



COMPANIES BILL 2009

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Focus on

- **Class Action**
- **Mergers**
- **Fair valuation**
- **NCLT**
- **Special Courts**
- **Significant changes in winding up procedures**



Class Action – Clause 216



Class action

- Clause 216 reads as follows:
 - **Any one or more members or class of members or one or more creditors or any class of creditors may**, if they are of the opinion that the management or control of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or creditors, file an application before the Tribunal on behalf of the members and creditors for seeking all or any of the following orders, namely:—
 - to restrain the company from committing an act which is ultra vires the articles or memorandum of the company;
 - to restrain the company from committing breach of any provision of the company's memorandum or articles;
 - to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by misstatement to the members or creditors;
 - to restrain the company and its directors from acting on such resolution;
 - to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;
 - to restrain the company from taking action contrary to any resolution passed by the members.
- Clause 32 pertaining to prospectus also seeks to permit class action for misstatements in the prospectus
- Read this with clause 243:
 - No appeal shall lie in any court or other authority and no civil court shall have any jurisdiction in respect of any matter in respect of which the Tribunal or the Appellate Tribunal is empowered by or under this Chapter and no injunction shall be granted by any court or other authority in respect of any action taken or proposed to be taken in pursuance of any power conferred by or under this Chapter.



Highlights of the provision

- If legislated the way it is drafted, corporate India is in for one of the most irritating shareholder rights
- Will breach the very line of distinction between civil jurisdiction against companies and that of the NCLT
- Note that the proceedings can be filed by
 - A single shareholder
 - A single creditor
- So, if you are right now bugged by a shareholder holding 1 share seeking to remove your chairman, theoretically
 - Any shareholder or any creditor
 - Can bring an injunction against the company for important business decisions
- Unfortunately, if a power is granted to a judicial or quasi—judicial body, it is usually implemented expansively, in full steam
 - Very difficult to repeal a power once legislated
 - Hence, right time to act now



Meaning of class action

- **Shareholder remedies**
 - Individual remedies
 - Derivative remedies
 - Class or collective remedies
- **An action brought in by a plaintiff seeking to represent a class. It is usually a civil procedure**
 - There is not, and does not have to be, a provision of law permitting class action
 - If permitted, it is permitted as a part of civil procedure
- **In practice, the practice is mostly US phenomenon**
 - **Why**
 - The biggest issue in collective or aggregate remedies is – who pays for the legal fees?
 - Because US laws permit contingency lawyers to spearhead claims against companies/others for a collective remedy
 - US has a big breed of contingency lawyers
- **Other countries**
 - Australia
 - Some EU countries have recently permitted
- **In Europe, it is mostly confined to consumer associations**
- **In India, mostly limited to “public interest litigation”**

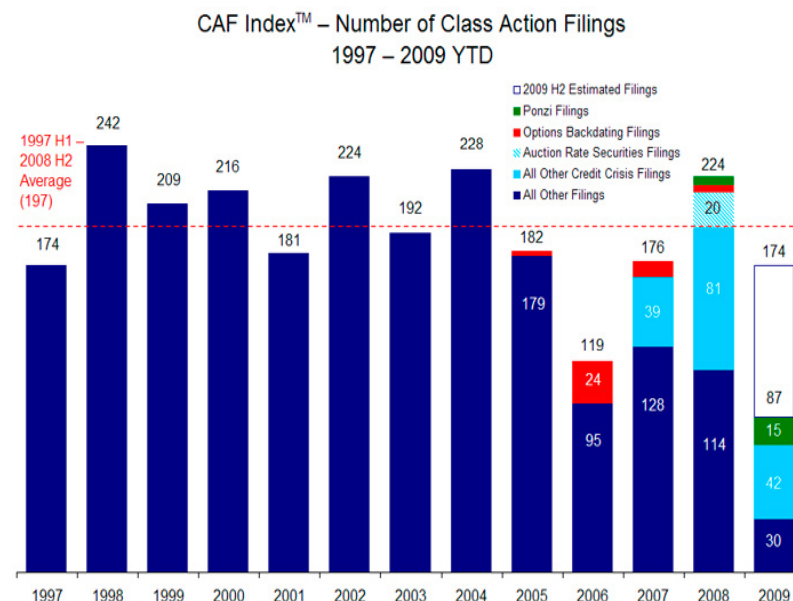


Class Action in US- a quick look

- **Federal class action suits:** Rule 23 of the Federal Rules of Procedure lay down the requirements of class action:
 - the class is so numerous that joinder of all members is impracticable
 - there are questions of law or fact common to the class
 - the claims or defenses of the representative parties are typical of the claims or defenses of the class
 - the representative parties will fairly and adequately protect the interests of the class
- If a court certifies a suit to be triable as class action, it will then proceed as such
- There are 3 possible outcomes of a class suit:
 - Dismissed
 - Settled
 - Leads to penalties – monetary and criminal
- As class suits may lead to massive liabilities, they throw a massive pressure on the companies to settle

