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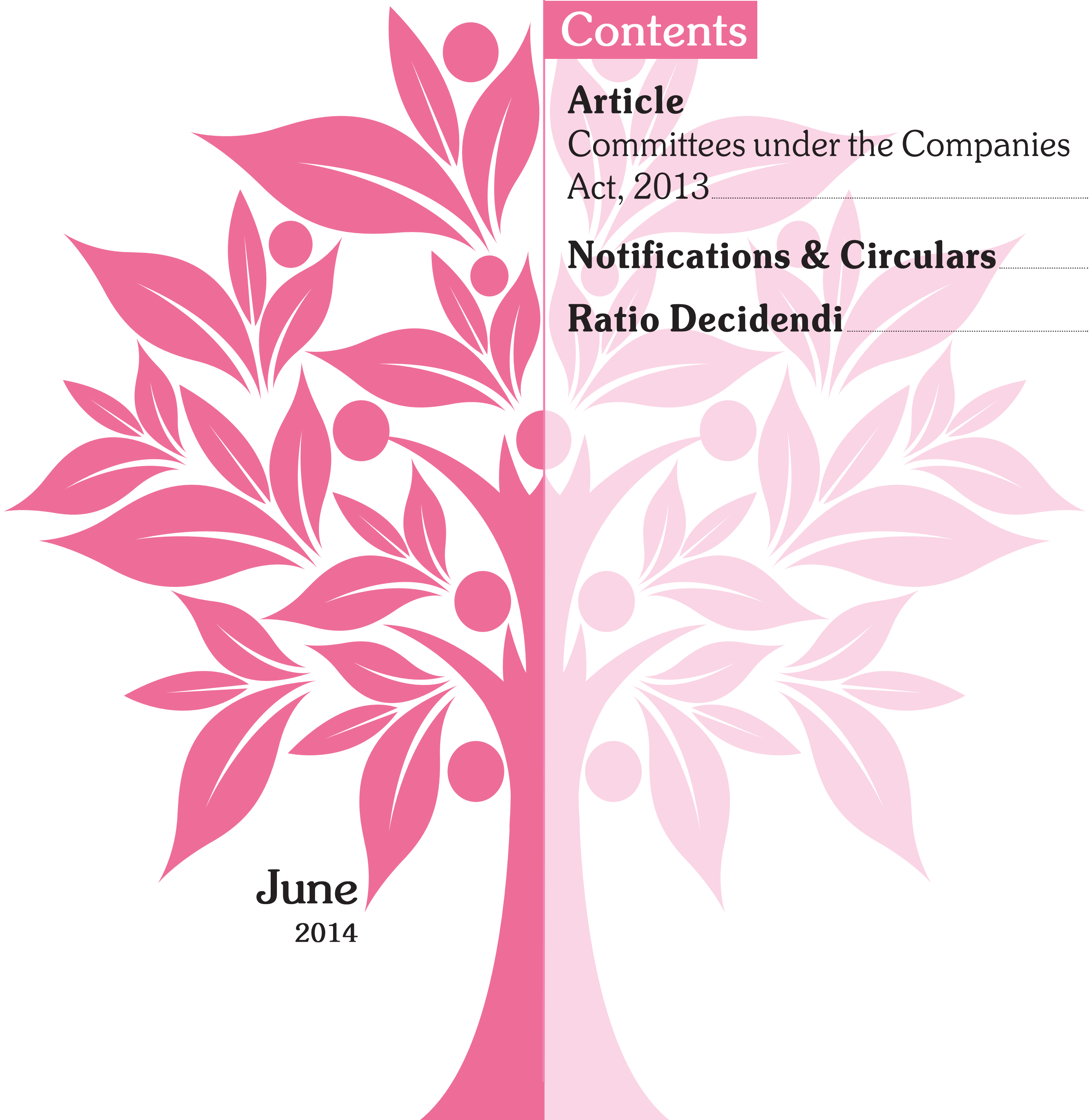

June
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Article

Committees under the Companies Act, 2013

By **Anup Koushik Karavadi**

Introduction

With an eye on improving governance the Companies Act, 2013 (2013 Act) mandates a number of Board committees for specified companies for audit, nomination and remuneration, corporate social responsibility and stakeholders relationship. Clause 49 of the Listing Agreement also envisages such committees for listed entities.

