The Companies Amendment Act, 2019: Way to better Corporate Governance

1. Introduction

The Companies Amendment Act, 2019 ("**the Amendment Act**") was notified on July 31, 2019, repealing three amendment ordinances issued between November 2018 and February 2019. The underlying objective for amending the Companies Act, 2013 ("**CA 2013**") is to bring accountability and transparency for good corporate governance by increasing certain penalties, de-criminalizing certain offences and liberalizing the existing regulatory framework. The Amendment Act introduced total of 43 changes and some sections were applied given retrospectively, effective November 2, 2018. Basis the speech of the Corporate Affairs Minister, it appears that the government is taking steps to enhance the framework for CA 2013 implementation in the hope that it will further facilitate ease of doing business.

This E-Newsline discusses certain selective amendments which could have a far-reaching impact on companies that continue to out corporate governance on the back-burner.

2. Key Amendments

2.1 Corporate Social Responsibility: CA 2013 provides certain financial thresholds for companies to undertake Corporate Social Responsibility ("**CSR**") activities.[1] Any company with a profit of INR 50 million (USD 703,600)[2] or turnover of INR 1 billion (USD 14 million) or net worth of INR 5 billion (USD 70 million) or more in preceding Financial Year ("**FY**") is obligated to expend at least 2% of three years' average net profit annually. Where a company fails to utilize its CSR spend, necessary disclosures with cogent reasons have to be included in Board report, failing which the company is liable to pay fine and every defaulting officer was susceptible for both fine and imprisonment. However, the aforementioned liability did not directly stem from non-compliance with CSR spend mandate, but arose out of inaccurate or incomplete disclosure in the Board report. The lack of penalty for failure to spend CSR allocation gave an opportunity to companies to accumulate CSR money annually. It would not be wrong to say that in certain cases, covered entities found it convenient to have a CSR committee and policy in place for paper compliance without actual intent to perform CSR activities.

The Amendment Act obligates companies to transfer their unspent CSR funds to any of the prescribed funds established by the Central Government[3] within 6 months of close of the fiscal year **and** disclose the reasons in the Board report for failure to spend. If funds are for ongoing projects, the company must transfer the amount to a special account with the name "Unspent Corporate Social Responsibility Account" with a scheduled bank within 30 days from the end of the FY to be utilized for corresponding projects within 3 years. In case of any default, the penalty is the same as was provided for inaccurate disclosure in the Board report.

[1] CSR activities are related to welfare of society, for e.g. eradicating hunger, poverty and malnutrition, promoting education, ensuring environmental sustainability, promoting gender equality, protection of national heritage, art and culture. Schedule VII of CA 2013 prescribes projects and programs related to such activities

[2] 1 USD = about INR 71 and rounded off

[3] These include Swach Bharat Kosh for promotion of sanitation, Clean Ganga Fund for rejuvenation of river Ganga, Prime Minister's National Relief Fund other funds for socio-economic development for the weaker sections

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This essentially means that CSR model will now be enforced strictly where consequences will be dire and mere explanations will not suffice. Companies will be required to maintain documents for ongoing projects and merely planning them will not make them ongoing. With these changes, companies can no longer justify efforts towards constituting CSR committee, formulating policy or identifying activities but failing to spend CSR amount.

2.2 Significant Beneficial Owner: The concept of Significant Beneficial Owner ("**SBO**") came into effect in June 2018. Every individual who holds, directly and indirectly, at least 10% shares or voting rights in a company is an SBO. For indirect holding, it is imperative to look through the corporate layers above the shareholders of the company. The SBO has to provide a declaration to the company, which then has to be filed with the Registrar of Companies ("**ROC**"). Companies have to send a notice to its shareholders who hold at least 10% shares or voting rights or any person (*whether or not a member of the company*) whom it knows or has reasonable cause to believe that he is the SBO or has knowledge of the SBO. The recipient is obligated to respond to the notice in the prescribed timeline. If no response or unsatisfactory information is received, the company has to file an application with the National Company Law Tribunal ("**NCLT**") for suspension of all rights attached with the corresponding shares such as right to vote, transfer, dividend etc. The NCLT may give the person an opportunity of being heard and pass an order restricting the rights attached with the shares.

