A CRITIQUE OF THE COMPANIES (AMENDMENT) ACT, 2018

India's Companies Act, 2013

Over the last five (5) years, India has adopted a new company law regime under the Companies Act, 2013 (the "**Act**") and the rules thereunder. Since its implementation, the Act has been amended once in 2015, and various clarifications and amendments have been issued to the rules by the Indian government. However, many concerns relating to implementation of the Act remained unaddressed.

On January 3, 2018, in response to feedback from stakeholders and suggestions from the Companies Law Committee (constituted in 2015) and the Standing Committee on Finance, the Indian government amended the Act by way of the Companies (Amendment) Act, 2018 (the "**Amendment Act**"). It must be noted that these amendments have not as yet been made effective, and the Indian government shall most likely also make consequential changes to the rules under the Act (as the rules have to be read in consonance with the Act).

Key amendments to the Act

Share Issuance and Shareholding Matters

- Private placement of securities: Currently, the Act and the rules prescribe cumbersome procedural formalities for private placement of securities. The Amendment Act has eased some of these formalities. It has done away with the requirement to maintain a record of all persons to whom an offer to subscribe securities is made and filing these records with the Registrar of Companies. It also permits a company to keep more than one (1) offer for subscription open simultaneously. One major request of many companies was to whittle down the private placement offer letter format, which required companies to include a host of details, many of which were available in the company's public financial statements. Although the Amendment Act has not made any changes to the offer letter format, the Indian government may do so in the new rules once released.

- Issue of shares at a discount: The Amendment Act permits companies to issue shares at a discount to creditors in case of conversion of debt into shares pursuant to a resolution plan, debt restructuring scheme, or any other guidelines or directions of the Reserve Bank of India. This change is in furtherance of the Strategic Debt Restructuring scheme of the Reserve Bank of India, which permits banks to convert loans into shares.

- Sweat equity shares: The Amendment Act permits companies to issue sweat equity shares at any time after incorporation. Until now, companies could issue sweat equity shares only after completing one (1) year from the date of commencement of business. This change will benefit start-ups as they will be able to issue sweat equity shares immediately after incorporation.

- Subsidiary company: In assessing whether a company is a subsidiary of another, the Amendment Act has excluded preference share capital from being taken into account in assessing the total share capital of a subsidiary company. Generally speaking, holders of preference shares do not have any voting rights (other than on dividend and winding-up matters) and cannot be considered to have

"control" over the company. Therefore, it is only logical that a company should not be considered as a subsidiary of another on the basis of preference share capital held by the latter.

- Beneficial interest in shares: The Amendment Act defines "beneficial interest in shares" to mean the right to exercise any or all rights attached to shares or the right to receive or participate in any dividend or other distribution in respect of shares, whether by contract, arrangement or otherwise, directly or indirectly. Further, the Amendment Act has introduced the concept of "significant beneficial owner," i.e., any individual (acting alone or together or through one (1) or more persons or trust, including a trust and persons resident outside India) holding beneficial interests in shares of not less than 25% or the right to exercise or the actual exercise of significant influence or control over the company ("**SBO**"). Now, SBOs will have to make declarations of their ownership to the company. Further, the company will have to maintain a register of SBOs and file returns with the Registrar of Companies in respect of the SBOs. Furthermore, companies will now have the obligation to report SBOs to the National Company Law Tribunal ("**NCLT**") if any SBOs fail to make a notification to the company of their beneficial ownership in the company, and the NCLT will have the power to restrict the rights attached to such shares. While Indian company law has always had requirements for declaration of beneficial ownership, practically, companies and shareholders were not complying with these requirements. Given that the Amendment Act prescribes stringent penalties for SBOs and companies for failure to comply with the new requirements, companies and shareholders will have to commence complying with these provisions at the earliest. This may also have an impact on trustee or nominee arrangements between foreign investors and Indian trustees/nominees in sectors where foreign investment is not permitted up to 100%, but investment banks or other advisors hold some of the shares in *de facto* trust for the foreign investor.

