Between the lines...

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Highlights

I. Government notifies exemptions for private companies

The Government of India has notified several changes and relaxations in the applicability of the provisions of the Companies Act, 2013 ('the Act') to private companies vide notification dated June 5, 2015. The key changes are highlighted below:

a. Related Party Transactions

Definition of related party under Section 2(76) (viii) for the purpose of Section 188 has been relaxed to exclude a private company in respect of compliance of related party contracts with its holding,, subsidiary or an associate company under Section 188 of the Companies Act, 2013.

In addition, Section 188 of the Act imposes some restrictions on shareholders considered to be related parties. Related parties cannot vote at general shareholders' meetings regarding a resolution to approve any contract or arrangement between the company and the related party. Pursuant to the notification, this restriction will not apply to private limited companies.

b. Kinds of Share Capital and Voting Rights

Private companies have now been exempted from application of Section 43 and Section 47 of the Act, which deals with kinds of share capital and voting rights, respectively, if memorandum or articles of the Company so provide. This means that private companies can now issue shares with differential rights with full flexibility to structuring their securities even without voting rights.

c. Rights issue

Section 62 (1) (a) (i) provides that time period for rights offer shall not be less than 15 days and not more 30 days. Private Company can now reduce the time period of rights offer than that prescribed under Section 62 (1) (a) (i) of the Act, if the 90 (ninety) percent of the members of a private company have given their consent in writing or in electronic mode. Furthermore, the requirement of sending the notice 3 days prior to opening of the issue, by way

of specified means, under rights issue is now exempted for private companies.

Section 62 (1) (b) of the Act provides that where a company intends to increase its share capital by the issue of further shares can do so by offering shares to employees under a scheme of employees' stock option (ESOP). Before the amendment, such further issue of shares by a company was to be done by passing a special resolution. Now, private company can make further issues of shares under ESOP scheme only by passing of ordinary resolution.

d. Restrictions on purchase by company of its shares

Under Section 67 (1) of the Act, a company was not allowed to buy its own shares unless it results in consequent reduction of share capital of the company. The notification now exempts private companies from the application of Section 67, provided:

a. No other body corporate has invested money in share capital of such private company;

b. The borrowings of such private company from banks or financial institutions or any body corporate is not equal to or more than twice its paid up share capital or fifty crore rupees, whichever is lower; and

c. Such private company is not in default in repayment of such borrowings subsisting at the time of making transactions under Section 67 of the Act.

However, there is ambiguity as to whether a private company can buy its own shares as there is no similar exemption provided to private companies under Section 66 (Reduction of Capital) and Section 68 (Buyback of Shares). In our view, the only objective achieved by this amendment is provision of financial assistance by a private company to purchase its own shares.

e. Acceptance of deposits from member

Section 73(2) allows acceptance of deposits by a company from its members with approval by way of ordinary resolution and subject to fulfilment of certain conditions prescribed under clauses (a) to (e) like issuance of circular including a statement showing financial position of the company, creation of a deposit repayment reserve account, obtaining deposit insurance, obtaining a certificate from the directors that the company has not defaulted in repayment of deposits accepted, etc.

The notification has now exempted private companies from the conditions in clauses (a) to (e) of Section 73 (2)in relation to deposits taken from members provided that the amount of deposit accepted by the private company does not exceed 100% of aggregate of paid-up capital and free reserves of such private company and the relevant filings with the Registrar of Companies has been made.

f. Management and Administration

Private companies have now been provided with an option to exclude the applicability of Sections 101 to 107 and Section 109 by providing for exclusions in its articles of association. Section 101 to 107 and Section 109

deals with procedure of conducting of general meetings by the companies, which are length of service of notice of meeting, explanatory statement, quorum, chairperson of the meetings, proxies, restriction on voting rights, voting by show of hands and demand for poll.

A private company was empowered to lay down its own procedure in respect of conduct of its general meetings under the Companies Act, 1956. The same has now been restored under the 2013 Act.

g. Filing of board resolutions

All companies are required to file copies of board resolution under Section 117(3)(g) of the Act passed in relation to matters prescribed under section 179(3) of the Act. These matters were:

a. calls on shareholders in respect of money unpaid on their shares;

b. buy-back of securities;

c. issuance of securities, including debentures, whether in or outside India;

d. borrowing of monies;

e. investment of funds of the company;

f. granting of loans or giving guarantee or providing security in respect of loans;

g. approval of financial statement and the Board's report;

h. diversification of business of the company;

i. amalgamation, merger or reconstruction;

j. takeover of a company or acquiring a controlling or substantial stake in another company;

k. additional matters as may be prescribed.

