Lakshmikumaran & Sridharan
corporate

corporate amicus

August 2015 / Issue – 48

An e-newsletter from
Lakshmikumaran & Sridharan, India

Contents

August
2015

Article

Letter and Spirit of the Law

By **Vijaya Sampath**

The universal complaint against lawyers is that they have five different and contradictory interpretations of the same sentence, each fully justified. Some of our laws are centuries old and the language is so archaic that the original intent of the then legislature is obfuscated by time and technology advances. But the same can also be said of an important and recent legislation like the Companies Act 2013. Some of these sections are delightfully vague and at times give even contra indications, this may well open a Pandora's box with un-intended consequences with companies adopting different practices and interpretations on the same subject matter.

The confusion commences from one missing word in the definition in Section 2(52) of a **listed company** meaning a company which has any of its securities listed on any recognized stock exchange", seemingly straightforward at first glance. As is well known, the disclosure, governance and compliance requirements of a 'listed company' are way higher than that of a closely held non listed entity. Even the composition of the Board, requirements for independent directors, manner of holding meetings, voting, etc., are different. The term listed company is used liberally at least 21 times in various sections in the Act setting out mandatory requirements for such companies to fulfil. Many companies list their issue of debt securities on the stock exchanges and until date, none of these companies are regarded as "listed" and hence not subject to the additional requirements of the Act. However, since listing as defined is not confined to equity securities, it is not clear whether all these companies will now fall within the purview of "listed" and hence have to comply with all the sections that were originally meant for publicly listed equity securities.

The definition of a **foreign company** in Section 2(42) presents an interesting dilemma and means any company or body corporate incorporated outside India which

(a) Has a place of business in India whether by themselves or through an agent, physically or through electronic means and

(b) Conducts any business activity in India in any manner.

This brings within its ambit companies that have appointed agents or distributors in India, e-commerce entities whose web site is accessible to Indians, who are now deemed to conduct business in India though they do not have any entity in India and even liaison offices of universities and non profit associations would now be covered. An entire chapter XXII is devoted to compliance requirements by such companies with respect to *inter alia* filing a balance sheet, details of its directors and secretary, naming a person who is authorized to receive a notice, etc., with the Registrar of Companies. Section 379 states that if not less than 50% of the capital (equity and/or preference) of a foreign company is held by

Indian citizens/ bodies corporate or companies incorporated in India, then it would be required to comply with all the provisions of the Act as if it were an Indian company even though it is incorporated overseas and is subject to another jurisdiction and may have very nominal "business activity" in India. Section 393 goes a step further in iterating that a foreign company will not be able to file any legal proceedings or enforce agreements/transactions until it complies with all the requirements set out in Chapter XXII though all contracts signed by it will be valid. This implies that the other party can sue for enforcement of such documents but this right is denied to the 'foreign company'.

Section 68(1) on **buy back of securities** allows companies to purchase its own shares out of (a) free reserves (b) securities premium account or (c) proceeds of the issue of any shares of other specified securities. The proviso states that no buy back can be made out of the proceeds of an earlier issue of the same kind of shares or securities. While clearly permitting amounts in the securities premium account to be used for buy back as per the sub section, the explanation indicates the contrary by prohibiting proceeds from any earlier issue of the same kind of security that had an element of share premium from being used for the buy back.

Further, share premium account may include amounts credited from multiple earlier issues and there is no segregation of the amount received for each issue. Since proceeds of an earlier issue cannot be used, companies have to establish/prove that the share premium used for buy back is not from the proceeds of an earlier 'same kind of security' issue in order to comply with the proviso. Penalty for non compliance is stringent with fines ranging from INR 100,000 to INR 300,000 and every officer in default shall be punishable with imprisonment up to 3 years and an additional fine.

The Act has introduced for the first time in Section 195, prohibition of **Insider trading** of securities. While the SEBI code on insider trading for publicly listed entities has been in force for a long time, this is the first time that even closely held, whether public or private, companies are covered within the ambit of "insider trading". Since there are only a few shareholders in these companies, who at most times will be in possession of 'unpublished price sensitive information' it would be difficult to transfer shares amongst themselves; Shareholder agreements of joint venture companies that have right of first offer clauses will also face a similar problem. Surely, the authorities could not have intended to include this restriction on non listed entities but the absence of the words "listed company" in this section leaves the reader in doubt as to the real intent and meaning of this section. In any case, insiders and connected persons of listed companies have been subject to stringent restrictions on insider trading under SEBI new regulations, hence the presence of this section in the Act, particularly as worded currently only creates confusion.

