at home or overseas, particularly in tax-friendly nations such as Mauritius for routing investments into another country. Large Indian business houses have several hundred subsidiaries that act as investment arms of the holding company or subsidiaries of the holding company. These are used to start new ventures, acquire businesses and enter into joint ventures. Several entities have been found to be using a web of subsidiaries to siphon funds from profitable ventures. By permitting only two levels of subsidiaries, the Bill hopes to check such practices. But companies worry that will restrict their ability to do business. "Restricting the number of subsidiaries could result in curbing the flexibility of corporate entities," says Akshay Chudasama, partner, J Sagar Associates. Another concern is about continuing with the structure in place and the prospective effect of the law. "What happens to existing structures? The Bill does not provide any timeline for unwinding the current structure," says Mehul Modi, senior director, DeloitteTouche Tohmatsu India.

- **<u>What Can Go Wrong</u>:**
  M&A activity can get severely affected due to a restriction on investment subsidiaries. Also, infrastructure companies and property developers that typically use multiple subsidiaries for fund raising and doing business could be badly affected.

Conclusion

The new Companies Act 2013 has come a long way from the old act. With its varied advantages there still exists a multitude of disadvantages fettered to it. The new act has maintained the sanctity of the old act whilst still being in keeping with the requirements of the present age.

A few changes are still required to be made in the new companies act as certain provisions still prove detrimental to the interests of chartered accountants and company secretariats.

However despite its pitfalls the new act is still a turning point and is indeed without a doubt a good breakthrough and a welcome relief from the old act. It was high time that the old act be reviewed.