Audit Committee

Under Section 292A of the Companies Act, 1956 ('1956 Act') an audit committee was required for every public company whose paid up capital was INR 5 crores or more. The 2013 Act read with the rules, requires every listed company and other public companies with a paid up capital of more than Rs. 10 Crores or a turnover of INR 100 crores or outstanding loans or borrowing exceeding INR 50 crores (as per the latest audited accounts) to form an audit committee comprising at least 3 directors, the majority of whom have to be independent as well as a Nomination and Remuneration Committee, in which at least half the members have to be independent.

The 1956 Act was silent on the terms of reference, leaving it to the Board of a company to define the scope and powers. The 2013 Act prescribes certain specific items like recommendations for the appointment and remuneration of auditors, scrutiny of inter corporate loans and investments, approval of related party transactions etc., though the Board may at its discretion add more functions. The 2013 Act and rules also envisage companies to set up a vigil mechanism under the oversight of the audit committee to enable complaints against frauds or misdemeanors' by employees or others. The audit committee is also empowered to protect whistleblowers and also to take action against frivolous complaints. The performance of the audit committee (as well as the Board and other committees) and its efficacy have to be evaluated under Section 134(3)(p) of the 2013 Act.

Under Section 292A(8) of the 1956 Act, the Audit Committee's recommendations were binding on the Board of Directors. However, under the 2013 Act any recommendation of the Audit Committee that is not accepted by the Board has to be reported in the Board along with reasons for the same. Furthermore, under Section 292A (6) of the 1956 Act, the Audit Committee was mandated to have periodic discussions with auditors about the compliance of internal control systems and to review the financial statements of the company. This power has been made discretionary under Section 177(5) of the 2013 Act. There is also no mechanism specified for electing the Chairperson of the Audit Committee in the 2013 Act which was included under Section 292A(2) in the 1956 Act though the Listing Agreement provides for qualifications of the Chairperson[1]. In the context of financial literacy, the Listing Agreement mandates the presence of

[1] Listing Agreement, Clause 49, II (A) (iii).

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at least one member with accounting expertise, while the 2013 Act requires the majority of members to be financially literate.

Nomination and Remuneration Committee (NRC)

Sections 178(2), (3) and (4) of the 2013 Act specify the responsibilities of the NRC whereby it shall make recommendations on the appointment and removal of directors, evaluate their performance, recommend levels of remuneration, etc. A provision for penalty for non-compliance with such requirements has also been incorporated.

Whereas the Listing Agreement specifies that the Remuneration Committee has to recommend the remuneration for executive directors only, the 2013 Act extends this to all key managerial personnel as well. In addition, the Listing Agreement mandates that all the members of the Remuneration Committee must attend all its meetings and that its Chairperson must attend the Annual General Meeting of the company.

The Institute of Company Secretaries recommended the constitution of nomination committees to identify suitable independent directors and recommend them to the board for their appointment[2]. Though the NRC is empowered to examine the sufficiency of remuneration, the link between performance and remuneration, etc., its recommendations have not been made binding upon the Board of Directors.

Stakeholders Relationship Committee

Under Section 178 of the 2013 Act, every company which has more than 1000 shareholders, deposit holders or other security holders, shall constitute a Stakeholders Relationship Committee ('SRC'), with a non-executive director as Chairperson with the objective of grievance redressal of various stakeholders. The Chairperson of the SRC is also mandated to attend the general meetings of the company. A penalty for non-compliance has been stipulated.

Corporate Social Responsibility Committee

Section 135 of the 2013 Act envisages a Corporate Social Responsibility Committee ('CSR Committee') of the Board in every company whose net worth is more than Rs. 500 Crores, or turnover over Rs. 1000 Crores, or having a net profit of more than Rs. 5 Crores. The Committee must consist of at least 3 directors of whom at least one should be independent. However, unlisted public companies and private companies are exempted from the requirement of an independent director on the CSR Committee and a minimum of two members is adequate for such companies.

