



## Concept Paper on Companies Bill 2012

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## **Introduction:**

One of the dominant underlying consideration for enactment of new Companies Act during 50`s for young India was – company legislation for a Welfare State where State assumes a paternalistic role and steps into all walks of its citizens` daily existence. The State thus becomes a great underwriter. Similar sentiments were also echoed by Hon`ble Supreme Court in 1951.<sup>1</sup> Companies Act 1956 was thus enacted with democratic character with striking socialist features. This approach is ideally best suited for an under-developed economy, as was India the then.

With the adoption of LPG accompanied by commensurative economic and financial reforms, Indian economy has exhibited sustainable robustness. Our Companies Act had been repeatedly amended in bits and pieces to respond to the churning dynamics of Indian Inc. Continued retention of many redundant provisions defeated intended objectives. Not to however suggest that attempts were not made to adopt a new Companies Act, all sincere efforts could not succeed. Companies (Amendment) Bill, 2003; containing important provisions relating to corporate governance was also introduced, the consideration of which was held back in anticipation of the comprehensive review of the Company Law. While piecemeal reform continued through amendments, it had not yet been possible to bring about comprehensive, new legislation to replace the existing Act. At the same time, economic restructuring around the globe necessitated many a countries including UK, Australia, Canada, New Zealand etc to comprehensively reform their Companies Act to be more responsive and facilitate sustainable economic development. For the first time in the legislative annals of India, a committee of stakeholders headed by Dr. J J Irani, Director, Tata Sons Ltd comprising of practioners of Companies Act to say Industry Chambers, Professionals, Legal experts, Professional Institutes were `entrusted with the task of advising the Government on the proposed revisions to the Companies Act, 1956. The objective of this exercise is perceived as the desire on the part of the Government to have a simplified compact law that will be able to address the changes taking place in the national and international scenario, enable adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models. It is a welcome attempt to provide India with a modern Company Law to meet the requirements of a competitive economy.`<sup>2</sup> After going through legislative rigour the Companies Bill 2012 (hereinafter referred to as the `Bill`) was passed by

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<sup>1</sup> Chiranjivilal Chaudary v. Union of India (1951) 21 Comp Cas 33 at para 66

<sup>2</sup> Concept Paper on Companies Bill 2011 ([www.mca.gov.in](http://www.mca.gov.in))

Lok Sabha on 18<sup>th</sup> December 2012. The salient and unique features of this Bill are briefly discussed in the following paragraphs.

### **One Person Company – Harbinger Of Economic Development**

The largest number of business concerns in India is sole proprietorship – the unorganised sector. The growth of these businesses is restricted and sustainability doubtful in an integrated globalised highly competitive market place. Besides, they are predominantly engaged in trading activities or tiny manufacturing units. This segment constitutes the largest employer of workforce in India. The Companies Bill 2012 carves out a unique sustainability model for such business – **One Person Company**. Corporatisation and Demutualisation of sole proprietary business into a private limited company will segregate the risk of the business from the Ownership thus enhancing funds mobilisation capacity, accountability, transparency, competitive advantage, brand equity of the business. This will also ensure better labour welfare regime in hitherto unorganised sector. In brief their contribution to national economy will get a philip. The compliance requirements of such companies have been proposed at minimum levels. This will also put our business policies in tune with global best practices.

### **Boost To Small Size Corporates**

As on 31<sup>st</sup> March, 2011 more than 82% of the registered companies are private limited companies<sup>3</sup>. There are many a compliances to be made by such private limited companies, under the extant Companies Act 1956, that are of little significance. This major block of corporates though critical for economy of the country, compliance cost becomes a roadblock. **Enlargement of private limited companies** from 50 to 200 with liberalised compliances will encourage deep-pocketed MNCs to open their shops in India. Besides, this will save revenue of the government as well of the corporate sector. A new class of company called **Small Company** has also been proposed in the Bill. Around 12% of companies in India are dormant companies<sup>4</sup>. They may now make an application to Registrar for obtaining the status of a **Dormant company**.

### **Gender Sensitive Legislation**

A survey by Mercer has established that Women hold merely 5% of top 100 posts in 27 major movers and shakers of Indian economy.<sup>5</sup> 64% of the companies surveyed have indicated that there are no barriers of

<sup>3</sup> Annual Report (as on 31<sup>st</sup> March 2011), Ministry of Corporate Affairs ([http://www.mca.gov.in/Ministry/pdf/55AR\\_English.pdf](http://www.mca.gov.in/Ministry/pdf/55AR_English.pdf))

<sup>4</sup> supra

<sup>5</sup> <http://www.mercer.com/leadership-india>

keeping women from advancing to senior positions, while 14% stressed that leadership style of women differs from senior leaders style. This is one of the lowest in the world. The Bill makes it now mandatory that specified class of companies shall have one Women Director. This welcome `departure is expected to bring in gender equality in corporate management and provide a humane face to managerial strategies.

