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Code on Wages, 2017 – An Analysis

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The labour law domain in India is a reaffirmation of India's colonial past and industrial revolution. While current labour legislations have been significantly tailored to suit the unique conditions of the Indian industry and labour force, they are nevertheless still largely influenced by issues of a bygone era. Adding to this, even the legislations which were drafted afresh after independence were done many decades ago, and though they have been subject to multiple amendments, there is now a pressing need to replace them altogether with laws which reflect India's real story today – the India which is growing at more than 7% annually[1] and has a labour force of more than 500 million[2].

The Constitution of India lists labour related subjects under the Concurrent List.[3] This means that both the Centre and the States are equally competent and permitted to enact labour legislations, keeping in mind the federal structure of the country. As a result, there are, at present, more than 45 major central legislations and more than 100 labour related state legislations operating in India, many times on overlapping matters. The multiplicity of these laws and their compliance burden has often been cited by domestic industries and foreign investors as an obstacle to investment.[4] Therefore, with an objective to soothe investor confidence, as well as to "*simplify, rationalise, and amalgamate the existing labour laws*"[5], the incumbent government in its annual budget presentation this year announced merging of 44 labour laws into 4 codes on (i) wages; (ii) industrial relations; (iii) social security and welfare; and (iv) safety and working conditions.[6]

This article analyses the issues surrounding one of these Codes – the Code on Wages, 2017 ("**Wage Code**" or "**Code**") – which was cleared by the Union Cabinet as a bill in July 2017, and is now pending in Lok Sabha to be passed as an Act.

Understanding the Code

The objective of the Wage Code is to consolidate 4 existing labour laws relating to wages – (i) the Minimum Wages Act, 1948; (ii) the Payment of Wages Act, 1936; (iii) the Payment of Bonus Act, 1965; and (iii) the Equal Remuneration Act, 1976 – into one integrated code. Evidently, all these legislations govern various aspects of the same subject, i.e., wages, and therefore to combine and cover all these aspects in one law, the Wage Code is proposed to be enacted. This exercise implements the proposal of the Second Indian National Labour Commission, which suggested rationalisation of labour laws in India way back in 2002.[7]

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[1] www.imf.org - For India, data and forecasts are presented on a fiscal year basis and GDP from 2011 onward is based on GDP at market prices with FY2011/12 as a base year.

[2] www.data.worldbank.org.

[3] Entry 22, 23 and 24 of the Concurrent List – Seventh Schedule, Constitution of India.

[4] http://economictimes.indiatimes.com/news/economy/policy/budget-2017-plan-to-simplify-labour-laws-irks-industry/articleshow/56944053.cms.

[5] Excerpts from speech of Finance Minister in Lok Sabha while presenting Union Budget 2017.

[6] *Ibid*.

[7] The Second Indian National Labour Commission was constituted almost after a gap of 72 years after the first National Labour Commission in 1929.

The Code is divided into separate chapters dealing with minimum wages, payment of wages, and provisions relating to bonus. Provisions relating to equal remuneration have been incorporated in different chapters, wherever necessary. There are then separate provisions and chapters concerning advisory boards, dues and claims, offences and penalties, as well as those relating to establishment and powers of various governmental and quasi-judicial authorities to monitor and implement the Code.

The most obvious and useful feature of the Code is rationalisation of various definitions contained in the 4 present legislations, which were, till now, subject to varied interpretations even though they regulated the same subject matter. For example, giving a singular definition of "wages" in the Code will allow consistent interpretation of the term, which was hitherto defined in modified forms in different legislations, sometimes even as "salary"[8] or "remuneration"[9].

Another important feature of the Code is the introduction of a universal minimum wage. Under the Minimum Wages Act, 1948, State Governments have the mandate to fix minimum rate of wages for employees employed in a scheduled employment.[10] On the contrary, the Wage Code proposes that Central Government will fix a universal minimum wage for all employees, irrespective of the type of employment or establishment they work in. Currently, this universal monthly minimum wage is proposed at Rs. 18,000[11]. Once the Wage Code is enacted, States will have the liberty to increase this amount, applicable for their State, though they cannot propose a reduction.

The Wage Code also seeks to:

- Allow payment of wages through electronic means (bank transfer) in addition to payment by cash and cheque. This incorporates the changes made to the Payment of Wages Act, 1936 by the Payment of Wages (Amendment) Bill, 2017 and is a possible effect of government's drive of demonetisation and less-cash society;
- Consolidate the compliance requirements – employers under the Wage Code would be required to maintain a single register for the record of employees, wages, bonus, muster roll etc. This would ease the requirement for employers to maintain separate records under different legislations. Though the Code does not prescribe the form and manner of maintenance of this register, it is possible that the register could also be maintained electronically;[12]
- Establish a common authority for claims – the Wage Code requires the State Governments to establish one or more authorities to handle claims under the Code like payment of wages, incorrect deductions, non-payment of wages, un-equal remuneration, non-payment of bonus, etc. These authorities will have powers to issue orders against employers for compensation, as well as issue orders for recovery of dues. The State Governments will also be required to establish appellate authorities to such authorities;
- Give a new role to "facilitators" – the existing legislations provide for labour "inspectors" to

[8] See Section 2(21) of the Payment of Bonus Act, 1965.
[9] See Section 2(g) of Equal Remuneration Act, 1976.
[10] Section 3 of the Minimum Wages Act, 1948.
[11] Currently the Payment of Bonus Act, 1985 is applicable only to workers earning wages below INR 21,000 per month. Similarly, the Payment of Wages Act, 1936 applies to workers earning monthly wages of INR 18,000 (S.1(6)).