Section 184 envisages the disclosure of **interest by every director** in companies, bodies corporate etc., as well as in any contract or arrangement whether direct or indirect. The objective is laudable and necessary to ensure that there is no conflict of interest. Towards this end, a director is required to also inform a company of his/her shareholding in any entity. However, sub section 5(b) clarifies that nothing in this section shall be applicable to any contract or arrangement between two companies where a director or two or more of them hold more than 2% in the other company. This in practice means that compliance officers of companies would have to constantly keep a watch on the individual and aggregate shareholding of all the directors to ensure that compliance when it crosses 2%. Failure by one director to disclose his/her shareholding may unwittingly make another compliant director liable to fine up to INR 100,000 and/or even imprisonment up to one year. It is only reasonable to make directors individually liable, principle of collective responsibility is clearly wrong in this case. Further, for directors who are active participants in the equity market, are now obliged to inform companies of their daily/weekly trading activity.

Section 135 (1) has introduced the new concept of the formation of a **CSR committee** of three or more directors by every company that fulfils any of the following criteria

(1) a net worth of INR five hundred rupees or more or

(2) net profit of INR 5 crores or more or

(3) turnover of INR 1000 crores or more

This section has been dissected and subject to numerous debates on each of its provisions. CSR rules excludes dividend received from other companies in India or any profit arising from an overseas branch from the definition of net profit. However, companies that have only dividend income and those that have a turnover of INR 1000 crores without any profit have to constitute a committee, hold meetings and also have a CSR policy even though they will not have to spend on CSR, making the entire exercise futile and meaningless. Additionally, no set off or adjustment is permitted in the next year if a company spend more or less in a year. Since it is almost impossible to spend the exact amount as required under the Act, every annual report will have an explanation for spending more or less than required unless the exact amount is contributed to the Prime Ministers Relief Fund for which even a tax deduction is permissible under income tax and may actually be more beneficial for companies from the tax and monitoring perspective.

There are other sections of the Act with similar issues of what may be described as 'form over substance' but that is for another time. The government has issued a number of notifications and clarifications post implementation of the Act and even an amendment Act has been notified. The Ministry of Corporate Affairs has sought comments from the public on further amendments to be made and it is hoped that a comprehensive review will address all these issues and truly make the Act in line with its objective of ease of doing business.

[The author is a Senior Partner and Country Head, Corporate Practice, Lakshmikumaran & Sridharan]

Notifications & Circulars

FPI Investment in security receipts of Asset Reconstruction Companies (ARC): The Reserve Bank of India has issued A.P. (DIR Series) Circular No. 6, dated 16-7-2015 to clarify on the applicability of Schedule 5 to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 to investment by Foreign portfolio investors (FPI's) in security receipts issued by the Asset Reconstruction Companies. The Circular clarifies that the restriction on investments with less than three years residual maturity shall not be applicable to investments by FPI's in such security receipts. However, such investments shall be within the overall limit prescribed for corporate debt by the Reserve Bank of India from time to time.

FDI policy - Introduction of composite caps: The Government of India has reviewed the FDI Policy Circular of 2015 (FDI policy) and has issued Press Note No. 8, (2015 Series) dated 30-7-2015 to introduce composite caps across the sectors in the FDI policy. The Government of India by this Press Note has *inter alia* clarified that foreign investment shall include all types of investments including FDI, FII, FPI, NRI, FVCI, QFI's, DR's or LLP'S regardless of the investment being direct or indirect. However, foreign currency convertible bonds and depository receipts having underlying of investments issued under Schedule 5 to the FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2000 being in the nature of debt shall not be treated as foreign investment. Portfolio investments upto 49% or sectoral cap whichever is lower, shall not be subject to government approval or compliance of sectoral conditions if the investment does not result in ownership and/or control to non resident entities.

SEBI modifies format of disclosures: The Securities and Exchange Board of India has issued Circular dated 5-8-2015 modifying the format for disclosures required to be made under Regulation 31(1) and 31(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The regulation requires promoters of the target company to disclose details of invocation of any encumbrance made by him or by persons acting in concert with the promoters or release of such encumbrance of shares, in the prescribed format.

Food Safety and Standards – Extension of timeline for obtaining licence/ registration: The Food Safety and Standards Authority of India has by Order dated 6-8-2015 extended the timeline for obtaining license/ registration, by the food business operators, in terms of Regulation 2.1.2 of the Food Safety and Standards (Licensing and Registration of Food Business) for a further period of 6 months i.e. up to 4-2-2016. The Order was issued on directions from the Central Government in terms of Section 85 of the Food Safety and Standards Act, 2006.

Ratio Decidendi

Sub-contracts – Person liable to pay: In a dispute involving payment of some amount by the contractor of a contract to the sub-contractor, the Supreme Court of India has held that simply because some payments were made by the contractee (who gave the works contract to the main contractor) to the appellant-subcontractor directly, so as to facilitate the contractor, no privity of contract is established between the contractee and the sub-contractor. Consequently, the contractee cannot be saddled with a liability to pay the amount payable to the sub-contractor by the contractor.