### **Market Centric Compliance Regime**

The existing Companies Act 1956 was enacted during an environment when the domestic securities market was in its infancy. Indian market has proven its maturity and robustness during recent financial tsunami in the world market. It is therefore imperative to acknowledge the contribution of listed entities to the economy. Empowerment to SEBI was restricted to initial public offering and related issues. Substantial provisions like Accounts, Meetings, Directors etc. were being regulated by SEBI through Listing Agreement route, as contractual obligation. This anomaly is proposed to be rectified. The Bill contains specific compliances provisions relating to **Listed Companies. Investors Protection measures** have been strengthened under the Company Law instead of leaving it for the market regulator. This will remove legislative overlap and make our law more responsive to market dynamics. Funds Mobilisation route through **Public Issue** and **Private Placement** have been separately provided in the Bill. **Rotation of Auditors** in a listed company will improve financial reporting system in corporate India. Insider Trading continues to haunt the corporate sector. Price Sensitive Information has now been defined under the Companies legislation. The Bill **prohibits Insider Trading**; similarly Directors and Key Managerial Personnel of a company have been prohibited from **forward dealings** in securities of a Company. Also for the first time, **Fraud** has been defined in a substantive Act, making the Bill a Forward looking Market centric Act. Statutory status to **Serious Fraud Investigation Office** has also been proposed in the Bill. Such provisions will enhance investors` protection and expected to increase their population in the domestic market, which is one of the lowest in the world.

### **Ushering Into Disclosure Based Company Law**

Informed Decision Making is the pillar of allocation of investible funds. The scope of the Directors has been widened in the Companies Bill 2012 to inter alia, indicating development and implementation of **Risk Management Policy** including identification therein elements of elements of risk, if any, which in the opinion of the Board may threaten the existence of the Company. It is also now mandatory to justify the related party transactions, the source of corporate mismanagement. Where a company is unable to spend in a given year 2% of its average net profits, the Board shall justify therefor. For the first time while

defining **Financial Statement**, the Bill provides that Statement shall include inter alia, Cash Flow Statement and Changes in Equity, if any for the financial year. These statements shall now be signed by **Chief Executive Officer and Chief Financial Officer**. The financial year for all the companies shall be 31<sup>st</sup> March each year. Constitution of **National Financial Reporting Authority** to recommend accounting standards and auditing policies and practices for companies will enhance disclosure standards. Its powers under CPC to investigate into alleged misconduct by professionals provide it requisite regulatory teeth. The pioneering changes will influence quality improvement in financial reporting system in India thereby sharpening decision taking process and risk minimisation efforts of the investors – institutional and retail. Enhanced **disclosures in the Annual Return** are proposed to strengthen investors' protection and corporate governance.

### **Regulatory Gaps Plugged**

Companies Act 1956 does not define **Key Managerial Personnel**, a market-driven definition. It has now been defined, their duties and responsibilities assigned in the Bill. Certificate of **Commencement of Business** has been proposed for all types of companies. This will improve accountability of private limited companies. **Functions and duties of Directors and Company Secretaries** have been prescribed under the Bill. Provisions relating to **resignation of a Director** will remove legislative anomaly and corporate suits. The Bill provides that every company shall have at least one **Resident Director** who has stayed more than 182 days in India. This will improve accountability of company directors. Some **insurance policies for indemnifying officers** of the Company against negligence, default, misfeasance, breach of duty or trust for which they may be guilty and prosecuted, shall no further be a part of remuneration of such officers. Be that so the new provision will considerably improve professional accountability and standards in Indian Companies.

Standards issued by the professional bodies are issued primarily to plug the legislative gaps. The **Standards** issued by the three professional bodies i.e. Chartered Accountants, Companies Secretaries and Cost Accountant now been made integral part of the Companies Act, compliance whereof is mandatory. **Company Liquidators** will include a panel of professionals from Chartered Accountant, Company Secretaries and Cost Accountant fraternity. This will provide professionalism to the fore to be regulated by their respective Code of Conduct. **Secretarial Audit** has been made mandatory and the report to be annexed with Directors Report will considerably improve corporate compliance and also provide to boost to the practice areas of professionals from the respective field.

**Class Action suits** has for the first time been proposed in the Companies Bill 2012. This legislative gap was felt more during the corporate scams, Satyam in the recent years. The extant Companies Act was the major road block of **Cross Border Mergers**. The Bill in appreciation of integration of global market place and need of inorganic growth for Indian companies provides for mergers of domestic company with a foreign company.

### **Paradigm Shift In Dispute Resolution Mechanism**

Dispute means difference of opinion. In a highly competitive market place happening of dispute is anybody`s guess. Prolonged dispute resolution is not only costly but also erodes reputation of the corporate – a critical component in competition-driven integrated market. The Bill for the first time gives a legislative mandate to Central Government to maintain a panel of experts to be called **Mediation and Conciliation Panel** for mediation between disputing parties. **Plea Bargaining** has been provided legislative stamp. **Special Courts** for speedy trials will considerably improve corporate peace and harmony. **NCLT** will improve quality of dispute resolution besides providing critical speed and cost saving.

In short, the shift in the law-making process in India involving the stakeholders of the proposed law through participative process produces a Forward Looking user friendly Law, ensures better participation of the stakeholders and its governance. Companies Bill 2012 has brought in revolutionary changes in the corporate administration and management. Some of the concepts, none could perceive till couple of years before. It is hoped that new Companies Bill will facilitate the Indian Inc. to usher our economy to more sustainable and robust world economic leader.

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**Best Wishes,**

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