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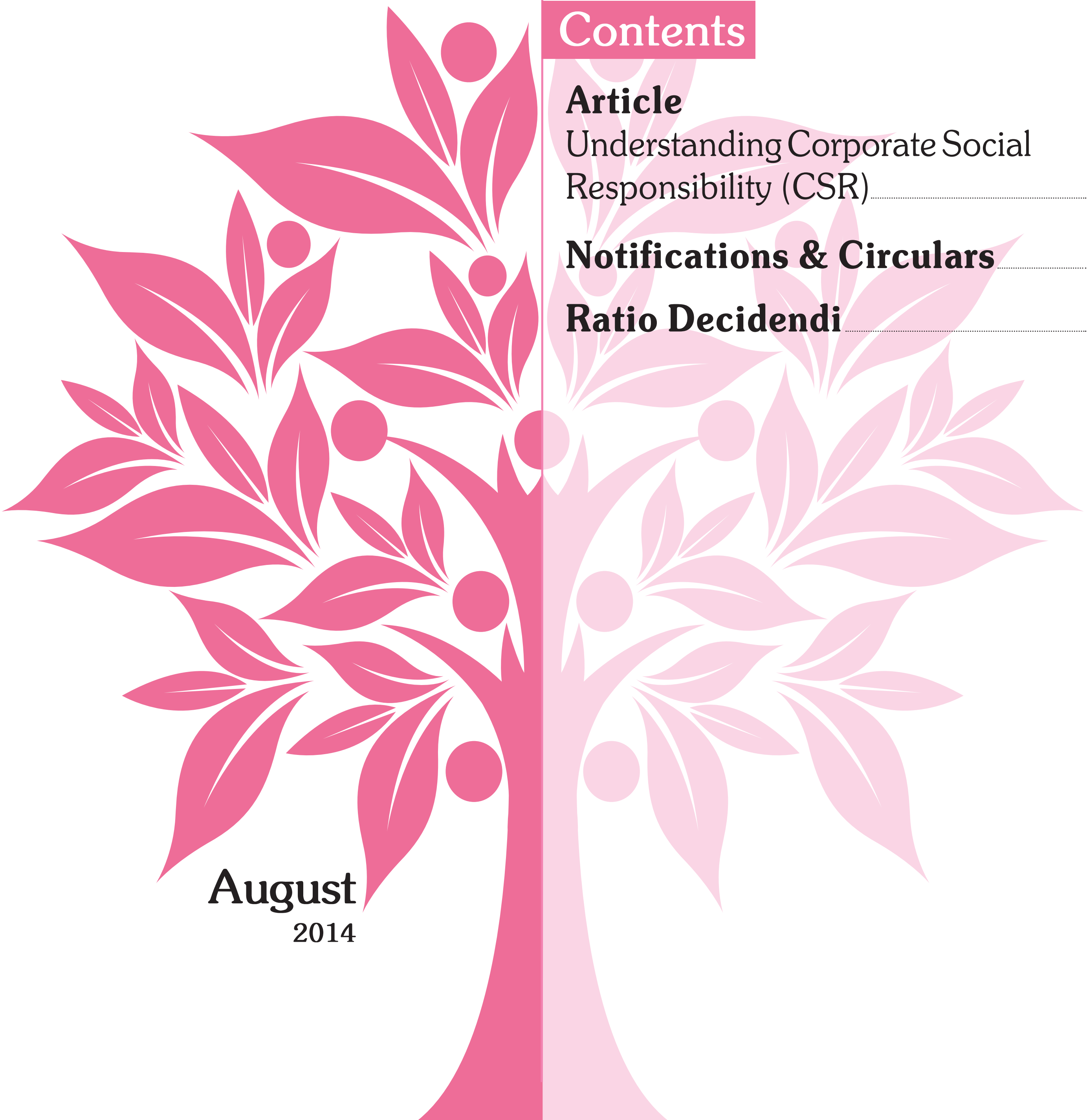

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Understanding Corporate Social Responsibility (CSR)

By **Divya Jain**

The Companies Act, 2013 (CA 2013) has introduced path-breaking changes in governance mechanisms, compliances and disclosures, appointment and scope of auditors, responsibilities of independent directors, investor protection and mergers and acquisitions. Introduction of new concepts like 'corporate social responsibility' for the first time anywhere in the world is in line with global thinking on corporate giving for social causes.

The origin of this idea is the expectation from government that companies need to spend time, money and effort to meet their social obligations and contribute to social and public welfare on an ongoing basis. Specified companies that make profits are required to set aside a portion of such profits and spend the same in promoting certain notified causes.