[12] The draft Labour Code on Wages which was released in 2015 for comments from industry and trade unions prescribed that this register should be maintained in an electronic format. It is possible that the same may be adopted in the Code.

conduct inquiry and investigation of an employer to ensure compliance. The new Code will replace this role with that of facilitators, who will, in addition to the powers of inspectors, be assigned the role of supplying information and advice to employers and workers on effective means of complying with the provisions of the Code;

- Re-emphasise the role of women and employment opportunities for women, a subject which will have to be statutorily deliberated by the Central and the State Advisory Boards under the Code;
- Expand the definition of "industrial dispute" than to the one provided under the Industrial Disputes Act, 1947.

India's benefit or loss?

Undoubtedly, the consolidated Code will offer compliance benefits. An entity complying with 4 different legislations containing somewhat similar and overlapping subjects and maintaining records and compliance in 4 different forms, would certainly breathe a sigh of relief. On the same footing would be a foreign investor looking at India as a potential destination for lucrative return on investment with cheap and abundant labour. All the features of the Code noted above are bound to enhance investor confidence and allow ease of doing business in India.

For employees and workers[13], it's an advantageous situation as well. The Code offers broadly the same extent of protection of labour rights and protection of workers in relation to their wages, as the existing legislations do. At the same time, it extends the applicability and benefits of the existing legislations as well. Not only do existing employees earning less than Rs. 18,000 a month get a guaranteed payment of this amount every month, but all those employees in the organised and unorganised sector, who did not fall within the ambit of current legislations merely by reason of their industry or establishment not being mentioned in the Schedule, will get covered by protection of the Code. This will help improve standard of living across India. Recent news articles[14] state that this universal minimum wage could benefit approximately 40 million employees (4 crore employees).

The Code is not, however, all beneficial for employers and employees. The earlier draft version of the Code, which was circulated in 2015 for comments from industry and trade unions, received scathing remarks on the lacuna and poor drafting.[15] Most of those provisions from the draft have been carried into the Code without much change. Some of the reasons why the industry, trade unions, and even labour rights' organisations are unhappy with the Code are:

- Imposing a universal minimum wage on all States in India does not take into consideration the diverse demography, topography and living standards across India, as well as the development and prosperity of different States. While Rs. 18,000 a month may be easy for an employer in Maharashtra to pay, the same may not be possible in Uttarakhand or Tripura. Various news articles have reported that the industry reaction to the proposed minimum wage is fairly negative

[13] The Code contains reference to both – "employees" and "workers".

[14] http://indianexpress.com/article/business/bandaru-dattatreya-union-cabinet-clears-minimum-wage-code-bill-4768446/; http://www.businesstoday.in/current/economy-politics/pm-narendra-modi-cabinet-clears-wage-code-bill-minimum-wage-employees/story/257233.html.

[15] https://www.bloombergquint.com/union-budget-india/2017/02/01/budget-2017-finance-minister-proposes-simpler-labour-laws. "*India's Labour Law Changes: Towards advancing principles of rights, inclusion and employment security*", 2015 report published by Society for Labour and Development, Citizen's Rights Collective and ActionAid India.

and it is feared that the Code may impact hiring.[16] The Supreme Court in the case of ***Hydro (Engineers) P. Ltd. v. Workmen***[17] had held that minimum wages should be defined by needs-based criteria that extend beyond physical needs. This should include nutrition, clothing and housing needs, fuel, lighting, family expenses, etc. All these factors are, undoubtedly, different in different States in India.

- Universal minimum wage will also affect the wage competition between States. States often allow lower wages than their neighbouring States to attract investment to their State. This in turn has helped States grow and promote a spirit of competition, fostering more investment. This will, to a great extent, be eliminated under the Code.
- The added wage burden may push industries to automate at a faster pace.
- Provisions of the Equal Remuneration Act, 1976 are scantily referred to in the Code. The Equal Remuneration Act, 1976 has, in essence, been confined to Sections 3 and 4 of the Code. Further, when the draft code was released in 2015, the equal remuneration provisions gave recognition to the third gender and provided that no discrimination should be made between men, women and transgenders. The third gender, however, does not find reference in the Code.
- The Code also does not include any measures to prohibit discrimination in employment on the basis of caste, religion or social origin, something which is much required in a country like India.
- Unlike the provisions of the Minimum Wages Act, 1948 and the Payment of Bonus Act, 1965, the Code decriminalises the penalty provisions at first instance. Thus, where an employer pays less to an employee than the minimum wage, at first instance, the employer will only be penalized by a fine of Rs. 50,000 under the Code. On the contrary, under the existing legislations, imprisonment term is prescribed for such offences.

These, along with other issues like diluting the scope of overtime pay, replacement of judicial appellate authority with an authority which may or may not be judicial, limiting the scope of trade unions and employees to question the balance-sheet or the profit and loss account of the employer (for the purposes of payment of bonus), etc., are some issues which may hinder the effective implementation of the Code.

What next?

As noted above, the Code is yet to become an Act and thereby come into operation. It is pending in Lok Sabha and then has to undergo the process of scrutiny and approval of the Rajya Sabha. It is likely that some of the issues noted above relating to misalignment between the current legislations and the Code may be resolved, though it is unlikely that other issues like easing the hiring fears of industries or addressing the issue of universal minimum wage mismatch with India's diverse topography, etc., will find a mention. We will get to know of this in the winter session of the Parliament.