Before the amendment, the company or the aggrieved person had the opportunity to file an application with the NCLT for lifting restrictions imposed on shares, but no specific period was prescribed for filing the application.[4] Now, the amendment provides for one year to file application with NCLT against an order passed. Where the application is not filed in one year, the shares in question will be transferred to Investor Education and Protection Fund Authority ("**IEPFA**"). The shares will be transferred without any restrictions, which means that the IEPFA i.e. the government will become the shareholder of the company. In such case, investigation will be initiated for non-compliance of provisions and everyone will get impacted including corporate layers just because of failure to file SBO declaration.

Further, the scope of penalties has been widened. Initially, the penal provisions were applicable only if the company did not maintain SBO register but now the penalty will be levied even if the company fails to furnish the notice for identification of the SBO. The law has become stricter for the SBOs as well. If they provide any incorrect information or suppress any material facts wilfully, that will amount to fraud. The purpose of SBO provisions is to pierce corporate veil of the company by making it a statutory mandate and identify the ultimate individual beneficial owner of the company, disregarding the intermediate non-individual shareholders.

2.3 From NCLT to RD: Under CA 2013, certain powers were vested with the NCLT, which have now been delegated to the Regional Directors (**"RD"**). These are as follows. *Firstly,* jurisdiction of the RD is enlarged by enhancing the pecuniary limits of fine for compoundable offence[5] from INR 500,000 (USD 7,036) to INR 2.5 million (USD 35,180). *Secondly,* under CA

[4] Section 433 of the 2013 Act allows the application of Limitation Act. Item #137 of Part II of Third division of Schedule of Limitation Act provides for 3 years to an aggrieved party for filing any application with the concerned authority against the order passed

[5] Compoundable offences are those that are punishable with specific penalty amount under the law, and such amount can be compromised upon hearing the reasons for default. However, no compulsory imprisonment should be involved with corresponding offence

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2013 the FY of an Indian company runs from April to following March 31. However, NCLT has powers to approve a different FY for those who are subsidiaries of foreign companies. Now, the power to approve such change has also been delegated to the RD. *Thirdly,* now RD can approve conversion of company from public to private. Since NCLT is already burdened with various matters relating to insolvency and other serious offences, the aim is to ensure it is not the forum for routine corporate matters and provide swift approvals.

2.4 Fit and Proper persons: Under CA 2013, if Central Government finds that the company's affairs are conducted in a manner prejudicial to the public interest, it may file an application to the NCLT for suitable orders to remedy the situation. Public interest is not defined in the Act, but can be decided on the facts and circumstances. It emphasizes the idea of the company functioning for the public good or general welfare of the community, and not in a manner which is illegal or opposed to public policy. NCLT, in the above mentioned application, had wide powers to pass orders, such as regulation of conduct of affairs of the company; restrictions on transfer or allotment of shares; removal of managing director, manager or any other director and appointment of new managing director, manager or any other director in their place; imposition of costs as may be deemed fit by the NCLT.

The Amendment Act empowers the Central Government to approach the NCLT for filing application and obtaining order declaring that a person associated with the conduct and management of the company including directors, key managerial personnel and other officers, is not a fit and proper person. Such person will be unfit and improper, if the Central Government is of the opinion that, he **(a)** is found to be guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions or of breach of trust; **(b)** has not conducted the business with sound business principles or prudent commercial practices; **(c)** has caused serious injury to the industry or damage to the interest of trade or industry; **(d)** has conducted business with an intent to defraud its creditors, members or any other person; and **(e)** has conducted business for fraudulent or unlawful purpose or in a manner prejudicial to public interest. The person concerned shall join the complaint as respondent and defend himself. If the NCLT adjudges that the person is not fit and proper, he shall not hold the concerned office and once such order is passed, he will be further debarred from holding any office in any company for a period of 5 years without receiving any compensation for loss of office.