The functions of a CSR Committee are to formulate a CSR policy including activities as have been listed under Schedule VII of the 2013 Act, monitor the said policy periodically and prepare a transparent monitoring mechanism. The 2013 Act also mandates that the CSR

[2] See, Press Release, *The ICSI Recommendations to Strengthen Corporate Governance Framework, 2009. ("ICSI Recommendations")*, available at: http://www.icsi.edu/docs/webmodules/LinksOfWeeks/Recommendations%20Book-MCA.pdf (last visited on 5th September, 2013).

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Committee must ensure that at least 2% of the company's net profits are directed towards CSR activities. The CSR Rules also provide further guidelines and enumerate various methods in which a company can conduct CSR activities such as setting up of not-for-profit organizations and collaboration with other companies to further CSR activities.

An escape route has been incorporated in the Act itself whereby companies who are unable, for sufficient cause, to spend 2% of their average net profit for the past 3 years, may explain the reasons for the same in the Board report.

Conclusion

The 2013 Act expands the number of committees and provides duties for each of them as compared to the 1956 Act. Further, there seems to be an attempt to bring the 2013 Act in consonance with the Listing Agreement to a certain extent. There is also significant emphasis on transparency norms and self disclosure mechanisms for these committees which have been incorporated within the new provisions. However, the roles accorded to these committees seem to be largely recommendatory with the final decision making power being vested in the Board of Directors. Only further implementation of the 2013 Act over the course of time would show the extent of impact these committees can make in the field of corporate governance.

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Notifications & Circulars

Delegation of certain powers to RoC and Regional Directors: The Central Government has delegated certain powers and functions to the Registrar of Companies ('ROC') and the Regional Director ('RD'). As per Notifications dated 21-5-2014, the ROC has been delegated powers relating to refusal of undesirable names, registration of not-for-profit companies, alteration of memorandum, omission of 'private limited' from the name of not-for-profit companies and the like. The RD has been delegated powers relating to alteration of memorandum in case of conversion into another kind of company, revocation of license granted to companies having charitable objects, change of registered office to another state, rectification of name, rectification of register of charges, removal of auditors and inspection of registers maintained by the Registrar. Further, the powers and functions in respect of allotment of Director Identification Number have also been delegated to the Regional Director, Joint Director, Deputy Director or Assistant Director posted in the office of Regional Director at Noida.

Appointment & qualifications of Independent Directors – Certain issues clarified: Ministry of Corporate Affairs has clarified that transactions like availing telecom services, courier services, etc., between a company and its independent director that are on par with products or services that are provided by the company to any member of the general public including price, will not create

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'pecuniary relationship' with the said company as contemplated under Section 149(6)(c to determine independence. General Circular No. 14/2014, dated 9-6-2014 further clarifies that the 'pecuniary relationship' provided under Section 146(6)(c) of the Act, does not include receipt of remuneration, from one or more companies, by way of fee provided under sub-section (5) of Section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission approved by the members, in accordance with the Companies Act. It has also been clarified that the appointment of an ID will have to be formalized through a letter of appointment in view of the specific provisions of Schedule IV. The Ministry has also clarified that if it is intended to appoint existing IDs under the new Act, such appointment would have to be made afresh within a year. Further, if the tenure of an ID was less than 5 years, the tenure would extend only to two terms regardless of whether the appointment for one tenure was for five years or less.

Audit Committee and Nomination & Remuneration Committee to be constituted within one year: Public companies with a paid up capital of Rs. 10 crore or more, or having turnover of Rs. 100 crore or more, or having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs. 50 crore or more, and which were not required to constitute Audit Committee and /or the Nomination and Remuneration Committee under the erstwhile Companies Act, 1956, are now required to constitute same within specified time. As per amendments by Ministry of Corporate Affairs Notification dated 12-6-2014 issued in this regard, the time period is one year from notification of Companies (Meetings and Powers of Board) Rules, 2014 (i.e. till 31-3-2015) or within one year of appointment of Independent Directors by such companies. Rule 6 of the Rules has been amended for the purpose.