Nevertheless, the Code is a positive move to ease the process of doing business in India. It also lives up to the statement made by the Union Finance Minister in his 2017 budget speech where he said the government is "*keen on fostering a conducive labour environment*

[16] http://www.businesstoday.in/current/economy-politics/wage-code-bill-2017-will-it-boost-jobs-or-hinder-businesses/story/257777.html; http://economictimes.indiatimes.com/jobs/new-wage-code-bill-to-impact-overall-hiring-scenario-experts/articleshow/59805844.cms.

[17] *Hydro (Engineers) P. Ltd. v. Workmen*, AIR 1969 SC 182.

wherein labour rights are protected and harmonious labour relations lead to higher productivity". It is reported that along with the Wage Code, the government may soon introduce the code relating to industrial relations as well as the social security and welfare, the latter of which is already available in draft form on Ministry of Labour's website for comments. It is about time that India takes a step in the direction of revamping its labour laws and attunes them to India's present growth story.

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Bills, Notifications and Circulars

Companies Amendment Bill, 2017: The Companies (Amendment) Bill, 2017 (Bill), as passed by Lok Sabha on July 27, 2017, seeks to make important revisions to the Companies Act, 2013 (Act) in relation to structuring, disclosure and compliance requirements for companies. The main purpose of the Bill is to promote ease of doing business in India by simplifying procedures and adherence to compliances. It also seeks to strengthen corporate governance standards and action against defaulting companies. The Bill is currently pending before the Rajya Sabha for its approval.

Some of the major amendments proposed to the 2013 Act are outlined below:

- ***Definition of 'associate company'* –**Under the Act, the definition of an associate company's 'significant influence' is derived from its control of share capital. The Bill substitutes the explanation to Section 2(6) of the term 'significant influence' to having control of at least 20 percent of the total voting power, or control of or participation in business decision-making under an agreement.[18] This potentially impacts and affects the financial accounting of its holding company, if any. This will also be significant in respect of insolvency management under the Insolvency and Bankruptcy Code, 2016. The Bill further introduces the definition of a 'Joint Venture' to mean a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.
- ***Definition of 'related party'*–** The Bill provides for expanding the existing definition of 'related party' by including "*an investing company or the venturer of a company*",[19] described as a body corporate whose investment in the company would result in that company becoming an associate company of the body corporate. This definition thus has the effect of bringing foreign companies under the ambit of related parties as well.
- ***Definition of a 'small company'* –** The Act provides a large number of benefits to companies falling within the definition of 'small company' *viz.* exemptions from filing cash flow statements, auditor regulations, reducing the minimum number of board meetings to be held etc. For a company to qualify as a 'small company', it is proposed to raise the ceiling of maximum paid-up share capital from Rs. 5 crore (rupees five crore) to Rs. 10 crore (rupees ten crore). It also increases the prescribed maximum turnover substantially from Rs. 20 crore (rupees twenty crore) to Rs. 100 crore (rupees hundred crore).[20] This provision will ensure that benefits provided to

[18] Section 2 (i), Companies Amendment Bill, 2017.

[19] Section 2 (xi), Companies Amendment Bill, 2017.

[20] Section 2 (xii), Companies Amendment Bill, 2017.

small companies could potentially be availed by a substantial number of companies.

- ***Definition of a 'subsidiary company'* –** In its present form, the Act lays down that a company shall be deemed to be a subsidiary of another, if the holding company controls the composition of the board of directors or exercises or controls '*more than half of the total share capital*'. The Bill proposes that instead of the words '*total share capital*', the words '*total voting power*'[21] be used to determine existence of a subsidiary-holding company relationship.
- ***Members severally liable* –** The Bill proposes to add a new section regarding liability of members in situations wherein a company carries on its business for more than 6 months, despite the number of members in a company being below the statutory minimum number prescribed, i.e. below 7 members in case of a public company, and below 2 members in case of a private company. It provides that every person who is a member of the company, while it is carrying on business and such member is cognisant of the fact that the company does not meet the minimum statutory criteria of members, shall be severally liable for payment of whole debts of the company contracted during that time, and can be severally sued.[22] Although Section 45 of the erstwhile Companies Act, 1956 contained an identical provision, the Bill proposes to fill the vacuum on this issue in the present Companies Act, 2013.
- ***Private placement process* –** The Bill proposes to substitute Section 42 of the Act that deals with the issue of subscription of securities on private placement. The Bill takes away the right of investors to renunciate their investment rights in favor of another entity, so that only investors whose names are mentioned in the information memorandum, filed by the issuer, can subscribe to the shares. The Bill also proposes that return of allotment has to be filed with the Registrar of Companies within 15 days from the date of allotment of securities instead of 30 days and that the money received through private placement shall not be utilized by a company unless such return of allotment is filed by it.[23]
- ***Annual Return* -** The Bill provides for prescribing a simpler form of annual return for small companies, one-person companies and private companies with turnover of less than Rs. 100 crore (increased from the previous limit of Rs. 20 crore). This may also apply to such other classes of companies as may be prescribed. The amendment extends the power of Central Government to prescribe abridged form of annual returns for other types of companies, in addition to one-person company or a small company. The Bill suggests that books of account of a company relating to a period prior to eight years from the date of examination must not be reopened. This will be highly beneficial for companies as they will not have to carry on the cumbersome task of maintaining books of accounts for several years as they are currently required to.[24]
- ***Issue of Sweat Equity Shares* –** The Act currently prohibits the issuance of sweat equity shares for a period of one year from the date of commencement of business of the company. The Bill proposes to remove this prohibition so that such shares can be issued at any time after registration of the company. This amendment will be beneficial for start-ups as these companies can issue such shares sooner, as incentives to directors or