The Amendment Act enlarges the grounds that Central Government can resort to, for initiating action against a company and its officials where the affairs are conducted in public prejudice. On a closer scrutiny of the new provisions, it appears that the Amendment Act elaborates on situations that would constitute as conduct in prejudice to public interest. While suitable orders will be passed by NCLT to redress company's affairs, the Amendment Act enables NCLT to take specific deterrent action against company officials who control the company's affairs.

2.5 Secured Borrowings: Companies need money for financing their projects or for operational activities. In order to secure funds, lenders need collaterals and often this is achieved by creation of a right in the properties of the borrowers which is known as a charge which is typically done by a lien or hypothecation of the assets. The charges are required to be filed[6] with the ROC within 30 days of creation or any modification. For delayed filing, CA 2013 allows a

[6] Form CHG-1

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further period of 270 days on payment of additional fee, taking the filing timeline to 300 days. If a company is still unable to file the form, it can approach the RD seeking condonation of delay justifying the delay and it is up to the RD to accept or reject, after hearing the company.

The Amendment Act has reduced the timeline from 300 to 120 days. The amendment provides that where filing is not done within 30 days, it has another 30 days to file by paying additional fees. If still not filed within these 60 days, it can be done within further 60 days by paying *ad valorem fee*[7], failing which the company has to approach the RD seeking condonation of delay. Earlier, the non-compliance of any charge related provisions was punishable under respective section only but now, if a person wilfully furnishes any false or incorrect information or suppresses any material information pertaining to registration of charge, it will be a fraud and fraud related penal provisions[8] will also apply.

The amendments tighten the noose around recalcitrant companies by reducing the timelines, increasing late fee by introducing *ad valorem fee* and treating furnishing false information as fraud. Clearly, vigilance has to be key in registration of secured loans which, in turn, will allow public to be cognizant of the ownership of assets and financial position of a company.

2.6 Offence re-categorization: Certain offences were under the ambit of criminal proceedings and punishable with fine or imprisonment or both. The Amendment Act has re-categorized such corporate offences and moved about 16 of them from the ambit of criminal to civil liability by replacing the word "fine" with "penalty" and, in some cases, removing penal sanctions of imprisonment. Some of these offences are **(a)** prohibition of issue of shares at discount; **(b)** failure or delay in filing notice for alteration of share capital; **(c)** failure or delay in filing financials and annual return; **(d)** failure in attaching explanatory statement with the general meeting notice; **(e)** any contravention related to a director's identification number or DIN; and **(f)** default with respect to appointment of key managerial personnel. By this amendment, the offences that are procedural or technical in nature and where the public interest is not evident are brought under the in-house adjudication mechanism of levying penalties to make the resolution swift and less cumbersome. It will not be necessary to launch investigation or the defaulting officer will not have to undergo judicial prosecution for these matters. Apart from this, the Amendment Act has also introduced a new section[9] providing for penalty with respect to defaults repeated within three years of previous order, by a company or its officers. This is twice the amount of penalty prescribed under respective section. In absence of such provision, default in timely compliance of corporate actions and getting the compounding done after several years of default, had become a common practice. Now, it will really help in curbing the tendency of taking the law lightly.

3. Conclusion

Broadly, the Amendment Act will benefit all the law-abiding corporations. Clearly, these are attempts to strengthen corporate governance norms which could increase financial burden on companies but, in fact, will aid in swift resolution of offences without undergoing lengthy and cumbersome proceedings with NCLT. Those who take the law lightly are going to be in for tough times. The government is clearly on an agenda and, given the nature of the amendments, it is clear

[7] It is a percentage based variable fee to be levied on the amount secured by the charge
[8] Section 447
[9] Section 454A

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that the regulators will not take enforcement lightly and will take proactive steps to ensure that gaps in corporate governance and compliance framework are enforced effectively. A clean-up in corporate governance practices is on the cards for those who have engaged in bad or non-governance. Once companies understand they have to comply with both the letter and spirit of the law, the path to good governance will be smoother.

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