Applicability of corporate social responsibility provisions

Section 135 and Schedule VII of CA 2013 and Companies (Corporate Social Responsibility) Rules, 2014 (CSR Rules) state that companies incorporated in India and a foreign company having branch and/ or project office in India, having an annual turnover of at least INR 10 billion and more, or a net worth of at least INR 5 billion, or a net profit of at least INR 50 million must spend 2% of their average net profits made during the three immediately preceding financial years on social activities prescribed in Schedule VII. The section is not applicable to a company which ceases to meet the above criteria for three consecutive years. The term 'net profit' as defined under Rule 2(f) of CSR Rules excludes dividend income received from another Indian company and profits made by the company from its overseas branches.

Rule 2(c) of CSR Rules defines corporate social responsibility to mean and include projects or programmes relating to activities specified in Schedule VII to CA 2013. Within these parameters, which the government has also stated are to be interpreted liberally in order to allow companies the flexibility of deciding on its CSR projects, a company may decide the activities that it will undertake for this purpose.

Compliance of CSR provisions

Rule 2(d) of the CSR Rules provides that every company which meets the above-mentioned criteria is required to constitute a CSR Committee of the Board of Directors consisting of three or more directors, one of whom must be an independent director. An unlisted public company or a private company, which is not required to appoint an independent director, need not have an independent director on its CSR Committee and the CSR Committee of such private company having only two directors can be constituted with only those two directors.

In respect of branch office/ project office of a foreign company, the CSR Committee must consist of at least two persons, of which one person must have the authority to accept notices or other documents on behalf of the foreign company in India and the other person should be the one who is nominated by the foreign company.

The CSR Committee is required to formulate and recommend a CSR policy to the Board indicating the activities to be undertaken and expenditure for such activities. The CSR policy once approved by the Board should be disclosed in its report and must also be made available on the company's website, if any.

The CSR Committee also monitors the CSR activities on a regular basis as well as the expenditure for the same to ensure that the company spends 2% of the average net profit of the three immediately preceding years on such activities. Further, in case the company fails to spend the requisite amount, the CSR Committee is required to disclose the reasons for such non-spending in its report.

CSR activities

Schedule VII of the CA 2013 lists out the activities which may be included by companies in their corporate social responsibility policies. The activities listed in Schedule VII aim at reducing inequalities faced by socially and economically backward groups such as eradicating hunger and promoting health care and sanitation; promoting education and gender equality; setting up homes and hostels for women and orphans; setting up old age homes; ensuring environmental sustainability, ecological balance; conservation of natural resources and maintaining quality of soil, air and water; protection of national heritage, art and culture; measures for benefit of armed forces veterans/ war widows; promotion of rural sports; slum development, contribution to Prime Minister's National Relief Fund; rural development projects, etc. The government has also stated that the activities are to be interpreted liberally and companies are permitted the flexibility to decide on the activities as long as they are within the broad framework of Schedule VII.

Vehicle for undertaking CSR activities

A company can undertake CSR activities through its holding, associate or subsidiary company or even through a trust, society, or a company incorporated under section 8 of the Companies Act, 2013. However companies should ensure that trust, society or such company not established by the company should have an established track record of three years in undertaking similar programmes or projects. Companies can join together to undertake these activities as long as they are able to monitor progress and spending of their contribution.

In terms of the CSR Rules, projects or programmes or activities undertaken in India only would amount to CSR spend under Section 135. Moreover, CSR programmes or activities that benefit only the employees of the company and their families or any activities that are undertaken in the normal course of its business are excluded for this purpose. Companies are also required to give preference to local areas and areas around it which it operates for spending the amount earmarked for CSR activities.

Critical analysis

Though the principle of CSR is laudable and pioneering in principle, there are some practical difficulties and legal lacunae in implementing the same. Section 135 of CA 2013 applies only to 'companies' incorporated in India, however the CSR Rules overreach the statutory provision and attempt to cover and regulate the branch or project office of the foreign company though in general the rules cannot overrule the Act.

Further, taxability of expenditure incurred by a company while complying with the corporate social responsibility provisions are an added concern. Since the rules specify that CSR activities will exclude normal business activities and tax deductibility will only be available for such projects, no tax deduction will be available for CSR activities undertaken by the company. However, if a company discharges its CSR obligations by contributing to a trust, society or the PM Relief Fund, which have a general tax exemption, the company may avail of the benefit of the same.