[21] Section 2 (xiii), Companies Amendment Bill, 2017.
[22] Section 3, Companies Amendment Bill, 2017.
[23] Section 10, Companies Amendment Bill, 2017.
[24] Section 23, Companies Amendment Bill, 2017.

employees for providing their know-how and can attract talent.[25]

- ***Meetings -*** The Bill provides relaxation to unlisted companies to hold their annual general meeting at any place in India, instead of the current requirement of it being held at the company's registered office or in the city, town or village where the registered office is situated. This relaxation is subject to the condition that all members of the company have given their consent for the same in writing or by electronic mode in advance.[26] The Bill also provides an option for a wholly owned subsidiary of a company incorporated outside India to hold its extraordinary general meetings at a place outside India.[27]
- ***Corporate Social Responsibility (CSR) –*** The Bill proposes to amend the eligibility criteria for the purpose of constituting the CSR committee and incurring expenditure towards CSR. Presently, the Act provides for calculation of such eligibility criteria on the basis of any preceding financial year. The Bill now proposes to amend this requirement to only the immediately preceding financial year.[28] The Bill has also clarified that where a company is not required to appoint an independent director on its Board as per the Companies Act, 2013, such company may instead appoint two or more directors to its CSR committee.
- ***Independent directors –*** The Act defines an independent director as a person who has or had no 'pecuniary' relationship with the company, its holding, subsidiary, or associate company, or their promoters, or directors during the two immediately preceding financial years or during the current financial year. The Bill seeks to exclude remuneration and transactions – not exceeding 10 percent of the independent director's total income – from what is defined as a pecuniary or financial relationship.[29] The Bill also proposes that the requirement to deposit Rs. 1,00,000 (rupees one lakh) with respect to nomination of directors as provided under Section 160 of the Act shall not be applicable in case of appointment of independent directors, or directors nominated by Nomination and Remuneration Committee, if any, or in the absence of a Nomination and Remuneration Committee, directors recommended by the Board of Directors of a company.[30]
- ***Director Identification Number (DIN) –*** The Bill provides Central Government power to prescribe any other identification number to be treated as DIN for purposes of the Act and if the person holds such a number, he shall not be required to hold a DIN. This amendment would potentially permit Aadhar number to be used as an alternative to DIN.[31]
- ***Forward dealings and Insider trading -*** The Bill proposes to omit Sections 194 and 195 of the Act which prohibit forward dealings in securities of a company by its directors or key managerial personnel and prohibits insider trading of securities as these actions fall under SEBI's domain and are adequately dealt with under SEBI regulations.[32]
- ***Loans to Directors and related companies –*** The Amendment proposes to completely replace Section 185 of the Act[33], which governs loans granted to, and security and guarantees provided on behalf of, directors and other parties in whom the directors are interested. The section in its current form under the Act, provides that the companies

[25] Section 13, Companies Amendment Bill, 2017.
[26] Section 26, Companies Amendment Bill, 2017.
[27] Section 27, Companies Amendment Bill, 2017.
[28] Section 37, Companies Amendment Bill, 2017.
[29] Section 46, Companies Amendment Bill, 2017.
[30] Section 50, Companies Amendment Bill, 2017.
[31] Section 48, Companies Amendment Bill, 2017.
[32] Sections 64 & 65, Companies Amendment Bill, 2017.
[33] Section 61, Companies Amendment Bill, 2017.

can grant loans to, or provide loans or security on behalf of directors or entities they are interested in provided the requisite permission was taken. Exemptions to this provision were provided to 'wholly owned subsidiaries' if such loans were utilised for the subsidiary's principal business activities. The Act also provides for exemptions for loans granted to a managing or whole-time director and to a company that provides loans or gives guarantees or securities for the due repayment of any loan in its ordinary course of business.

The Amendment proposes to bifurcate the regulatory framework into two categories: the first contemplating certain transactions which are prohibited and another consisting of transactions which may be permitted, subject to approval of the shareholders by way of a special resolution passed at a general meeting. The prohibition applies to loans, guarantees or security provided to a director of the company or a director of its holding company or any partner or relative of such director, and in any firm where such person is a partner. The transactions pertaining to a private company wherein a director of the company provides loans, guarantee or security is also a director or member is now permitted by passing of a special resolution. This is subject to the condition that the explanatory statement for the general meeting, contains detailed disclosures regarding the proposed transaction. The permission given under the Act for providing such loans is also retained if the loans are utilised by the borrowing company for its principal business activities under the Bill. The amendment also retains its provisions under the Act applicable to managing or whole-time directors and companies providing loans and guarantees to its wholly owned subsidiaries or in its ordinary course of business. One difference in the exemptions is in the provision relating to the "ordinary course of business" where under the existing position of the 2013 Act such exemption could be availed of if the interest charged on the loans granted was at least equal to the bank rate declared by the Reserve Bank of India. The Bill provides for the interest to now be charged at least at the rate of prevailing yield of one year, three year, five year or ten year Government securities, that is closest to the tenor of the loan.