PAN requirement for foreign nationals: Considering the difficulties being faced by the foreign nationals while filing the incorporation documents in India, the Ministry has clarified that Permanent Account Number (PAN) details are mandatory only for those foreign nationals who are required to possess PAN as per Income Tax Act, 1961 on the date of application for incorporation. It has been further clarified by General Circular No.12/2014, dated 22-5-2014 that if the intending Director who is a foreign national not required to compulsorily possess PAN, furnishing of passport number along with undertaking on non-applicability of provisions relating to PAN would be sufficient. Further, through General Circular No. 16/2014, dated 10-6-2014, it has been clarified that the provisions of the earlier circular are applicable to a foreign national who is a subscriber/promoter at the time of incorporation of the company. If the said subscriber/promoter does not have PAN, declaration as per proforma shall be furnished as an attachment to the Incorporation Form

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(INC-7). Resident Director of the proposed company shall be required to submit PAN details at the time of incorporation.

Repayment of deposits - Sub-sections (2) and (3) of Section 74 come into effect: 6th of June, 2014 is the date from when the provisions of Sections 74(2) and 74(3) of the Companies Act, 2013 have come into force. Section 74 provides for repayment of deposits accepted before commencement of the Companies Act, 2013. While sub-sections (2) empowers the Tribunal (Company Law Board till the Tribunal is notified – Refer, Order dated 6-6-2014) to allow time for repayment, sub-section (3) provides for payment of fine if the company does not repay the amount within the specified time.

'Financial year' – CLB to exercise certain powers till NCLT is constituted: Ministry of Corporate Affairs has clarified that until the National Company Law Tribunal (NCLT) is constituted under Section 408 of the Companies Act, 2013, all the powers, functions and authority under the first proviso to clause (41) of Section 2 of the Companies Act, 2013 shall vest with the Company Law Board. The CLB will now be able to allow following of any period as financial year by a holding company or subsidiary of a company incorporated outside India if such company is required to follow such different financial year for consolidation of its accounts outside India. Order dated 2nd June, 2014 *(Published in the Gazette of India on 3rd June, 2014)* has been issued in this regard.

Foreign investment - Participation by registered FPIs, SEBI registered long term investors and NRIs: RBI has allowed registered Foreign Institutional Investors (FIIs), Qualified Foreign Investors (QFIs) deemed as registered Foreign Portfolio Investors, registered Foreign Portfolio Investors (FPIs), long term investors registered with SEBI – Sovereign Wealth Funds (SWFs), Multilateral Agencies, Pension/ Insurance/ Endowment Funds, foreign Central Banks to invest on repatriation basis, in non-convertible/redeemable preference shares or debentures issued by an Indian company, in terms of A.P. (DIR Series) Circular No. 84 dated January 6, 2014 and listed on recognized stock exchanges in India, within the overall limit of USD 51 billion earmarked for corporate debt. Further, according to RBI A.P. (DIR Series) Circular No.140, dated 6-6-2014 issued for the purpose, NRIs may also invest, both on repatriation and non-repatriation basis, in non-convertible/redeemable preference shares or debentures as above.

Limited Liability Partnership (LLP) as 'Indian Party': Limited Liability Partnership (LLP), registered under the Limited Liability Partnership Act, 2008, is now an "Indian Party" under clause (k) of Regulation 2 of Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004. Accordingly, an LLP may now undertake financial commitment to / on behalf of a JV / WOS abroad in terms of the extant FEMA provisions under Regulation 6 (and Regulation 7, if applicable) of the Notification No. FEMA.120/RB-2004 dated 7-7-2004. Reserve Bank of India has issued A.P. (DIR Series) Circular No.131, dated 19-5-2014 for this purpose.

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Ratio Decidendi

Reference to arbitration in cases of void or voidable contracts – SC lays down guidelines: The Supreme Court of India has declined to accept the proposition that whenever a contract is alleged to be *void ab-initio*, the courts exercising jurisdiction under Sections 8 and 11 of the Arbitration and Conciliation Act, 1996 are rendered powerless to refer the disputes to arbitration. The Apex Court in this regard relied on an earlier judgment in the case of *Hindustan Petroleum Corpn*., laying down that if there is a clause for arbitration in an agreement, it is mandatory for the civil court to refer the dispute to an arbitrator. Accordingly, the judgment in the case of *N. Radhakrishnan*, was held as being *per incuriam* by the court in the present case where the respondent had pleaded that the contract is void inasmuch as the petitioner had engaged in corrupt or fraudulent practices in connection with the agreement.