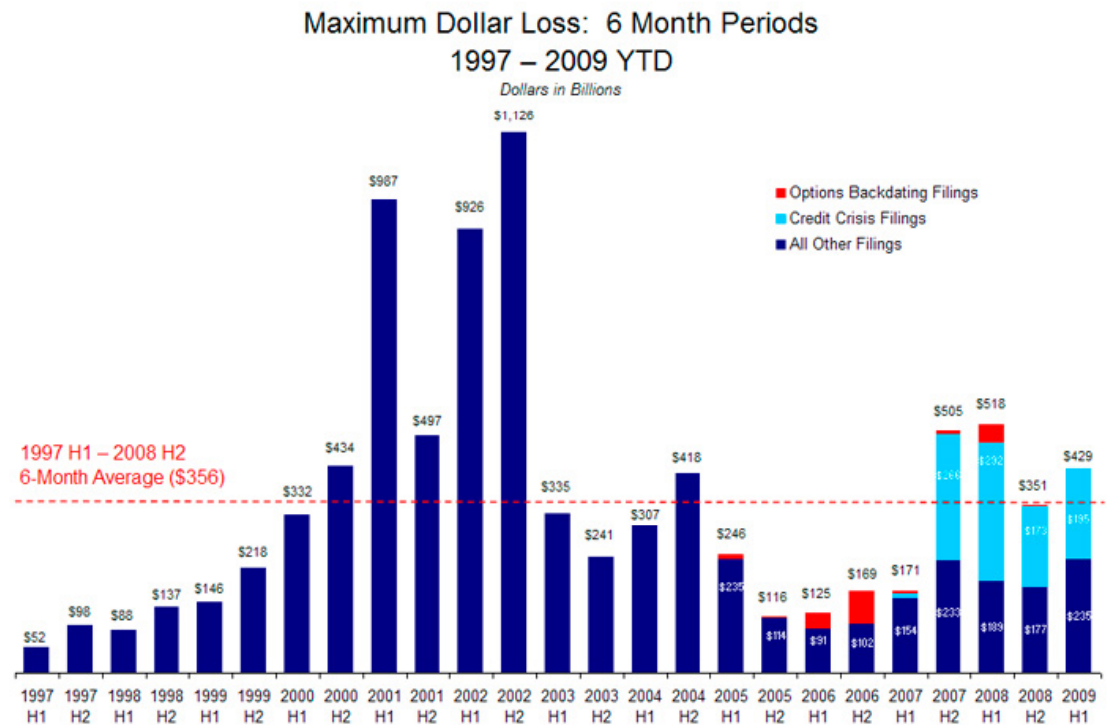
Class Action in US- a quick look

- **Shareholder Class action:**
 - Generally filed for such matters as violation of securities regulations, accounting fraud, etc.
 - Commonly referred to as *securities class litigation*.
 - Most suits allege a breach of Rule 10b-5 of the SEC, which pertains to use of manipulative or deceptive practices in connection with purchase or sale of securities.
 - Corresponding to sec 12A of SEBI Act.
- Of late, large part of all class litigation is securities class litigation
 - So significant is the securities class suit industry that Cornerstone Research at Stanford University runs an index for securities class action filings – called CAF index



Magnitude of class action filings in the USA

- “private securities class actions present a serious threat to the health of the US economy” - US Chamber Institute for Legal Reform
- Disclosure dollar losses in just 2008 amounted to \$ 856 billion
- Since 1996, 2,758 companies, 41% of all publicly listed companies have been sued





US Class action vs Indian class action

- US class action is not a provision of law; it is a procedure – if there is a collective cause of action, it may be pursued collectively
 - India has sought to come with a legal provision
- There is no list of causes, for which action may be filed
 - Clause 216 has a closed list of causes
- Class action is mainly to seek remedies
 - Clause 216 is injunctive
- A penal class action may lead to a cash payout – hence, litigation becomes self financing
 - Injunctive remedy cannot lead to any settlement payment; hence, there is no reason why collective remedy will be pursued at all
- US legal profession has a contingency fees practice
 - India does not allow contingency fees
- Conclusion
 - The so-called class action will never be pursued at class action – it will remain limited to sectional interests who can finance their own litigation
 - It will be used as a tool in shareholder feuds, competitive litigation or pure arm twisting



Was it, in fact ever conceived as class action?