- ***Conversion into Companies –*** The Act provides for a partnership firm, limited liability partnership, cooperative society, society or any other business entity to be converted into a company if it is consisting of seven members or more[34]. The Bill provides that such a conversion into a company will be possible even if they consist of at least two members or more provided that, the company shall register as a private company and not a public company.[35]
- ***Members of NCLT and NCLAT -*** The Bill also brings in line provisions relating to qualification of technical members of National Company Law Tribunal (NCLT) and composition of the selection committee for appointment of technical members of NCLT and National Company Law Appellate Tribunal (NCLAT)[36] with the judgment of Supreme Court in *Madras Bar Association* v. *Union of India & Anr.* (2013).[37]

Consolidated FDI Policy: The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India has released the latest Consolidated FDI Policy, 2017 (FDI Policy 2017), effective from August 28, 2017. Some major changes reflected in the FDI Policy 2017 are outlined below:

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[34] Section 366, Companies Act, 2013.
[35] Section 75, Companies Amendment Bill, 2017.
[36] Section 85, Companies Amendment Bill, 2017.
[37] *Madras Bar Association v. Union of India & Anr.*, Writ Petition (C) No. 1072 of 2013.

- ***Investment exceeding Rs. 5000 Crores -*** Previously, additional infusion into the same entity/its Wholly Owned Subsidiary, within approved FDI limits, did not require fresh approval of FIPB to be sought. As per the latest FDI Policy, any additional infusion into the same entity/ its Wholly Owned Subsidiary, exceeding the cumulative amount of INR 5,000 Cr, shall require fresh approval to be sought.
- ***Conversion of a Limited Liability Partnership (LLP) into Company -*** Conversion of an LLP into a company (and vice-versa) operating in sectors/activities where 100% FDI is allowed under the automatic route and where there are no FDI-linked performance conditions, has now been permitted under Automatic route.
- ***Single Brand Product Retail Trading (SBRT) -***

- Under the FDI Policy, SBRT entities having FDI exceeding 51% are required to source at least 30% of the value of goods purchased, from within India, preferably from MSMEs/cottage industries/artisans. However, SBRT entities trading in 'state of art' or 'cutting edge' products may seek relaxation from such compliance with local sourcing norms. Given the ambiguity surrounding assessment of products that qualify as 'state of art' and 'cutting edge', the Government of India have now announced that a Committee comprising of representatives from DIPP, NITI Aayog, technical experts would examine 'state of art' and 'cutting edge' qualifying features in such proposals.
- Under the previous FDI Policy, Indian Manufacturers (i.e owner of an Indian brand) having FDI were required to manufacture at least 70% of its products (in terms of value) in-house. That is, an Indian Manufacturer could previously outsource manufacturing for only a maximum of 30% of its products (in terms of value).

  With the deletion of the notion of an 'Indian Manufacturer' under the FDI Policy 2017, domestic entities engaged in SBRT will no longer be required to meet the stringent criteria of in-house manufacturing of minimum 70% of its products. Nevertheless, local sourcing norms will still need to be complied with by domestic SBRT entities having FDI exceeding 51%.

- ***E-Commerce -*** The previous FDI Policy mandated only a maximum of 25% sales from a single vendor/vendor's group companies, but had not specified the manner of computation. The FDI Policy now clarifies that only a maximum of 25% of the sales value on financial year basis can be affected by an e-commerce entity through its marketplace, from one vendor/vendor's group companies.

Reserve Bank Commercial Paper Directions, 2017: The Reserve Bank of India (RBI) notified the Reserve Bank Commercial Paper Directions, 2017 ("RBI Directions") on August 10, 2017 in supersession of the existing directions on the issuance of Commercial Paper (CP). CP(s) are money market instruments, typically issued as promissory notes to meet the short-term funding and working capital requirement of corporates. The RBI Directions prescribes a minimum denomination value of Rs. 5 lakh and multiples thereof for CP issuance at discount to face value *sans* any pre-emptive options. All resident and non-resident(s) are permitted to invest in CPs subject to restrictions under the Foreign Exchange Management Act, 1999 as well as any conditions imposed by the relevant sectoral regulator. However, the RBI Directions prohibits investment in CPs issued by related parties, whether it be in the primary or secondary market(s).

One of the highlights of the RBI Directions is that, minimum net-worth requirement(s) vis-à-vis eligibility of issuers have been removed thereby facilitating even small and medium sized companies to issue CPs to meet their short-term funding requirements. Apart from companies, the RBI Directions have also carved out a separate category for entities such as co-operative societies/unions, government entities, trusts, limited liability partnerships and other body corporate having presence in India, to raise funds through CPs, albeit subject to fulfilment of minimum net-worth requirement of Rs.100 Crore.

Entities with total CP issuance exceeding Rs. 1000 crore or more in a calendar year, are required to obtain credit rating from two credit rating agencies out of which, the one with the lower rating shall be quoted. In so far as end-uses are concerned, although RBI does not impose any restrictions, the issuer is obligated to state end-usages clearly in the offer document(s) and ensure that the proceeds are utilized accordingly. The RBI Directions also facilitates the buy-back of instrument subject to a waiting period of 30 days from the date of issuance. The buy-back can be made in full or in part at the prevailing market price, wherein uniform price and terms shall be offered to all investors who have participated in the issue. At the outset, RBI has widened the access to CPs by easing eligibility norms, however at the same time disclosure norms have been enhanced to ensure accountability of the issuers.

