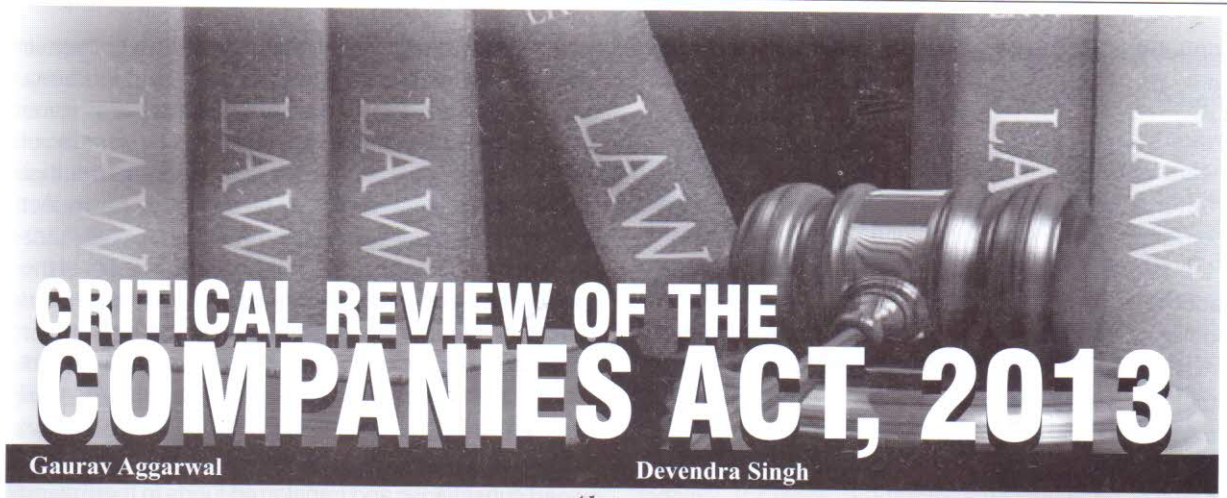

CRITICAL REVIEW OF THE COMPANIES ACT, 2013

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Abstract

The new company law has been put in place by the Government with the best intentions and it is now the turn of the corporate sector to demonstrate that it will play according to the rules. The Government on its part must trust the corporate sector to function honestly and also keep a watch.

What the Government wants the corporate sector to do is to give back a small portion of the wealth it has created with the help of the resources drawn from the society and its surroundings to provide succor and relief to the under-privileged sections of the society. Companies would in fact gain from such initiatives as they would enhance their reputation and image among all sections of people.

The Government has rightly reduced the need for companies to seek approvals for managerial remuneration from the government. Shareholders must satisfy themselves that the remuneration, managerial personnel in their company wish to draw, are in line with the market and that they do not enrich themselves merely because they are serving prosperous companies.

Keywords- *Companies Act, 2013, Good Governance, Corporate Social Responsibility, Mandatory Disclosure Norms.*

Introduction

The new Companies Act, 2013 (here after, the Act) that has already been partially enforced has been criticized by many for two main reasons. Firstly, many provisions of the Act will get implemented through Rules to be prescribed (this is seen as excessive delegation that may lend itself to frequent change of Rules by the Ministry of Corporate Affairs) and secondly, companies would have to frequently approach shareholders by convening general meetings or adopting the postal ballot route to seek their approvals.

The first criticism may be unfair because the Ministry of Corporate Affairs (MCA) has already instituted a practice of consulting the stakeholders while drafting the Rules. Representatives of industry, industry bodies like chambers of commerce, investor protection organizations, various autonomous professional institutes, company secretaries, chartered accountants and cost accountants in practice, participated as a team in several meetings over a period of almost a year to review the draft Rules, consider suggestions based on experience and practical difficulties and tweak the Rules while ensuring they are aligned with the relevant provisions of the Act. It is reliably learnt that the Minister of Corporate Affairs, has strongly advocated and supported the initiative of the MCA in instituting the consultative process for Rules-making. The MCA is likely to constitute a formal Committee comprising the representatives of the stakeholders to discuss amendments or modifications to the existing Rules or prescription of Rules before being notified.

