Companies Act 2013: Changing of the guard

By Siddharth Hariani, Aditya Bhargava and Raghuveer Sarathy, Phoenix Legal

PHOENIX LEGAL

New Delhi
Second Floor,
254, Okhla Industrial Estate,
Phase III, New Delhi-110020
India
Tel +91 11 4983 0000
Fax: +91 11 4983 0099
Email: delhi@phoenixlegal.in

Mumbai
First Floor, CS-242,
Mathuradas Mill Compound,
NM Joshi Marg, Lower Parel
Mumbai - 400 013, India
Tel: +91 22 4340 8500
Fax: +91 22 4340 8501
Email: mumbai@phoenixlegal.in

After much vacillation, the Companies Act, 2013, has finally been enacted by the Indian parliament to replace the Companies Act, 1956, which was increasingly being viewed as archaic and out of step with the requirements of the corporate world.

Some aspects of the act

One person companies: In addition to private limited companies and public limited companies, the new Companies Act has introduced the concept of the one person company (OPC) – a company that can be incorporated with a single shareholder. The previous legislation required companies to be established with at least two members. OPCs are primarily aimed at giving small-scale entrepreneurs, artisans and people engaged in traditional industries, such as handicrafts, handlooms and pottery, the benefits of a corporate structure, such as limited liability and easier access to credit.

Corporate social responsibility: The new Companies Act is said to be the first companies' legislation globally that requires companies fulfilling prescribed criteria to spend on corporate social responsibility (CSR) initiatives. Companies that do not spend on CSR initiatives would be required to explain their non-compliance. While the "comply or explain" regime is non-interfering in theory, some commentators have raised concerns that the prescriptive definition of CSR in the Companies Act coupled with the requirement to explain non-compliance may result in regulatory interference in the affairs of companies.

Tightening the screws: The new Companies Act has removed some of the leeway granted to private companies (which were not subsidiaries of public companies) under the previous act. For instance, section 180 of the new act (similar to section 293 of the previous act) providing for restrictions on the powers of the board, and section 186 of the new act (similar to section 372A of the previous act) providing for restrictions on the powers of a company to provide a loan or guarantee, now apply to both private as well as public companies. Notably, section 186 of the new act also prescribes that a company cannot (except in certain cases) make investments through more than two layers of investment companies.

Private companies are also no longer exempted from provisions governing voting rights and the types of share capital that can be issued by a company, and therefore may no longer have flexibility to issue different classes of shares with differential voting and other rights. Further, under the new act, if any variation in the rights of any class of shareholders affects any other class of shareholders, such variation can only be carried out with the consent of three-fourths of the other class of shareholders.

Executive remuneration: In a move presumably to clamp down on excessive executive remuneration, the draft rules on appointment and remuneration of managerial personnel published by the Ministry of Company Affairs (MCA) require that a listed company provide a statement from its board disclosing names of employees with an annual income of ₹6 million (US$97,000) or more, as well as the ratio of the remuneration of each director to the median remuneration of the employees of the company. Further, a listed company would also be required to explain "the relationship between average increase in remuneration and company performance", and disclose the increase in remuneration of each director and the chief executive officer in a financial year.

Piecemeal implementation

The new Companies Act received the assent of the president of India on 29 August and in a move which attracted much rancour, 98 sections of the act were notified on 12 September. The confusion was exacerbated by the government not notifying section 465, which deals with the repeal of the Companies Act, 1956.

This had the unfortunate consequence of creating a situation where both the new act and the previous act were in force. This situation was rectified by the subsequent issuance by the MCA of a clarification on 18 September stating that the sections of the previous act that corresponded to the notified sections of the new act would no longer be in effect from 12 September.

Conclusion

The MCA is believed to be targeting 1 April 2014 to fully implement the new act. To this end, the MCA has already released two sets of draft rules on certain provisions of the new act, and was expected to release the final set of draft rules by the first week of October.

Once in full operation, the new act is expected to provide much needed succour to the corporate world, and is also expected to ease doing business in India. However, given that its eventual success will depend on clear rule-making and capable enforcement, the jury is still out on the Companies Act, 2013.

Siddharth Hariani is a partner, Aditya Bhargava is a senior associate, and Raghuveer Sarathy is an associate at the Mumbai office of Phoenix Legal.