Companies (Incorporation) Second Amendment Rules, 2017: The Ministry of Corporate Affairs (MCA) recently amended the Companies (Incorporation) Rules, 2014 (Incorporation Rules) *vide* its notification dated July 27, 2017 (Notification). The Notification provides for the following amendments:

- Form INC 23 incorporates amendments made to the Incorporation Rules.
- *Per* new Rule 28, an application for shifting the registered office of a company within the same state must be filed in Form INC 23 along with the following documents:
  1. Board resolution for shift in registered office;
  2. Special resolution of members of the company approving such a shift in the registered office;
  3. A declaration given by key managerial personnel or two directors authorised by the board that the company has not defaulted in payment of dues to its workmen and has obtained consent of its creditors for the proposed shift in the registered office;
  4. A declaration that the company shall not seek change in the jurisdiction of the Court where cases for prosecution are pending; and
  5. Acknowledged copy of intimation to the Chief Secretary of the State as to the proposed shift of the registered office of the company and that the employees' interest is not adversely affected consequent to such proposed shifting.

  The requirement to publish a notice in the daily newspaper or serving individual notices to debenture holders, depositors and creditors of the company with respect to shifting the registered office within the state, has been omitted.
- *Per* new Rule 30, an application for shift in registered office of a company from one state to another must be filed in Form INC 23 along with the following documents:
  1. A copy of Memorandum of Association with proposed alterations;

2. A copy of the minutes of the general meeting at which the resolution authorising such alteration was passed, giving details of the number of votes cast in favour or against the resolution; and
3. A copy of board resolution or power of attorney or the executed Vakalatnama, as the case may be.

Filing additional documents enumerated in the erstwhile rule has been omitted.

- The process to be followed in case of objection to shifting of registered office from one state to another has been provided under new Rule 30 as follows:
  1. The Central Government shall hold a hearing or hearings, as required, and direct the company to file an affidavit to record the consensus reached at the hearing, upon executing which, the Central Government shall pass an order approving the shifting, within sixty days of filing the application.
  2. Where no consensus is reached at the hearings, the company shall file an affidavit specifying the manner in which objection is to be resolved within a definite time frame, duly reserving the original jurisdiction to the objector for pursuing its legal remedies, even after the registered office is shifted, upon execution of which the Central Government shall pass an order confirming or rejecting the alteration within sixty days of the filing of application.

Under new Rule 30 of the Incorporation Rules, a company is required to, in not more than thirty days before the date of filing the application in Form INC 23, advertise in newspapers, serve individual notices to debenture holders and creditors, and serve notices to the Registrar and other regulators. Under the erstwhile rule, the said requirements were to be fulfilled within fourteen days before the date of hearing.

IRDA (Other Forms of Capital) Regulations, 2015 clarified: A Circular has been issued by IRDA on August 4, 2017 in relation to creation of debenture redemption reserve. It may be noted that through IRDA (Other forms of Capital) Regulations, 2015, insurers were allowed to raise capital in forms such as Preference Shares and Subordinated Debt. Insurers have now sought clarification from IRDA as to whether they are required to create debenture redemption reserve (DRR) as contemplated under the Companies Act, 2013. To clarify the above, IRDA has stated that the requirement of creating a DRR of 25% of the value of outstanding debentures, as per the Companies Act, 2013, shall be adequate. It is further clarified that the said DRR shall not be considered as a liability to compute solvency margin and ratio.

Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2017: The Securities and Exchange Board of India (SEBI) *vide* Notification dated August 14, 2017 (Notification) has amended SEBI (Substantial Acquisition of Shares and Takeovers), Regulations 2011 (Takeover Code).

The Takeover Code exempts certain kinds of acquisitions from the obligation of making an open offer under Regulation 3 (substantial acquisition of shares or voting rights) or Regulation 4 (acquisition of control) of the Takeover Code. The recent amendment extends the exemption from the obligation of making an open offer to certain additional kinds of acquisitions, such as:

- Henceforth, in addition to acquisitions pursuant to a scheme of arrangement pursuant to an order of a court, acquisitions pursuant to a scheme of arrangement *vide* an order of *"a tribunal"* shall also be exempted from the obligation of making open offer. Thus, orders passed by the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) will be given the same weightage as an order passed by a court.

- This exemption from making a mandatory open offer is also extended to an acquisition pursuant to a resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016.
- The exemption shall also been extended to such acquisitions where shares are acquired by a person on allotment by the target company or are purchased from the lenders, pursuant to a debt restructuring scheme in accordance with the guidelines specified by RBI, provided that the following conditions are met by the purchaser:

a) Guidelines for determining the purchase price have been specified by RBI and the purchase price is determined in accordance with such guidelines;

b) The purchase price is certified by two independent qualified valuers, and the valuers include an independent merchant banker registered with SEBI or an independent chartered accountant having a minimum experience of ten years until Section 247 of Companies Act, 2013 comes into force;

c) Securities acquired are held for a lock-in period of at least 3 years from the date of acquisition;

d) Special resolution has been passed by shareholders of the issuer before the acquisition;

e) In the general meeting called for passing the special resolution, the issuer, in addition to the disclosures required under the Companies Act, 2013, has to disclose the following information:

1) Identity including of natural persons who are the ultimate beneficial owners of the shares proposed to be acquired and who would ultimately control the proposed acquirer(s);
2) Business model;
3) A statement on growth of business over the period of time;
4) Summary of audited financials of previous three financial years;
5) Track record in turning around companies, if any; and
6) The proposed roadmap for effecting turnaround of the issuer

f) Applicable provisions of the Companies Act, 2013 are complied with.

Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, and the Insolvency and Bankruptcy Board of India (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017, amended: On August 16, 2017, the Insolvency and Bankruptcy Board of India ("IBBI") amended two sets of regulations framed under the Insolvency and Bankruptcy Code, 2016 ("Code"), namely the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, and the Insolvency and Bankruptcy Board of India (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017 (collectively "Regulations").