Debentures and Deposits

- Debentures: The Act defined a "debenture" as a debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. This all-encompassing definition brought under its purview money market instruments and commercial papers. The Amendment Act exempts money market instruments covered under the Reserve Bank of India Act, 1934, including commercial papers, deposits and other debt instruments of original or initial maturity of up to one (1) year from the purview of "debentures." This will reduce the compliance requirements for companies raising short-term funds using money market instruments.

- Deposit repayment reserve: The Amendment Act reduces the requirement of maintaining a deposit repayment reserve of 15% of the total amount of deposits maturing in the current financial year and the next financial year to 20% of the total amount of deposits maturing in the current financial year. This may significantly reduce the cost of borrowing for companies which accept deposits.

- Deposit insurance: The Amendment Act removes the requirement of having to obtain insurance coverage on the deposits of the company (which was relaxed until March 31, 2016 by way of a notification, but reinstated thereafter). As Indian insurance companies presently do not offer deposit insurance, it was practically impossible for companies to comply with this requirement. Therefore, this relaxation will make things much simpler for companies.

Procedural and Reporting Matters

- Incorporation of companies: Under the Amendment Act, the name approved by the Registrar of Companies at the time of incorporating a new company is valid only for twenty (20) days from the previously prescribed sixty (60) day period. Further, the Amendment Act also removes the requirement of directors and subscribers to the charter documents from providing notarized affidavits in the prescribed format. Only self-declarations from directors and subscribers will now be necessary. Furthermore, the Amendment Act permits new companies to notify their registered office address within thirty (30) days as opposed to fifteen (15) days earlier. However, as the Amendment Act does not remove the requirement of apostilling charter documents, foreign parties seeking to incorporate companies will need to ensure that they are able to keep the incorporation documents ready within the reduced time period. This may be difficult for foreign parties in jurisdictions where having documents apostilled entails significant time.

- Authentication of documents: The Amendment Act permits employees authorized by the board of directors of the company (the "**Board**") to execute or authenticate documents for and on behalf of the company. This will ease practical difficulties encountered in getting documents signed on behalf of the company, as only officers (i.e., the top level management) were previously permitted to authenticate documents under the Act.

- Place of holding general meetings: The Amendment Act permits unlisted companies to hold annual general meetings at any place in India subject to receiving consent of all shareholders. Further, the Amendment Act permits wholly-owned subsidiaries of a company incorporated outside India to hold extraordinary general meetings outside India. These relaxations give flexibility to foreign-owned companies and closely held companies to convene general meetings.

- Board's report: The Amendment Act has whittled down the list of disclosure requirements in the Board's report and has clarified that any disclosures made in the financial statements may simply be referred to in the Board's report without having to be repeated. Also, the extract of the annual return is not required to be annexed to the Board's report as long as it is placed on the website of the company. The Amendment Act also introduces an abridged form of the Board's report for one person companies and small companies. The Act required a host of disclosures to be made in the Board's report, which made the process time and cost intensive, and therefore, the proposed changes are welcome.

- Change in promoters or top ten (10) shareholders: The Act requires listed companies to report any change in the shareholding of its promoters or top ten (10) shareholders. The Amendment Act has omitted this requirement as these reporting requirements are covered under the regulations of the Securities and Exchange Board of India and stock exchanges.

- Accounts: The requirement of uploading audited accounts in respect of each subsidiary on the website of the holding company will now be applicable only to listed companies. Unlisted companies will only be required to provide copies of such accounts at the request of a shareholder. Further, if a foreign subsidiary of an Indian company is not required to get its accounts audited as per the laws of the host country, then the unaudited accounts in English can be placed on the website. These

changes are a big relief for Indian companies having many overseas subsidiaries. However, consolidated financial statements will now need to include associate companies' accounts also.