Further, acknowledging Section 16 of the Arbitration Act, 1996 and noticing the concept of separability of arbitration clause/agreement from the underlying or the main contract, the Supreme Court was of the view that all matters including the issue as to whether the main contract was void or voidable can be referred to arbitration. Elaborating on the issue while noting difference in the term "void" and "voidable" in the Indian Contract Act, 1872, it was held that where the court can conclude that the contract is void, on a meaningful reading of the contract document itself without requiring any further proof, arbitration can be declined. It was however clarified, providing few examples, that such cases would be few and isolated. Benefit of arbitration was hence found to be available in cases of voidable contracts of circumstances like unsoundness of mind, absence of free consent, undue influence, fraud or misrepresentation, etc. The Apex Court also advised the courts to act with caution and circumspection while examining the plea that the main contract is void or voidable.

The Court permitted arbitration to proceed simultaneously along with criminal proceedings. Defence that the decision of the criminal proceedings, in respect of corrupt practices, should be awaited before the arbitral tribunal is constituted, was hence rejected. It noted that if the matter is not referred to arbitration and the criminal proceedings result in an acquittal, it would lead to delay in arbitration. According to the Court, even if the arbitration award is given and the criminal proceedings lead to conviction, thereby proving that the contract was void, necessary plea can be taken to resist enforcement of the award. [*Swiss Timing Limited* v. *Organising Committee, Commonwealth Games 2010, Delhi* – Judgment dated 28-5-2014 in Arbitration Petition No. 34 of 2013, Supreme Court]

CLB not empowered to order issue of shares: The Company Law Board (CLB) does not have power under Section 111 of the Companies Act, 1956 to decide on right to shares and decree suits for specific performance as well as order rectification of register. The Bombay High Court examined the powers of the CLB as regards ordering rectification of register when on facts, there was no agreement to purchase shares, no consideration was paid and when provisions including those relating to acquisition of shares by a foreign company were not complied with. The CLB can decide on a question relating to the title

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but when title itself is in dispute, a party cannot apply to the CLB for rectification. Title has to be established through trial in a civil court.

The respondent, along with its subsidiaries who had advanced loans and were trading partners, claimed that it was a majority shareholder in the company of the appellant and the former was refusing to register the same in its books.

The High Court emphasised that right to shares has to be established by way of valid transfer deed and share certificate. A mere letter of accommodation is not a share certificate. In the instant case, an undertaking signed by directors without the company's seal, issued for 'internal purpose' of the purported holder, was the basis of the claim to shares. The consideration which was claimed to be paid towards the share was loan amount and there was no record of any intention to appropriate the same towards consideration. Regarding the respondent's claim that as a foreign resident, it could invest through the automatic route without approval, the High Court pointed out that the subject company was governed by the Industries (Development & Regulation) Act, 1951, and it was also not an SSI. [*Advansys (India) P. Ltd.* v. *Ponds Investment Ltd.* – Judgment dated 9-5-2014 in Company Appeal No. 14 of 2013, Bombay High Court]

SEBI (Stock Exchanges and Clearing Corporations) Regulations – Constitutional validity upheld: Allahabad High Court has upheld the constitutional validity of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012. The High Court has rejected the contention that the said regulations supplant or are *ultra vires* the Securities Contracts (Regulation) Act, 1956 (SCRA) or the rules framed under it. It was noted that the SEBI, while framing the regulations, had not traveled beyond the bounds of the statute [Sections 4, 8A and 31 of the SCRA]. Noting further that according to Section 11(1) of the SEBI Act, SEBI is duty bound to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, it was held that SEBI had not acted *ultra vires* either the SEBI Act or the SCRA.

Repelling the argument on the regulations violating Article 19 of the Constitution of India, the court held that the legislation having nexus with the preservation of public interest in the transparent and accountable functioning of the activity/business is clearly permissible and does not violate Article 19(1)(c). It was held that the impugned regulations defining the conditions for recognition, minimum net worth, composition of the board of directors, dispersal of ownership and norms for governance, do not infringe the right under Article 19(1)(c) of the Constitution. The regulations were also held as not violative of Article 19(1)(g). [*U.P. Stock Exchange Brokers' Association* v. *SEBI* – Judgment dated 23-5-2014 in Civil Misc. Writ Petition No. 45893 of 2012, Allahabad High Court]

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