The amendment seeks to recognize and protect claims of creditors who, despite being owed debts by a corporate person, do not qualify as either a 'Financial Creditor' or 'Operational Creditor' under the Code.

Prior to this amendment, there was an ambiguity regarding existence of a third class of creditors as the Code envisaged only two classes of creditors- Financial and Operational. Different NCLT Tribunals have taken divergent views on existence of a third, separate class of creditors.

The amendments have been introduced in light of the corporate insolvency resolution process initiated against a developer by National Company Law Tribunal ("NCLT") on August 09, 2017 involving several housing projects where aggrieved buyers of undelivered flats did not fall under either category of financial or operational creditors.

Henceforth, creditors who otherwise do not qualify as either Financial or Operational Creditors, may now file their proof of claim with the Insolvency Resolution Professional in the prescribed form ('Form 'F') to raise their claims against the corporate debtor.

Ratio Decidendi

Listed companies suspected of being shell companies - SAT stays SEBI's Order imposing trade restrictions

Key points:

Any communication made by the Securities and Exchange Board of India (SEBI) to stock exchanges, which is approved by whole-time members of SEBI and which is in respect to a selective number of companies and affects the rights and obligations of such companies as well as its promoters and directors shall fall within the category of a quasi-judicial order and shall be appealable under Section 15T of the Securities and Exchange Board of India Act, 1992 (SEBI Act).

Background:

In the present case, the appeals were filed by the appellant companies to challenge the communication issued to three stock exchanges as well as the orders passed by two of the stock exchanges in compliance with the directions made by SEBI. The impugned communication was issued in the backdrop of letter dated June 09, 2017 issued by the Ministry of Corporate Affairs (MCA) which identified a total of 331 companies as suspected shell entities. The MCA *vide* the aforesaid letter directed SEBI to investigate whether these 331 companies were in fact shell companies, and if so, to take appropriate action.

SEBI, in pursuance of the MCA Letter, forwarded the list of suspected shell companies to the stock exchanges and directed them to take measures such as suspending trading in the securities of these companies on daily basis.

The Order:

The primary objection raised by SEBI was with respect to the validity of the appeal and reliance was placed on the Supreme Court's decision in the *National Securities Depository Limited* v. *Securities and Exchange Board of India* [(2017) 5 SCC 517]. In the aforesaid matter, the impugned communication by SEBI to the stock exchanges was held to be an administrative direction and, thereby, it was held that the appeal is not maintainable. However, in the present case, the Securities Appellate Tribunal (SAT) held that the impugned communication is not a general direction made by SEBI neither does it have any administrative purpose. On the contrary, the impugned communication prejudicially impairs the rights and obligations of the appellants as well as its promoters and directors and held that the impugned communication would fall in the category of a quasi-judicial order and, hence, was appealable before the tribunal under Section 15T of SEBI Act.

Further, the SAT observed that the impugned communication was issued without giving an opportunity of hearing to the appellants and neither was any investigation undertaken by SEBI and nor any direction issued to the stock exchange to investigate the companies and determine the allegations against them.

Upon examination of the criteria(s) for the application of GSM framework, the SAT observed that the said restrictions can only be made applicable to companies that witness abnormal price rise, which is not commensurate with the financial health and fundamentals of the company. The aforesaid facts cannot be certainly determined without auditing the financials of the appellant companies. To counter this argument, the respondent stated that SEBI was simply implementing the direction given to it by the MCA and the directions did not instruct SEBI to conduct any investigation on the companies suspected of being a shell entity.

The SAT, on the contrary, was of the view that the MCA merely directed SEBI to take necessary actions under SEBI laws and regulations, which required some sort of investigation to be carried out by SEBI and the very fact that there was a time-gap of two months between issuance of the MCA letter and the impugned communication clearly evidences the lack of urgency in the matter. Considering the above, the SAT stayed SEBI's communication dated 7-8-2017 and directed the stock exchanges to reverse their decisions as well. [*J. Kumar Infraprojects Ltd.* v. *Securities and Exchange Board of India* – Order dated 10-8-2017 in Appeal No. 174 of 2017, Securities Appellate Tribunal]

Committed/Assured Returns amount to 'financial debt' under IBC

Facts:

a. Appellants had executed various agreements/memorandum of understanding with the Respondent for purchasing a residential flat, shop and office space in a project which was being developed and promoted by the Respondent.

b. The Appellants purchased a unit under the 'Committed Return Plan' which required the Appellants to pay a substantial portion of the total sale consideration upfront upon execution of the MOU. As per the said plan, the Respondent had to pay certain amounts as Committed Returns/Assured Returns, on a monthly basis, from the execution date of the MOU till the time of handing over of the actual physical possession of the unit.

c. When the Respondent failed to pay the Assured Returns, the Appellants filed an application under Section 7 of IBC before NCLT, Principal Bench, Delhi, which application was dismissed by the said NCLT vide Order dated 23rd January, 2017, stating that the Appellants did not fall within the definition of 'financial creditors' under Section 5(7) of IBC. Challenging the said order, the present appeal was filed before the National Company Law Appellate Tribunal (NCLAT) by the Appellants.