- Ratification of auditors: The requirement of ratifying the appointment of statutory auditors at every annual general meeting will be done away with. Therefore, auditors will be appointed for terms of five (5) years. While this change reduces the procedural requirement of ratification of appointment of auditors each year, the Amendment Act does not address concerns raised by audit firms on being appointed for a term of five (5) years.

Directors

- Requirement of a resident director: The Act requires every company to appoint a director who has stayed in India for at least 182 days in the previous calendar year. The Amendment Act provides that companies will be required to appoint a director who stays in India for at least 182 days in the financial year in which he is a director. Further, this criterion will apply only proportionately to a new company at the end of the financial year in which it is incorporated. Therefore, companies will be required to ascertain a director's residential status during the financial year.

- Maximum directorships: Under the Act, an individual can hold office as a director of twenty (20) companies. Now, the Amendment Act provides that dormant companies will not be included to assess the limit of twenty (20) companies.

- Notice of resignation by directors: The Act imposes a mandatory requirement for directors to file a separate notice of resignation with the Registrar of Companies, in addition to the filing made by the company. The Amendment Act makes this requirement optional. This requirement was imposed by the Act in order to prevent misuse of the director's name post-resignation by providing a double check on the resignation. Practically though, many directors were not informed of this requirement by the company and were not able to comply with this requirement.

- Participation via video-conference in board meetings: While the Act permits board meetings to be held by way of a video-conference, certain matters, such as approval of financial statements and approval of mergers or amalgamations, cannot be taken up through video-conference. The Amendment Act provides that for such matters, if the directors physically present at a meeting venue form a valid quorum, other directors can participate by way of video-conference. However, it is unclear whether the directors participating by way of video-conference call also vote on these matters, which should be clarified.

- Loans to subsidiaries with common directors: The Act imposed a complete embargo on extending loans to subsidiaries in which directors were interested or where the parent and subsidiary had common directors. A limited exemption from this prohibition was given to private companies last year. The Amendment Act permits companies to extend loans to other companies in which directors are interested subject to: (i) obtaining a special resolution at a general meeting; and (ii) fulfilling the condition that the loan will be utilized by the company for its principal business activity. This change will reduce the difficulties faced in genuine loan transactions.

Managerial Remuneration

- Limits on managerial remuneration: As per the Amendment Act, approval of the Indian government will no longer be required in case the limits on managerial remuneration are exceeded. Any excess managerial remuneration can be approved by passing a special resolution at a general meeting. This change is logical as deciding the remuneration is a company's prerogative, and the shareholders should be the sole deciding authority in this regard.

Condonation of Delay Scheme, 2018

In September 2017, the Indian government released a list of companies that were not conducting any business and had defaulted in complying with annual audit and filing requirements, along with a list of their directors, who were disqualified from holding directorships of any company with their respective director identification numbers being disabled.

On December 29, 2017, the Indian government notified the Condonation of Delay Scheme, 2018 (the "**Scheme**") which:

- permits defaulting companies to file financial statements and annual returns for the preceding three (3) financial years along with the late filing fee; and

- apply for condonation of delay in filing the above documents by paying a fee of INR30,000 (Indian Rupees Thirty Thousand).

Further, to enable the defaulting companies to make the above filings, the director identification numbers of the disqualified directors will be enabled. If a defaulting company complies under this Scheme, their directors' disqualification will be retracted, i.e., the directors will be eligible to act as directors of Indian companies, and no further penalty or action for default in filing financial statements and annual returns will be imposed. This Scheme will be valid until March 31, 2018.

Although the decision to disqualify directors was backed and enabled under the provisions of the Act, this move was highly criticized by stakeholders as no prior notice was given to the defaulting companies or their directors. In addition, without having any valid directors, the defaulting companies were not able to rectify the defaults in filing of the financial statements and annual returns, as directors are required to sign these documents. In the circumstances, the Scheme will be extremely beneficial for defaulting companies and their directors, who will now be able to rectify these defaults with minimal penalty and time costs.