Now, Section 117 (3)(g) of the Act will not apply to private companies, hence, a private company will not be required to file copies of board resolution in relation to all of the matters mentioned above with the Registrar of Companies.

h. Number of company audits

For the purpose of limit on number of companies of which audits can be taken at a time by the audit or under Section 141 (3)(g) of the Act, which is 20, all one person companies, dormant companies, small companies, and private companies having a paid up share capital of less than ₹ 100 crores will be excluded.

i. Appointment of directors to be voted individually

Provisions of Section 162 which provided for the manner of appointing of two or more were to be voted individually will now not apply to private companies.

j. Restrictions on powers of Board

Section 180(1) of the Act which provided that board may exercise its power in relation to the following matters, only with the consent of members by way of special resolution:

i. Sale, lease or disposal of the whole or substantially whole of the undertaking of the company;

ii. Investment of the amount of compensation received by the company as a result of merger or amalgamation in trust securities;

iii. Borrowing money exceeding the aggregate of the company's paid-up share capital and free reserves; and

iv. Remittance or granting time for the repayment of, any debt due from a director

Now, there is no need for a private company to pass special/ ordinary resolution for exercising powers under Section 180 of the Act.

k. Interested Directors

Section 184 (2) provided that directors of a company will refrain from participating in a board meeting for matters in which they are interested. Interested director in a private company can now participate in board meetings after disclosure of his interest.

l. Loans by private companies

A partial exemption from Section 185 has now been given to private companies giving a loan, providing a guarantee or offering a security in connection with a loan taken by a director(s) or by any persons/ entities in which the director(s) have an interest. There are 3 cumulative conditions for availing the exemption:

(a) There is no body corporate shareholder in the lending/guaranteeing company;

(b) The lending company's aggregate borrowings from other bodies corporate or banks or financial institutions is limited to two times the paid-up share capital of the company or ₹ 50 crores whichever is lower;

(c) No default in repayment of such borrowings is pending by the lending company.

m. Appointment of managerial persons

Section 196(4) and (5) of the Act prescribes the procedure and approval requirements for appointment of managing director, manager or whole-time director and requires companies to comply with the provisions of Section 197 and Schedule V with respect to remuneration payable to such personnel. The provision requires board approval followed by approval of members in the next general meeting for appointment of such personnel and filing of return of appointment of such personnel within 60 days from the date of such appointment.

Private companies are exempt from the above requirements.

Source: http://www.mca.gov.in/Ministry/pdf/Exemptions_to_private_companies_05062015.pdf

VA View

Many of the changes under this notification are to restore the exemptions that were earlier available to private companies under the Companies Act, 1956. The 2013 Act constrained the operational flexibility hitherto available to private companies bringing them at par with public companies on several compliances. The notification is a welcome step towards easing the operations of private companies.

II. Relaxing FDI policy

The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India has amended the Consolidated Foreign Direct Investment (FDI) Policy Circular of 2015with respect to investments by Non Resident Indians (NRIs), Persons of Indian Origin (PIOs) and Overseas Citizens of India (OCIs) through its Press Note 7 (2015 series).

Under the erstwhile FDI policy, an NRI meant an individual resident outside India who is a citizen of India or who is a person of Indian origin. This definition has been amended. NRI now means an individual resident outside India who is a citizen of India or is an OCI cardholder within the meaning of Section 7A of Citizenship Act, 1955. PIO card holders registered as such under Notification No. 26011/4/98 F.I, dated 19.8.2002, issued by the Central Government are deemed to be 'Overseas Citizen of India' cardholders.

Investment by NRI under Schedule 4 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2000 (FEMA Regulations) will deemed to be domestic investment at par with investments made by residents. The NRI investments on a non-repatriable basis will now be treated as domestic investments for purpose of sectoral caps, pricing guidelines, types of investment instruments, downstream investments, etc. However, we are of the view that NRI investments on a non-repatriable basis are to be made in accordance with Schedule 4 of the FEMA Regulations.

The press note shall take effect from June 18, 2015.

Source: http://dipp.nic.in/English/acts_rules/Press_Notes/pn7_2015.pdf

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This measure is expected to result in augmenting inflow of foreign capital in key sectors, leading to economic growth of the country. This move will enable investments by NRIs, OCI cardholders and PIO cardholders under Schedule 4 on a non-repatriation basis, across sectors, without being subjected to any of the conditions associated to foreign investment.

III. Amendments to Negotiable Instruments Act

An Ordinance to amend the Negotiable Instruments Act, 1881 ('NI Act') has been promulgated by the President of India on June 15, 2015.