The court also observed that the arbitration agreement was only between the sub-contractor and the main contractor while the contractee was not a party to it. The court upheld the majority view of the Arbitral Tribunal that the contractee was not liable inasmuch as they were not party to the contract or the arbitration agreement. Absence of any correspondence establishing contractual relationship between the contractee and the sub-contractor, was also relied on to overrule the High Court Order which had observed presence of a tripartite agreement between the parties. [*Essar Oil Ltd. v. Hindustan Shipyard Ltd.* - Civil Appeal Nos. 3353 and 3355/2005, decided on 2-7-2015, Supreme Court]

Arbitration - Interest when contract provides for non-payment of same: The Supreme Court of India has held that the contractor cannot claim interest either before a Civil Court or before an Arbitral Tribunal when the agreement between the parties barred payment of interest on the amount payable to the contractor under the contract. It was held that when parties to the contract had agreed to non-payment of interest on the amount payable to the contractor, they were bound by their understanding. The court in this regard also noted that Section 31(7) of the Arbitration and Conciliation Act, 1996, by using the words "unless otherwise agreed by the parties", categorically specifies that the arbitrator is bound by the terms of the contract so far as award of interest is concerned, and hence gives more respect to the agreement entered into between the parties. Decision in the case of *Secretary, Irrigation Department, Government of Orissa* v. *G.C. Roy* [(1992) 1 SCC 508] was distinguished by the Court observing that the same pertained to the period when the earlier Arbitration Act, 1940 was in force. [*Union of India* v. *Bright Power Projects (I) P. Ltd.* - Civil Appeal No. 2404/2008, decided on 2-7-2015, Supreme Court]

Tenure of Managing Director does not cease automatically upon turning 70: The Bombay High Court has held that the tenure of a Managing Director of a public company does not cease automatically by operation of law the moment he turns 70 years of age. Section 196(3)(a) of Companies Act, 2013 provides that no company shall appoint or 'continue' the employment of any person as managing director, whole-time director or manager who is below the age of twenty-one years or has attained the age of seventy years. However, the appointment of a person who has attained the age of seventy years may be made by passing a special resolution in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

The Court in this regard held that Section 196(3) does not operate to interrupt the appointment of any Director made prior to the coming into force of the Companies Act, 2013, even in a case where the Managing Director crosses the age of 70 years during the term of his appointment. It was held that the provision also does not interrupt the appointment of a Managing Director appointed after April 1, 2014 where at the date of such appointment or re-appointment the Managing Director was below the age of 70 years but crossed that age during his tenure, and that there is no mid-tenure cessation of Managing Directorship as a result of Section 196(3)(a). It was observed that all that Section 196(3)(a) does is to sound a note of caution in the public interest and to demand from the company a special resolution when a person who has already crossed the age of 70 at the date is proposed to be appointed or re-appointed as Managing Director. [*Sridhar Sundararajan* v. *Ultramarine & Pigments Limited* - Notice of Motion (L) No. 434 of 2015 in Suit (L) No. 146 of 2015, decided on 16-7-2015, Bombay High Court]

Arbitration - Additional District Judge whether has jurisdiction to decide an application under Section 9 of Arbitration and Conciliation Act, 1996? Calcutta High Court has referred to the Larger Bench the issue as to whether the Additional District Judge has jurisdiction to decide an application under Section 9 of the Arbitration and Conciliation Act, 1996. The Court in this regard differed with the judgement of a Bench of co-ordinate strength in the case of *National Highway Authority of India* v. *B. Seenaiah & Company (Projects) Ltd.* The Court found it difficult to agree that the Court of the Additional District Judge is not a Court within the meaning of Section 2(1)(*e*) of the 1996 Act. It was observed that Article 233 read with Article 236 of the Constitution makes it clear that the Court of the Additional District Judge is not inferior to the Court of the District Judge in any manner. [*Development Corporation Ltd*. v. *Impression* - F.M.A. 1966 of 2015 with C.A.N. 3697 of 2015, decided on 1-7-2015, Calcutta High Court]

NEW DELHI
5 Link Road,
Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014

B-6/10, Safdarjung Enclave
New Delhi - 110 029
Phone : +91-11-4129 9811
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park,
Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025.
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden,
2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Ph: +91(80) 49331800
Fax:+91(80) 49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church, Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail : lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune – 411 001. Maharashtra
Phone : +91-20-6680 1900
E-mail : lspune@lakshmisri.com

KOLKATA
2nd Floor, Kanak Building
41, Chowringhee Road, Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59, Sector 26,
Chandigarh - 160026
Phone : +91-172-4921700
E-mail : lschd@lakshmisri.com

GURGAON
OS2 & OS3, 5th floor,
Corporate Office Tower,
AMBIENCE Island, Sector 25-A,
Gurgaon- 122001
Phone: +91- 0124 – 477 1300
Email: lsgurgaon@lakshmisri.com

EUROPE
Lakshmikumaran & Sridharan SARL
35-37, Avenue Giuseppe Motta, 1202 Geneva
Phone : +41-22-919-04-30
Fax: +41-22-919-04-31
E-mail : lsgeneva@lakshmisri.com

www.lakshmisri.com www.addb.lakshmisri.com www.lakshmisri.cn www.lakshmisri.ch