PRIVATE COMPANIES CAN NOW BREATHE EASIER IN INDIA

Introduction

On June 5, 2015, the Ministry of Corporate Affairs, Government of India (the "**MCA**") issued a notification (the "**Notification**"), which significantly reduces the compliance requirements for private companies under the Companies Act, 2013 (the "**Act**").

With these changes, corporate governance of private companies will become easier. This update discusses the key changes.

Key exemptions provided to private companies

- Issue of share capital: Section 43 of the Act specifies that companies can issue only equity shares with or without differential voting rights or preference shares having voting rights only in respect of dividend and liquidation preference. As such, this limited the rights that could be given to preference shareholders. This issue has been rectified. Now, a private company can make inapplicable Sections 43 and 47 of the Act by so providing in its memorandum or articles of association, and thereby, freely issue preference shares with additional voting rights. Venture capital and private equity funds stand to benefit significantly from this amendment.

- Related party transactions: Section 188 of the Act, which applies to all companies, requires the approval of a company's board of directors ("**Board**") and its shareholders before the company can enter into a related party transaction. Now, in case of a private company, any holding company, subsidiary company or associate company, or a subsidiary of a holding company to which such private company is also a subsidiary, will not be considered as a "related party" of such private company. This change will alleviate the difficulties in complying with the related party provisions of the Act in a private company parent-subsidiary transaction scenario. However, as "common shareholders" and "common directors" continue to be considered as "related parties" under the Act, parents and subsidiaries of private companies having common directors or shareholders may not be able to derive much benefit from this exception.

Further, the requirement that a shareholder who is a related party cannot vote on a resolution to approve any related party transaction is now inapplicable to private companies. This exception reinforces the rule of the majority.

- Further issue of share capital: As per the Act, an offer for a rights issue should remain open for at least fifteen (15) days. Further, the notice of a rights issue should be dispatched at least three (3) days before the opening of the rights issue. These requirements will now not apply to a private company in case 90% of its shareholders have given their consent that periods lesser than those prescribed under the foregoing provisions shall apply. With this exception, private companies will be able to raise money from their members within a shorter time period.

Also, for issue of shares under an employee stock option plan ("**ESOP**") by a private company, approval by a simple majority (50% + 1) of the shareholders will be required and not approval of three-fourths

(75%) majority of the shareholders. This exemption reduces the approval threshold for issue of shares consequent to an ESOP.

- Acceptance of deposits: Sections 73(2)(a) to (e) of the Act specify the conditions to be complied with by a company accepting deposits from its members, such as issuance of a circular containing, *inter alia*, the financial position of the company, credit rating of the company and creation of the deposit repayment reserve account. These conditions will be inapplicable to private companies. This exception eases the procedural requirements for acceptance of deposits by a private company (which can only accept deposits from its members).

- General meetings: Sections 101 to 107 and Section 109 of the Act deal with the procedural requirements to be complied with by a company for conducting general meetings (i.e., the notice and explanatory statement of the general meeting, the quorum of the general meeting and how to demand a poll). These provisions will be inapplicable to a private company if the articles of association expressly override such provisions. This exception reduces the extensive compliance requirements in respect of general meetings for private companies.

- Filing of Board resolutions: Private companies are now exempt from having to file resolutions of the Board with the Registrar of Companies. This exception ensures that matters discussed in Board meetings which may be of a confidential nature from a business perspective are not available to the public.

- Appointment of directors at general meetings: Section 162 of the Act requires that a single resolution should be passed for appointment of each director at a general meeting. This requirement is now inapplicable to private companies, and therefore, a composite resolution can be passed if more than one (1) director is proposed to be appointed at a general meeting.

- Restrictions on powers of the Board: Matters relating to sale, lease or disposition of the whole or substantially the whole of the undertaking of a company, investments of a company (other than in trust securities), borrowing amounts which together with existing loans (if any) exceed the aggregate of the paid-up share capital and free reserves of a company, and remitting or giving time for repayment of a debt due to a director can now be taken up and approved by the Board of a private company. Previously, the prior approval of three-fourths (75%) majority of the shareholders was required by all companies to approve the foregoing matters. While this reduces compliance requirements for private companies, shareholders of private companies and joint venture partners should ensure that they have adequate representation on the Board as these significant powers are now under the ambit of the Board.

- Participation of interested directors: Interested directors can now participate in Board meetings after disclosure of their interest at the Board meeting. In a majority of private companies, as the shareholders or representatives of shareholders act as directors of the company there are very few instances where a director is not interested in a particular matter. Therefore, private companies were hamstrung and could not pass the necessary resolutions. This exemption will streamline the functioning of private companies.

- Restrictions on giving of loans to directors: The restrictions on giving loans to directors and to persons in whom the director is interested, or issuing guarantees or giving security for any loan availed by directors and to persons in whom the director is interested will not be applicable to a private company:

- if no shareholder of such company is a body corporate;

- if borrowings of such company from banks, financial institutions or any body corporate are less than twice its paid-up share capital or INR500,000,000 (approx. US$7,849,294) (whichever is lower); and

- the company is not in default in repayment of borrowings subsisting at the time of making such transactions.

- Provisions relating to managing director, whole-time directors and manager: Section 196(4) of the Act provides that a managing director, whole-time director and a manager may be appointed in compliance with Section 197 (overall managerial remuneration (applicable only to public companies)) and Schedule V of the Act, and the appointment will have to be approved by the board and ratified at the next general meeting. Section 196(5) of the Act provides that if the shareholders do not ratify the appointment, then any act done before such meeting will not become invalid. These sub-sections will not be applicable to private companies. It is pertinent to note that consequent to the foregoing exception, the requirements specified under Schedule V of the Act (such as the managing director, whole-time director and a manager should be a resident of India, age limits, etc.) do not have to be complied with by private companies. This will serve as a big relief to foreign companies who establish private subsidiaries in India.

Conclusion

Many exemptions provided by the Notification reinstate the provisions applicable to private companies under the Companies Act, 1956, and the Notification definitely provides a compliance breather to private companies.

The draft notification which was placed in Parliament in July 2014 gave a complete exemption from compliance with the requirement of Board and shareholder approval for related party transactions by private companies having less than fifty (50) shareholders and from the requirement that a whole-time key managerial personnel can hold office in only one (1) company. However, in the Notification, these exemptions have not been included. We hope that the Company Law Committee constituted by the Indian government will suggest further amendments.