Section 138 of the NI Act deals with the offence of dishonour of cheques for insufficiency of the funds, etc. There are number of cases which have set a precedent on jurisdictional aspect to try an offence pertaining to dishonour of cheque. But, unfortunately, lakhs of cases are pending before the courts.

To address the difficulties faced by the payee or the lender of the money in filing the cases under Section 138 of the NI Act, because of which, large number of cases were stuck, the jurisdiction for offence under Section 138 has been proposed to be clearly defined.

The Ordinance provides for filing of cases only to a court within whose local jurisdiction the bank branch of the payee, where the payee delivers the cheque for payment is situated. Further, where a complaint has been filed against the drawer of a cheque in the court having jurisdiction under the new scheme of jurisdiction, all subsequent complaints arising out of section 138 against the same drawer shall be filed before the same court, irrespective of whether those cheques were presented for payment within the territorial jurisdiction of that court.

Further, it has been provided that if more than one prosecution is filed against the same drawer of cheques before different courts, upon the said fact having been brought to the notice of the court, the court shall transfer the case to the court having jurisdiction as per the new scheme of jurisdiction.

Source: http://bombayhighcourt.nic.in/libweb/ordinc/2015/2015.06.pdf

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The Negotiable Instruments (Amendment) Bill, 2015 was passed in the Lok Sabha last month but could not be taken up in the Rajya Sabha, hence an ordinance was passed by the Government. This ordinance has been brought to ensure fairness keeping in view the interests of the complainant by clarifying the territorial jurisdiction for trying the cases for dishonour of cheques. This would help the trade and commerce in general and allow the lending institution, including banks, to continue to extend finance to the economy, without the apprehension of lack of effective remedy on account of bouncing of a cheque.

IV. SEBI's view on disclosure of material litigation

Clause 36 of the Equity Listing Agreement requires that a listed company shall promptly inform the Stock Exchange of the developments with respect to any dispute in conciliation proceedings, litigation, assessment, adjudication or arbitration to which it is a party or the outcome of which can reasonably be expected to have a material impact on its present or future operations or its profitability or financials.

Additionally, by way of a guidance note issued in 2014, SEBI had clarified that the listed entity may consider the impact of such disclosure on legal/court proceedings while making the disclosures and make the disclosure accordingly. If, the listed entity is of the opinion that making any such disclosure is not in the interest of the listed entity, disclosure may be limited to the extent of stating the occurrence of the event.

In view of the above requirement, SEBI passed an order against New Delhi Television Ltd. ("Issuer") for non-disclosure of material information to the stock exchanges and also imposed a monetary penalty. The issuer had failed to disclose a tax demand of ₹ 4500 million raised by the income-tax department to the exchanges. The issuer contended that the disclosure requirements are limited to only those litigation or disputes which materially affect the operations, profitability or financials of the company and the said demand by the taxman was not disclosed because the demand lacked merit in law. The issuer relied on professional advice and on the basis of bona-fide and reasonable belief, it did not make disclosure.

SEBI however took the view that since the amount demanded by the taxman was greater than the revenue of the company and significantly larger than its net profit and also greater than its net worth, the issuer should have treated the information as material and accordingly, disclosed the same to the stock exchanges.

Source: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1433431158961.pdf

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Clause 36 gives flexibility to the listed company to determine events/information, which in its opinion is material. However, in the present case since amount of the income tax demand was more than the revenue of the company and substantially more than its net profit SEBI held that information was material in nature and should have been disclosed.

Contact Details :

www.vaishlaw.com

NEW DELHI
1st & 11th Floor, Mohan Dev Bldg.
13 Tolstoy Marg
New Delhi - 110001, India
Phone: +91-11-4249 2525
Fax: +91-11-23320484
delhi@vaishlaw.com

MUMBAI
106, Peninsula Centre
Dr. S. S. Rao Road, Parel
Mumbai - 400012, India
Phone: +91-22-4213 4101
Fax: +91-22-4213 4102
mumbai@vaishlaw.com

GURGAON
803, Tower A, Signature Towers
South City-I, NH-8
Gurgaon - 122001, India
Phone: +91-124-454 1000
Fax: +91-124-454 1010
gurgaon@vaishlaw.com

BENGALURU
Unit No. 305, 3rd Floor
Prestige Meridian-II, Building No. 30
M.G. Road, Bengaluru - 560001, India
Phone: +91-80-40903581/ 88 /89
Fax: +91-80-40903584
bangalore@vaishlaw.com