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Critical Analysis of important recommendations by CLC to revamp Company Law

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The Company Law Committee ('CLC') presented it's report in March 2022 and made recommendations on changes aimed at facilitating and promoting greater ease of doing business in India and effective implementation of the provisions of the Companies Act, 2013 ('Act'). CLC has recommended various amendments to the Act to recognise new concepts, expedite corporate processes, improve compliance requirements and remove ambiguities from the existing provisions of the Act. CLC has made some important recommendations like, introduction of Restricted Stock Units (RSUs) and Stock Appreciation Rights (SARs), capital raising for distressed companies, holding general meetings through the use of technology, maintaining statutory registers through electronic platform, revising provisions on disqualification and vacation of director's office, clarifying the manner of resignation of certain KMPs, easing restoration of de-registered companies, *etc.*

This article critically analyses few recommendations made by CLC and also analyses it's impact, if the same are accepted and then part of the Companies Amendment Bill.

Revamped concept of 'Wholly-Owned Subsidiary Company' included under 'drafting & clarificatory changes': CLC suggested that in case of wholly-owned subsidiary company ('WOS', whether public or private), the holding company (whether public or private) should be allowed to be the only member. CLC observed that this should also be permitted in case of a WOS in which the entire shareholding is held by holding company along with one or more of its WOSs. Ironically, such important recommendation falls under 'drafting and clarificatory changes'. However, there should also be clarity on the status of such WOS companies *i.e.* private company subsidiary of public company and compliances thereafter. Presently, there are many companies in India who have this challenge about identifying compliances under Companies Act. It is also important that the provisions are included for holding company incorporated in India and outside India. Probably, it would be necessary to review the definition of public company (section 2(71) of the Act). The proviso to section 2(71) of the Act states that "*Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles*". The Rules under Companies Act and FEMA also need to provide the manner in which existing WOS company would be WOS (with 1 member). Probably, WOS would be another class of company with different set of compliances.

Unwarranted clarification on buy-back of securities : Section 68(1) of the Act lays down general power of a company to carry out buy-back and section 68(2)(c) stipulates certain conditions on the total

amount of buy back of shares or securities. It mandates that the buy-backs by a company, in a given FY, cannot exceed 25% of the aggregate of paid-up capital and free reserves of the company. However, the proviso to section 68(2)(c) of the Act, which clarifies the manner in which such 25% shall be construed in respect of buy-back of equity shares, omits a reference to 'free reserves' to calculate 25% limit. CLC was of the opinion that 'free reserves' are to be included in the calculation of buy-back of equity shares, even if the term has not been specifically included in the proviso.

In my view, such calculation is quite obvious and there is no interpretation issue in the same. The larger issue that is unaddressed by CLC is - whether section 68 of Companies Act, 2013 provides for maximum limit of buy-back of equity shares in a financial year similar to section 77A of the Companies Act, 1956? The buy-back limits under Companies Act, 1956 shall be reintroduced in Companies Act, 2013. Presently, this issue is not addressed in CLC Report.

Trust - whether to include or not in the register of members? According to section 153 of erstwhile Companies Act, 1956 - the register of members or debenture holders shall not contain notice of any trust expressly, impliedly or constructively. The rationale of such provision was to relieve the company from taking notice of third-party rights regarding the shares registered in the names of any members. However, the Companies Act, 2013 is completely silent of such provision. Therefore, the trusts were included in the register of members after 2014 till date. Now, CLC suggests to include a provision similar to section 153 of the Companies Act, 1956. CLC has not addressed the issue of the compliance done by companies from 2014 to 2022 i.e. by including the name of trusts in the register of members. If the amendment is passed by the Parliament, then whether the companies are required to make changes retrospectively in the register of members? Whether such change would amount to rectification of register of members? Also, if the trust name is not included in the register of members, the provisions should provide for some disclosure and other compliances under the Companies Act.