The second criticism is unwarranted because in the company form of organization, the shareholders are supreme and the boards of companies have to function within the powers and sanctions accorded by them. If a company needs to convene meetings in addition to the annual general meeting, why should one complain? Yes, it does involve costs but so do all activities that company executives and board members undertake. For many years, companies have operated (and some of them unfairly) with the support of a few hundred shareholders who attend general meetings to pay obeisance to the Chairman and some of the eminent directors rather than to ask the management critical and relevant questions. We now have a generation of enlightened shareholders that is conscious of its rights and wishes to participate more actively. Postal ballot, e-voting, video-conferencing are new tools that are available to the present generation of companies to

seek the mandate of their shareholders.

Good Governance

Several measures introduced in the Act are based on the tenets of good governance. The concept of independent directors introduced by SEBI has now been incorporated in the Act. Having one third of the strength of the board comprising independent directors is no draconian provision. The candidates would still be people known to either the Chairman or some members of the Board or their friends. So what is there to complain? Prescribing a Code of Conduct (Schedule IV of the Act) is a step in the right direction. A written code and the one mandated by law draws the lines for the conduct of independent directors.

The need to appoint a woman director of the Board is another welcome step. It is not 'reservation' for women. If this was not mandated, Boards of companies would rarely induct women because, by nature women, especially those educated are independent and would not 'play along'. We have examples in renowned companies, banks and financial institutions (of women directors, some even occupying the positions of Chairman and/ or CEO), and their performances have been admirable and laudable.

The provisions enabling a company to have a small shareholder's director are currently not mandatory. They should not be mandated because we have seen many instances of how some shareholders with vested interests could 'gang up' and cause nuisance to the management. The independent directors and a woman director would bring about a balance in the policies and decisions of companies to advance and protect the interests of small shareholders among other stakeholders.

Increasing the scope of reporting in the director's annual report including the assessment of the performance of the Board and the remuneration paid to directors and senior management are welcome measures. The common refrain that is heard is what would the shareholders do with all the information contained in the directors' report? It is not only the shareholders but a wide range of people including the government and its agencies that refer to the directors' reports of companies and several purposes could be served by providing comprehensive information in such reports.

Shareholder Supremacy

The Act upholds the supremacy of the shareholders of a company and, therefore, it has vested authority in the shareholders to approve significant transactions that the management wants to undertake. Investment of a company's funds or providing loans out of the company's funds and furnishing guarantees on behalf of others are all transactions that directly impact the fortunes of a company. The law recognizes that some leeway needs to be provided for the Boards of companies to operate based on opportunities that present themselves and this is reflected the in Act permitting companies to make investments, give loans or provide guarantees up to 60% of the net-worth of the company or up to 100% of its free reserves. It is beyond these limits that the prior approval of shareholders is mandated. A show-stopper is the removal of the exemption that was available in respect wholly-owned subsidiaries but this is also not without justification.

Companies are known to have created several wholly-owned subsidiaries and transferred funds to them using the exemption that was available under the old Act. Once the funds are thus transferred, the management could do anything with those funds using the wholly-owned subsidiary as a vehicle that is called 'special purpose vehicles'. The shareholders would only learn later about what transpired.

Related party transactions have also been dealt with by companies many a time to allow related parties to enrich themselves at the cost of the company's larger interests. By mandating that some of the related party transactions cannot be undertaken unless approved by the shareholders, the law has plugged a loophole. The measure is fortified by prescribing that if a shareholder is the related party, that shareholder would have to abstain from voting on the resolution. For example, a parent/holding company that draws out a significant amount from its subsidiary or other promoted companies in the guise of a royalty would now have to get the contract/agreement for payment of royalty approved by the shareholders. The parent/ holding company cannot itself vote on the resolution for approving such a contract.

Managerial remuneration norms have been significantly liberalized and shareholders have been vested with power to sanction managerial remuneration. The Government has rightly reduced the need for companies to seek approvals in this regard from the government. Shareholders must satisfy themselves that the remuneration managerial personnel in their company wish to draw are in line with the market and they do not enrich themselves merely because they are serving prosperous companies.

Auditor's Responsibilities & Tenure

The Act has introduced several requirements for determining the eligibility of a person or a firm to be appointed as an auditor. While it is true that actions of a few professionals who did not do a sincere job or colluded with managements to perpetrate wrong-