The clause is also enacted on the basis of "gentle and firm persuasion" since it is based on 'expense or explain' principle by permitting a company to explain the reason for not undertaking any CSR activity, there are no penal provisions for not doing or spending. The real challenge thus lies in execution and effective implementation of corporate social responsibility provisions to achieve a higher level of corporate governance and social responsibility.

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Notifications & Circulars

Company Law Settlement Scheme 2014 introduced: Ministry of Corporate Affairs has introduced Company Law Settlement Scheme 2014. This scheme provides for condoning delay in filing of annual documents (Annual Return and Financial Statements) on the MCA 21 electronic registry. The Scheme, which will be in force from 15-8-2014 and remain in force till 15-10-2014, grants immunity from prosecution and allows for reduced additional fee of 25% of the actual additional fees payable for belated filing documents. As per General Circular No. 34/2014, dated 12-8-2014, this scheme would be available for belated filing of Forms 20B, 21A, 23AC, 23ACA, 23AC-XBRL, 23ACA-XBRL, 66 and 23B.

Appointment of an individual as both Chairman and Managing Director / CEO: The Ministry of Corporate Affairs has notified that public companies having paid-up share capital of Rs. 100 crore or more and annual turnover of Rs. 1000 crore or more, which are engaged in multiple business and have appointed Chief Executive Officer for each such business shall be the class of companies for the purposes of the second proviso to sub-section (1) of Section 203 of the Companies Act, 2013. The second proviso excludes application of first proviso to said section in specified cases.

According to the first proviso of Section 203(1), no individual can be appointed /reappointed as Chairman as well as Managing Director or CEO of the company at the same time, except under specified conditions. MCA Notification S.O. 1913(E), dated 25-7-2014 issued in this regard also states that the paid-up share capital and the annual turnover shall be decided on the basis of the latest audited balance sheet.

Resolutions passed under the Companies Act, 1956 - Clarifications on transitional period: The Ministry of Corporate Affairs has clarified that resolutions approved or passed by the companies under relevant applicable provisions of the Companies Act, 1956, during the period from 1-9-2013 to 31-3-2014, can be implemented, in accordance with provisions of the Companies Act, 1956. Circular No. 32/2014, dated 23-7-2014 states that such implementation would be subject to the conditions (a) that the implementation actually commenced before 1-4-2014, and (b) that this transitional arrangement will be available upto expiry of one year from the passing of resolution or six months from the commencement of the corresponding provision in the Companies Act, 2013, whichever is later. It is also clarified that any amendment of the resolution must be in accordance with the relevant provision of the Companies Act, 2013.

Appointment of auditors by C&AG in deemed Government companies - Clarifications: The Ministry of Corporate Affairs has clarified that the Companies Act, 2013 does not alter the position vis-à-vis old Companies Act with regard to audit of deemed Government companies through Comptroller and Auditor General of India (C&AG) and thus such companies are covered under sub-sections (5) and (7) of Section 139 of the Companies Act, 2013. Observing that the words "any other company owned or controlled, directly or indirectly.....by the Central Government and partly by one or more State Governments" appearing in the said sub-sections are to be read with the definition of 'control' in Section 2(27), Circular No. 33/2014, dated 31-7-2014 states that shareholders' agreements, etc., envisaging 'control' are to be taken into account while deciding whether an individual company, is covered under the said provision. This circular also clarifies that the company concerned would be responsible for intimating the C&AG about its incorporation along with name, location of registered office and capital structure and such company shall share such intimation with the relevant Government so that such Government may also send a suitable request to the C&AG.

Monitoring of compliance by stock exchanges: SEBI has directed all recognized stock exchanges to step-up and equip their monitoring framework so as to ensure compliance with the requirements laid down by 'Principles of Corporate Governance' in the revised Clause 49 of the Listing Agreement. SEBI Circular CIR/CFD/DIL/4/2014, dated 1-8-2014 issued in this regard notes that the said principles provide that shareholders should have opportunity to participate effectively and vote in general shareholder meetings.

Change in Government Debt Investment Limits: SEBI had enhanced the investment limit in government securities available to all FPIs by USD 5 billion i.e. (from 20 billion to 25 billion) by correspondingly reducing the amount available to long term FPIs from USD 10 billion to USD 5 billion within the overall limits of USD 30 billion. Circular CIR/IMD/FIIC/17/2014, dated 23-7-2014 issued for this purpose also mentions that the incremental investment limit of USD 5 billion shall be required to be invested in government bonds with a minimum residual maturity of 3 years. All future investment against the limit vacated, when the current investment by an FPI runs off either through sale or redemption, shall also be required to be made in government bonds with a minimum residual maturity of 3 years. However, there will be no lock-in period and FPIs shall be free to sell the securities (including those that are presently held with less than 3 years of residual maturity) to the domestic investors.