Sending documents to shareholders of company on shorter notice: Section 136 of Companies Act provides a company's members with the right to get copies of audited financial statements for all general meetings. While the proviso to section 136(1) provides that such copies may be sent to members in a shorter time, it does not distinguish between AGMs and other general meetings. CLC received suggestions to amend the first proviso to Section 136(1) to allow sending of copies of relevant documents at a shorter notice, both in case of AGM and other general meetings. However, it would be completely irrelevant to amend section 136(1) of the Act for sending documents of the extra-ordinary general meeting on shorter notice. As section 136 of the Act deals with 'right of member to copies of audited financial statement' and the proposed amendment relates to documents of EGM. It is necessary to amend section 100 of the Act that relates to 'calling of extra-ordinary general meeting'. If such amendment is introduced under section 136 of the Act, then in future the Companies Act would again be amended under the head 'drafting and clarificatory changes'. Interesting to note that the extant CLC has recommended this amendment under the head 'drafting and clarificatory changes' itself !

Penalty u/s. 188 of the Act shall be included as a ground for disqualification: Under the extant provisions, section 164 of the Act provides for the disqualification for the appointment of directors. Section 164(1)(g) disqualifies a director who has been convicted of an offence dealing with related party transactions under section 188 at any time during the last preceding five years. As section 188 of the Act has decriminalised by Companies (Amendment) Act, 2020, the question of conviction does not arise. Therefore, CLC has recommended inclusion of such penalties attracted u/s. 188 of the Act also as a ground for disqualification under Section 164(1)(g) of the Act. It is important to note that CLC has made this significant recommendation under the head 'drafting and clarificatory changes'. Therefore, an imposition of penalty of Rs. 20,000/- (example) by Adjudicating Authority would amount to disqualification under section 164 of the Act. However, there is no provision / suggestion, where such penalty order has been appealed. If CLC's suggestion would be part of Amendment Bill and then law, then the cost of decriminalising non-compliance of related party transaction has ultimately resulted in disqualification of a director.

'Lesser' penalties for OPC, small companies, start-ups & producer companies: Under the extant provisions of the Act, section 446B provides for lesser penalties for OPC, small companies, start-up and producer companies. In such cases, as per the current provision, the penalty *shall not be more than one-half of the penalty* provided for other companies. CLC felt that there is a need to remove the extant discretion of the adjudicating authority and stipulate that penalty shall be equal to precisely one-half of that provided for other companies. Let's understand this with an example :

Section 92(5) of the Act provides that: *If any company fails to file its annual return under sub-section (4), before the expiry of the period specified therein, such company and its every officer who is in default shall be liable to a penalty of Rs. 10,000/- and in case of continuing failure, with a further penalty of Rs. 100/- for each day after the first during which such failure continues, subject to a maximum of Rs. 2,00,000/- in case of a company and Rs. 50,000/- in case of an officer who is in default.*

Considering small company with 2 directors, in case of non-compliance, the penal provisions (maximum) would be: (i) Company Rs. 2,00,000/- and directors Rs. 1,00,000/-.

Penalty u/s. 446B for the said small company with 2 directors would be **maximum up to (and not more that)**: (i) Company Rs. 1,00,000/- and Director Rs. 50,000/-. Depending upon facts of the case, reasons for delay and factors considered by Adjudicating Officer at the time of imposing penalty, such amount of penalty (as mentioned above) would be maximum or less than that.

If CLC's recommendation is accepted, then the penalty of 50% would remain irrespective of facts of the case, reasons for delay and factors considered by Adjudicating Officer at the time of imposing penalty. Inspite of the fact that the suggestion is significant for MSME sector, such recommendation is under the head of 'drafting and clarificatory changes'.