- There are serious reasons to suspect that the draftsmen never realised whether they were enacting a class suit provision or derivative suit provision
 - JJ Irani committee made a consolidated reference to both class suits and derivative litigation
- The section has been put alongside oppression and mismanagement
 - Perhaps the draftsmen equated derivative action with class action
- So, is it good as a piece of derivative action?



Clause 216 for derivative action

- The way it stands, clause 216 cannot be derivative action either
 - First, because it empowers both a shareholder and a creditor
 - Derivative action is action on behalf of the company; creditors have no reason to file a suit on behalf of a company
 - It empowers a single shareholder
 - Key principle of derivative action is *Foss v Harbottle*
 - Courts cannot preside over internal matters of companies, any more than they can settle household problems
 - Only person to file a remedy for the company is the company itself
 - Sections 397/398 granted special powers to a particular shareholder strength to plead for wrongs done against the company – for example – mismanagement
 - UK has now considerably widened the scope for derivative action
 - But before a shareholder can represent a company, the court must be satisfied that the suit is fit to be pursued as derivative case
 - Usually, derivative suits are for breach of duty or faith by directors
- As it stands, clause 216 is nowhere close to the idea of derivative action either



So what will clause 216 do?

- Abuse of power by single shareholder: No safeguards against abuse of power for personal gain. E.g. in case like *Dabur India Ltd. v. Anil Kumar Poddar*, (2001) 4 Comp LJ 351, power to remove director misused
 - Notice menace continues unabated; companies all over the country are being harassed by a limited number of corporate blackmailers
- Clause 216 (1) (e)
 - Technically requires NCLT to decide alleged violations of any law of the country
 - Is the NCLT intended to be a comprehensive court of justice?
- Read this with clause 243
 - Civil jurisdiction in all these matters is ousted
 - So, strictly speaking, no civil court can take any matter pertaining to any company, as all alleged civil law actions are justiceable under clause 216
 - All commercial disputes, property disputes, contract law breaches, in fact, every thing comes under clause 213



Mergers



Highlights

- Implementation of recommendations of the JJ Irani Committee on a large scale
 - Amalgamation without court's intervention
 - Explicit provision for Cross border mergers
 - Valuation Report in respect of shares and properties to be obtained by Registered Valuers
 - Objections to the compromise or arrangement to be made only by persons not holding less than 10% of share capital or having outstanding debt of not less than 5% of total outstanding debt
 - Provision included with respect to set-off of fees payable on authorized capital, though the language of the clause is ambiguous



Compromises, arrangements and amalgamations

- Note the heading of the chapter – compromises, arrangements and amalgamations
 - Existing law uses the words compromises, arrangement and reconstruction
- Why would the law make a provision for compromises?
 - If two persons are entering into a compromise, why would the court be concerned with it?
- The provisions were always envisaged as quasi-winding up proceedings – akin to Chapter 11 of US Bankruptcy Code
- Hence, sec 390 said
 - These sections apply to companies liable to be wound up under the Act
 - Bombay High court in Khandelwal Bros and Acme Mfg case took a very wide view
 - Said every company formed under the Act is liable to be wound up
 - Thereby giving a universal application to the section
- That is how the section is used by all companies – healthy and sick
 - Quite often used for restructuring of capital
- The existing sec 390 does not have any place in the Bill
 - Maintaining the universal application



Significant changes

- Reduction of capital is now explicitly included; variation of class rights is also merged into these provisions
- Corporate debt restructuring explicitly included
 - This is verbatim based on JJ Irani committee recommendations
 - Committee said CDR schemes sanctioned by the CDR Committee were objected to by minority shareholders
 - This is clearly a mixed up reference
 - CDR under RBI purview is only a restructuring of loans by banks; do not involve non-banking creditor
 - Creditors' compromises were always included under sec 391: hence, not clear what the Irani committee in fact aimed at
- As recommended, a creditors' restructuring now needs additional safeguards
 - Creditors responsibility statement
 - Safeguards for protection of secured and unsecured creditors
 - Liquidity report – report by the auditor that post-restructuring liquidity will be as per liquidity test
 - Surprising if any auditor can give any such report at all
 - Valuation by registered valuer is required here too
- BIFR proceedings shall abate
 - BIFR is consistently being made dysfunctional
 - SARFAESI Act makes a provision for abatement of provisions
 - This clause also says the same
- Includes mandatory takeover too – this is in addition to clause 206