Guidelines on disclosures, reporting and clarifications under AIF Regulations, clarified: SEBI has extended the deadline upto 31-8-2014 for sending of annexures to placement memorandum to the investors under Clause 2(a)(iii) of 'Guidelines on disclosures, reporting and clarifications under AIF Regulations' issued under Circular No. CIR/IMD/DF/14/2014 dated 19-6-2014. Circular CIR/IMD/DF/16/2014, dated 18-7-2014, issued in this regard also clarifies that the disclosure of disciplinary history, is applicable for the last 5 years and where monetary penalty is involved, in cases where such penalty is greater than Rs. 5 lakh. Liabilities in personal capacity of an individual will not apply here and contingent liabilities shall have to be as disclosed in books of accounts of the entity. Joint investors shall mean cases where each of the investor contributes towards the AIF.

FDI - Pricing guidelines on issue/transfer of shares or convertible debentures, revised: Revised pricing guidelines have been issued by the Reserve Bank of India regarding issue/transfer of shares or convertible debentures. As per RBI A. P. (DIR Series) Circular No. 4, dated 15-7-2014, while in the case of listed companies, it will be as per the SEBI guidelines, in the case of unlisted companies, such issue and transfer, with or without optionality clauses, shall be at a price worked out as per any internationally accepted pricing methodology on arm's length basis. Indian companies have to disclose, in the balance sheet, details of valuation of such shares or convertible debentures, the pricing methodology adopted for the same as well as the agency that has given/certified the valuation.

Flexible structuring of long term project loans to infrastructure and core industries: Reserve Bank of India has notified extension of the facility of flexible structuring of long term project loans to infrastructure and core industries. RBI Notification RBI/2014-15/126 DBOD. No.BP.BC.24/21.04.132/2014-15, dated 15-7-2014 issued in this regard states that if banks refinance any existing infrastructure and other project loans and fix a longer repayment period, the same would not be considered as restructuring if conditions as specified in the notification are satisfied.

Ratio Decidendi

Arbitration - Disputes alleging criminal actions of 'fraud' and 'misrepresentation' capable of resolution through arbitration:

Bombay High Court has held that 'fraud' and 'misrepresentation' as defined under Sections 17 and 18 of the Contract Act are well accepted grounds which would vitiate 'free consent' and consequently the contract itself and therefore, as a general rule, it cannot be said that once fraud and misrepresentation are alleged in the context of a contract, the subject matter of the dispute would be rendered incapable of resolution by arbitration. The respondent had initiated arbitration proceedings against the petitioner seeking relief in relation to Share Subscription Agreement (SSA) alleged to be vitiated due to fraud and misrepresentation made by the petitioner. Holding that if the subject matter of dispute has an eminently civil profile, then it may not be proper to conclude that the subject matter of dispute is incapable of settlement by arbitration, merely because parties have initiated criminal actions for fraud or misrepresentation, the court noted that the parties were unable to prove the existence of any general or peremptory rule that allegations of fraud, in all cases, are incapable of settlement by arbitration under the law of India. Petitioner's submission of non-enforceability of any award that may eventually be made by the Arbitral Tribunal at Singapore, upholding allegation of fraud and misrepresentation leveled by the respondent against the appellants, was hence rejected by the Court.

While determining the applicable law governing arbitration proceedings, the court noting various clauses of agreements, also held that parties either expressly or in any case by implication had intended to exclude applicability of Part-I of the Act of India (except Section 9 of the Arbitration and Conciliation Act, 1996). It was held that even if the entire decision in the case of *Bharat Aluminium* is to be regarded as having only prospective effect, principle as laid down in cases of *National Thermal Power Corporation* and *Sumitomo Heavy Industries* would apply. [*Avitel Post Studioz Ltd.* v. *HSBC PI Holdings (Mauritius) Ltd.* - Appeal No. 196 of 2014 in Arbitration Petition No. 1062 of 2012, decided on 31-7-2014, Bombay High Court]

Directors continue to be liable for breach of RBI Regulations irrespective of sanction of amalgamation scheme:

The Delhi High Court has, in a case relating to sanction of amalgamation scheme, held that if it is found that the transferee-company has violated any provision of the Reserve Bank of India Act then the Directors of such company, who are guilty of said breach, shall continue to be liable irrespective of the sanction of the amalgamation scheme. The Regional Director had raised an objection that since the transferee-company was an NBFC, it was required to give an undertaking for all compliances from the Reserve Bank of India and hence the transferee had filed an affidavit that all compliances, applicable as per the RBI Guidelines to the transferee NBFC, shall be complied with.