Certain non-audit services can be rendered by statutory auditor: Pursuant to extant provisions of section 144 of the Act, the statutory auditor of a company (private or public) is prohibited from rendering certain services, which includes services relating to accounting, bookkeeping, actuarial services, etc. After detailed deliberations, CLC was of the opinion that different classes of companies may be permitted to avail different non-audit services from their auditors. Thus, CLC recommended that section 144 of Act may be amended to enable Central Government to prescribe a differential list of prohibitions on availing non-audit services or total prohibition of the same for such class or classes of companies where public interest is inherent, as may be prescribed. If such recommendation is accepted then, the entire of purpose of auditor's independence is lost. The purpose of introducing section 144 of the Act was to ensure that auditor is completely independent and does not have any other pecuniary interest. Through the concept of 'companies with or without public interest' or 'different services to different classes of companies', the auditor's independence is largely affected. In the interest of auditors and the companies, this suggestion should not be part of the Companies Amendment Bill.

Safeguarding rights of 'nominee directors': According to the provisions of the Act, a nominee director may be considered as non-executive and non-independent director. The nominee director is required to represent the interests of the appointing financial institution and may not be actively involved in day-to-day affairs or decisions of the company. CLC has recommended that a new proviso be inserted in section 164(2) of Act to the effect that disqualification as referred to in clause (*b*) (*i.e.* failure to repay deposits/debentures, interest on deposits/debentures or dividend) shall not apply to nominee directors appointed pursuant to nomination by the debenture trustees registered with SEBI. This suggestion is in interest of all nominee directors and not just nominee directors appointed pursuant to nomination by the debenture trustees registered with SEBI. CLC's recommendation shall protect all nominee directors, as the purpose of appointing nominee director is the same for all financial institutions. Interestingly - only the heading of CLC's recommendation states 'Safeguarding rights of nominee directors' but not the content.

Easing restoration of struck off companies: Under the extant provisions, the Registrar of Companies is empowered to remove name of a company from the register of companies after due compliance with the

procedure laid down in the Act and Companies (Removal of Names of Companies from the Register of Companies) Rules, 2016. The NCLT may order restoration of the company's name upon satisfaction that the name was struck off without any justified cause or in the absence of a valid ground. CLC noted that the NCLT hears matters both under the Act and IBC and is reported to be overburdened. CLC recommended that in cases where aggrieved persons applies for restoration within 3 years under section 252(1) of the Act, the application should be filed before Regional Director ('RD'), and the RD may pass an order of restoration of name upon satisfaction. Where the application is filed after 3 years but before the expiry of 20 years, the power of restoration should continue to rest with NCLT so that it can exercise adequate discretion and scrutiny before the name of the company is restored in the register of companies. By this recommendation, the same powers under the Act will be exercised by executive officers (for 3 years) and then quasi-judicial authority (for balance 17 years). This probably would be first suggestion where two different authorities have same powers under different time of its application. Interesting to note that in the earlier recommendation by CLC (on the same page!) there is a proposal to have special benches at NCLT. So, if NCLT's burden would be balanced then such powers can continue with NCLT. However, the success of special benches of NCLT depends largely on the prompt recruitment of NCLT members by the Central Government.

Conclusion : As mentioned earlier, there are some progressive changes suggested by the CLC. It is interesting to note that quite a few provisions of Companies Act, 1956 are now being re-introduced in Companies Act, 2013. However, there is no suggestion by the CLC to amend section 184 of the Companies Act, 2013 and re-align it with section 299 of the Companies Act, 1956, as the later was well-drafted and had very less ambiguity. Inpsite of several rounds of amendments to Rules under the provisions of Significant Beneficial Owners (SBO), there are many issues in interpretation and compliance. The CLC has not recommended any change with respect to SBO. On June 5, 2015, the Government had issued a notification and granted certain exemptions to private companies, section 8 companies, etc. Certain provisions w.r.t. exemptions have been further amended / replaced by subsequent Companies (Amendment) Acts. However, the notification dated June 5, 2015 has not been reviewed till date. The CLC has not recommended any changes in this regard. In order to introduce 'ease of doing compliance' along with 'ease of doing business', the CLC should consider the above suggestions as well.

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