Contentions:

The Appellants contended that Committed Returns/Assured Returns is a method adopted by real estate developers to raise finance from the public or open market rates below normal rates made available by banking and other financial institutions, without having to offer any collateral and with no regulatory intervention/supervision. Therefore, the above transaction makes the Appellant "Financial Creditors" of the Respondent. The Appellants also relied on an Order dated 19th December, 2014, passed by Securities Exchange Board of India (SEBI), in the case of *MVL Limited*, WTM/PS/57/CIS/NRO/DEC/2014, wherein it was held that:

> *"transactions where the developer offers to pay assured returns to the buyers 'are not pure real estate transactions', rather they satisfy all the ingredients of a Collective Investment Scheme as defined under Section 11AA of the SEBI Act, 1992."*

It was mentioned that various winding up petitions are pending against the Respondent for non-payment of assured returns to various buyers wherein liability was admitted by the Respondent, and promises to settle claims were made, but no such action was taken by the Respondent. Therefore, it was contended that since winding-up related provisions under the Companies Act have now been substituted by IBC, relief sought by the Appellants under IBC must be granted.

The Appellants contended that they are 'financial creditors' of the Respondent since the Respondent owes quantified debt to the Appellants, therefore, the Appellants have a valid claim against the Respondent.

It was also contended that as per the annual return filed by the Respondent, the amounts to be paid to the Appellants are shown as "Commitment Charges" under the head "Financial Costs", along with interest costs on borrowings. It was also contended that the Respondent was deducting TDS on the Committed Return under Section 194(A) of the Income Tax Act, 1961, which applies to deduction of TDS as "Interest, other than Interest on Securities". In light of the above, it was contended that the payment to the Appellants are essentially in the form of interest payments, thereby implying that the amounts paid by the Appellants to the Respondent while booking the units, are in the nature of 'loans' extended to the developer for completing the project.

Decision:

To understand whether the transaction falls under the definition of 'financial debt' or not, the NCLAT assessed the clauses of the MoU and noticed that the Appellants are referred to as 'investors', and the Respondent had agreed to pay monthly committed returns to such investors. In light of the above, it was held that the amounts due to the Appellants satisfy the definition of 'debt' as defined in Section 3(11) of IBC.

It was observed that the Respondent treated the Appellants as 'investors' and borrowed amounts from the Appellants for a commercial purpose, thereby showing the amounts as 'loans' in their annual returns. Furthermore, the Respondent was required to pay Committed Returns to the Appellants every month, till possession was handed over, therefore, even the criterion of the 'amount being against the consideration of the time value of money' was fulfilled in the instant case. Further, TDS was also deducted as if they are interest on loans. NCLAT observed that the Respondent did not object to the aforesaid facts and it is also not the case of the Respondent that construction has stopped or is delayed on account of factors beyond the control of the Respondent. In light of the above, the amounts invested by the Appellants satisfied the meaning of 'Financial Debt', as defined in Section 5(8)(f) of IBC. It was held that the Appellants are 'financial creditors' within the ambit of IBC, the order passed by the NCLT, Delhi, was set aside, and the matter was remitted back with a direction to admit the insolvency petition. [*Nikhil Mehta and Sons* v. *AMR Infrastructure Limited* - Order dated 21-7-2017, NCLAT, Delhi]

Insolvency petition admitted under IBC

Facts:

Amit Spinning Industries Limited (Applicant Company) had taken loans to conduct its business operations from financial creditors including- Axis Bank Limited and UCO Bank Limited (which assigned the rights, title, interest and benefit in respect of their claims to JM Financial Asset Reconstruction Company). Therefore, JM Financial stepped into the shoes of the financial creditors.

Since the Applicant Company's net-worth was eroded, it filed its reference before the Board for Industrial & Financial Reconstruction (BIFR) in 2011. On 18th July, 2012, BIFR passed an order declaring the Applicant Company as sick. By virtue of such a declaration, moratorium under Section 22 (1) of SICA (which states that no proceeding shall be initiated by any party against such a sick company) was granted to the Appellant Company, which the Appellant Company had been enjoying for 5 years. However, no revival plan had been filed before BIFR.

Thereafter, the financial creditors Axis Bank Ltd. and UCO Bank Limited had sent loan recall notices and had sought payment of the loan amounts from the Applicant Company. Axis Bank had also filed a petition against the Appellant Company in the Debt Recovery Tribunal, Delhi, to recover the amounts pending to be paid by the Appellant Company.

The Insolvency and Bankruptcy Code (IBC) provides that any proceeding pending before the BIFR or the Appellate Authority as per the Sick Industrial Companies (Special Provisions) Act, 1985, shall stand abated and the company with respect to which such an appeal or reference or inquiry stands abated may make a reference to the NCLT under IBC, within 180 days from the date of commencement of IBC.

The Applicant Company, in its petition, submitted all documents required under Section 10 of IBC, and sought initiation of insolvency resolution process under IBC.

JM Financial Asset Reconstruction Company, one of the financial creditors of the Applicant Company, raised no objection to the insolvency petition filed by the Applicant Company being admitted. However, it contended that since the Corporate Debtor had been enjoying moratorium under SICA for the past five years and had not been able to give any viable scheme of revival, it would be inappropriate for the Applicant Company to have a further moratorium as enumerated in the IBC.

Decision:

a. The Hon'ble National Company Law Tribunal (NCLT), Principal Bench, Delhi, admitted the instant petition for initiating the corporate insolvency resolution process.
b. Moratorium under Section 14(1) of IBC was granted and since the Applicant Company had been enjoying moratorium for a period of 5 years, speedy resolution of the insolvency resolution process, preferably within 100 days, was ordered.

[*Amit Spinning Industries Limited* - Petition filed under Section 10 of IBC, decided on August 1, 2017, NCLT (Delhi) Principal Bench]

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