In respect of another objection of the Regional Director relating to valuation of the shares in the scheme placing reliance on valuation of shares of the transferor and transferee in previous schemes sanctioned under Sections 390-394 of Companies Act, 1956, the court observed that since the transferor-company is being dissolved, and shareholders of the transferor-company would become of the shareholders of the transferee company, having approximately 99.96% shareholding in the transferee-company, and that since the shareholders of both the transferor and the transferee companies have approved the scheme, scheme of amalgamation would not be prejudicial to the interest of the shareholders of the transferor-company. [In Re: *LRSD Global Holding Private Limited* - C. P. 84 of 2014, decided on 1-8-2014, Delhi High Court]

COMPAT upholds penalty on National Stock Exchange: Competition Appellate Tribunal has upheld the Competition Commission of India's ruling in respect of National Stock Exchange of India Ltd. finding it to be a dominant player in the relevant market and abusing its dominance (by introducing predatory pricing by waiving transaction fee altogether in the newly established Currency Derivatives Segment). Penalty of 5% of average turnover was also upheld by the Tribunal in this regard.

However, it was held that competition law assessment can and should be done only with respect to the services being offered, especially when the enterprises concerned do not have any control over the products being traded because the products do not belong to them, nor are they created by them. Overruling the finding of the CCI in respect of relevant product market [CCI found the market to be stock exchange services in respect of the Currency Derivative (CD) segment], the Tribunal held that if the stock exchange services were common, then there was no need to restrict these stock exchange services in respect of CD segment alone. It was held that the market for assessment has to be the services offered by stock exchange independent of the product being traded on that exchange because a stock exchange does not sell a product. It was also held that merely because a broker could get a service of CD from a separate platform, merely because at the relevant time period, the services of the stock exchange of respondent were limited to CD segment, it does not mean that the relevant market had to be held as CD segment market. Case law from other jurisdictions was found to be not applicable by the Tribunal.

The Tribunal however held that NSE was nevertheless dominant in the relevant market considering the size of NSE as one of the factors. It was also held that it cannot be said that the respondent was in a better position than NSE to sustain the losses and to keep on sustaining them. Further in respect of abuse of dominance, the Tribunal rejected appellant's (NSE's) argument that since the average variable cost - the AVC - was zero hence not charging any transaction fees for transactions did not amount to predatory pricing. It was held that NSE could not show that its total variable cost was zero. The Tribunal hence held that the zero transaction fee policy was a well intentioned policy to oust the competitors from the market (respondents here) who had no other segment except the CD segment. It was noted that initially the introduction of zero transaction fee policy may be justified (in order to infuse liquidity in the market at nascent stage), but its continuance after 20-5-2009 was certainly not justified. CCI's finding of breach of Section 4(2)(e) of the Competition Act, 2002, was however overruled by the Appellate Tribunal noticing that there was only one market and that market was the services of the stock exchange. [*National Stock Exchange of India Ltd.* v. *Competition Commission of India* – Appeal No. 15 of 2011, decided on 5-8-2014, COMPAT]

Penalty for misdeclaration of shareholding pattern of promoters: The Securities Appellate Tribunal has upheld penalty on company, Company Secretary and Chairman who failed to inform the stock exchanges about the true shareholding pattern of the promoters. The Tribunal in this regard held that the expression "otherwise deal in securities" appearing in Regulation 3(a) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 read with Section 12A(a) of SEBI Act, 1992 is wide enough to cover cases where general investors are misguided by the promoters by inclusion of the third parties' shares as their own share holding. It was held that these persons were not mere conduit to pass-on the details they receive from the promoters to stock exchanges irrespective of the records maintained by the company. Submission that then existing proforma prescribed by Clause 35 of the Listing Agreement had no requirement of separate mention of shares held by third parties on behalf of the promoters and the provisions were amended only in February 2009, was rejected by the Tribunal noting that the law only required promoters to mention their own shareholding which they are holding in their own right. Similarly, penalty on the promoters for violating Regulations 3(a), (b), (c) and (d), 4(1) and 4(2)(f) of FUTP Regulations, 2003 read with the provisions of Section 12A(a), (b) and (c) of SEBI Act, 1992 was also upheld by the Tribunal. [*GHCL Ltd.* v. *SEBI* – Order dated 31-7-2014, SAT]