Clause 201 – drafting problems

- Drafting problems
 - sub-clause (3) – notice to be sent – wrongly says notice to be sent to all creditors and members; Should say – “as may be applicable”
 - Provision to sub-clause (4) is badly drafted – objection shall be made only by at least 10% in value
 - There cannot be any bar to objection
 - The policy should be – if objected to by more than 25%, the scheme fails
 - If objected to by more than 10% but less than 25% - NCLT shall pass appropriate orders
 - If objected to by less than 10%, objection shall be dismissed, unless NCLT in its discretion considers it appropriate to pass amendments
 - Sub-clause (5) – requires notices to be sent to SEBI, stock exchanges, Competition Commission – fails to distinguish between listed and unlisted companies
 - Significant clash – no need to take NOC from stock exchange, as the provision says if not objected to, presumptive sanction



Clause 203 – mergers

- Special provision for mergers, demergers
- The following to be circulated to members/ creditors:
 - Draft scheme
 - Confirmation of having filed a copy with the RoC
 - Explanatory statement by the directors
 - Report of the expert on valuation – this should be changed to registered valuer
 - At present, valuation reports are not being circulated
 - Accounts made upto a date not preceding the date of the first meeting by more than 6 months
 - Clause (f) is difficult to understand
 - approval of the draft of the proposed terms by an ordinary resolution of the transferor company or, as the case may be, each of the transferor companies in the case of merger by formation by a new company
- Special provisions
 - Merger of a listed company into an unlisted company
 - Exit route to dissenting shareholders of the transferring company
 - Talks about payment for the value of shares and “other benefits”
 - Provides for even the transferor company to become unlisted, if it is left with “small portion of the assets”
 - Provision for transfer of the fee paid on authorised capital of the transferor to the transferee



Definition of merger in clause 203

- Not clear why the definition was needed at all
 - There is nothing special about mergers – all schemes covered by clause 203 get equal treatment
- Drafting errors evident
 - Explanation (i) - a scheme involves a merger and where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of a new company;
 - Explanation (iii)- a scheme involves a division where under the scheme the undertaking, property and liabilities of the company in respect of which the compromise or arrangement is proposed are to be divided among and transferred to two or more companies each of which is either an existing company or a new company
 - First line of Explanation defining merger has too many words
- Terminology refers to 3 types
 - Merger by absorption
 - Merger by formation of a new company
 - Division of a company
- Apart from academic significance, not clear as to why the law had to talk about these 3 methods



Self administered Mergers

- Clause 204 provides for non-judicial mergers – the transfer of property happens by registration of the scheme
- The use of the word “merger or amalgamation” is a bit confusing – as it is essentially limited to merger
- Scope:
 - Two small companies
 - Both companies must be small companies
 - Holding and wholly owned subsidiary
- Requisites
 - Notice is given to “persons affected by the scheme”
 - Very vague and unclear
 - In judicial proceedings, members/creditors/ others affected may approach the court
 - In self-administered mergers, there may be variety of interests involved
 - Special resolution of both companies “considers” objections and affirms the scheme
 - Reference to class of members is unwarranted
 - 3/4th in value of the creditors approve it in either a meeting or by writing
 - Hopefully, rules of meetings apply to creditors meetings too
 - References to class of creditors are wrong here too
 - Filing of the scheme with the registrar and OL
 - 30 days time for the OL to communicate objections; on lapse of 30 days, deemed to have consented
 - Registrar to register the scheme
 - If registrar has objections that the scheme is not in public interest, he may apply to NCLT within 90 days of receiving the scheme
 - NCLT may pass appropriate orders
 - Registration of the scheme shall have the effect of dissolution of the transferor



Effect of the self administered merger

- Transfer of assets and liabilities
- Charges on the transferor's assets continue to apply
- Legal proceedings shall be continued
- Missing gap
 - Right not granted to dissenting shareholders to approach the NCLT
 - Relevant in case of small companies



Cross border mergers – clause 205

- What is a cross border merger:
 - Indian business of a foreign company being merged in Indian company:
 - Presently covered
 - Foreign business of a foreign company being merged in Indian company
 - Presently covered by share-swap provisions of overseas investments
 - Foreign business of an Indian company being merged in a foreign company:
 - Presently not covered
 - Indian business of an Indian company being merged in a foreign company:
 - Presently not covered
- Note the deletion of existing sec 390
 - Existing section refers to companies liable for winding up – hence includes all foreign companies having office in India
 - Read with sec 584 – foreign companies may be wound up in India as unregistered companies
 - Therefore, foreign companies are now totally excluded from schemes/arrangements, except as provided by clause 205
- Clause 205 permits cross border mergers only in such companies as may be notified
- Clause 205 is a sketchy provision: just permits cross border mergers and applies the provisions of the Chapter
 - As the provisions of the Chapter import jurisdiction of NCLT, there is nothing about jurisdiction of the reciprocal country



Mandatory takeovers – clause 206

- Clause 206 (Power to acquire shares of shareholders dissenting from the scheme) – a replica of the section 395 of the Companies Act, 1956
- This section is, in fact, superfluous, as clause 201 already includes takeovers



Clause 209 – registration of schemes for transfer of shares

- This clause is completely difficult to understand
 - In relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company under this Chapter,—
 - every circular containing such offer and recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information and in such manner as may be prescribed
- Difficult to understand how is this section different from the compromises/arrangements under clause 201
- Clause (b) is even more difficult to understand
 - every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available
- The clause apparently applies prospectus-related provisions to the scheme under this clause
 - The whole section is vague and difficult to appreciate



Other provisions

- Clause 211 says:
 - Notwithstanding anything contained in any other Act, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such acquisition, merger or amalgamation
- Liability for offences under this Act shall continue
 - Not sure what about liability for offences under other Acts
- Liability for offences is a criminal liability
 - Has nothing to do with the existence of the company



Registered valuers



Registered Valuers- Chapter XVII

- A whole new chapter on valuers has been added
- Mandatory provision: any valuation under the Act for property, shares, debentures, goodwill or net worth, etc. to be done by registered valuers
 - Clause not applicable if valuation is not “required to be made” under any provision of the Act
- Valuer to be appointed by
 - Audit committee, where there is one
 - BoD otherwise
- Rate of charges of valuers to be notified



Who can be valuers

- Registration of valuers with central government
- Chartered accountants, company secretaries, cost accountants, persons possessing prescribed qualifications entitled to register
 - No further qualifying attribute apparent from the law
- A committee of experts shall scrutinise the applications and advise the names that may be registered
 - This is very strange
 - Ideally, the registration must have been based on an additional valuation course of the prescribed institutes
 - There cannot be any basis for the recommendation of the advisory committee
 - The only objective basis is an examination
- The only additionality is a declaration- Clause 219(3)
 - Every application under sub-section (2) shall be accompanied by such fee as may be prescribed, containing a declaration to the effect that the applicant shall—
 - make an impartial and true valuation of any assets which may be required to be valued;
 - make the valuation in accordance with such rules as may be prescribed, and
 - shall not undertake valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during the valuation of the assets.



NCLT



Constitution of NCLT- Chapter XXVI

- Justice Eradi Committee in its Report recommended constitution of NCLT, NCLAT and repeal of SICA.
- Provisions relating to NCLT were incorporated in Companies (Second Amendment) Act, 2002
- The Bill provides for constitution of National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) for:
 - Revival of sick industrial units
 - Rehabilitation, mergers & amalgamations
 - Reduction of capital
 - Winding up and liquidation of companies
- NCLT and NCLAT to supersede CLB, BIFR and AAIFR
- NCLT and NCLAT to assume powers of High Court (Company Court) for reduction of capital, merger & amalgamations and winding up of companies



Constitutional validity of NCLT

- *Thiru R. Gandhi v. Union of India* (2004) 120 Com Cases 210 (Mad):
 - The constitutional validity of the amendment effected to the Companies Act by Companies (Second Amendment) 2000 was questioned
 - The question involved was “To what extent is ‘wholesale transfer’ of judicial functions to NCLT and NCLAT valid?”
 - The question was decided in affirmative by the Madras High Court on 30th March 2004
 - The matter was appealed in the Supreme Court which referred the same to Constitution Bench



Exclusive jurisdiction to NCLT- Clause 391

- No civil court shall have jurisdiction to entertain any suit or proceedings in respect of matter which the NCLT and NCLAT is empowered to determine
- No injunction can be granted to any court in respect of any action taken by the NCLT or NCLAT
- Clause 243 says the same thing



New powers to NCLT

- Clause 191 – new power to pass orders against transfer of funds, disposal of funds, properties or assets – likely to take place
- Power of the NCLT to impose a freeze
- Will give rise to a flood of anticipatory freezes



Special Courts



Special Courts- (clause 396)

- Parallel judicial machinery
- New machinery for redressal:
 - NCLT for most matters except prosecution
 - Special courts for trial of offences
 - Jurisdiction of Civil courts ousted and conferred on special courts
- Single judge appointed with the concurrence of CJ of the High court
- Offences under this Act to be triable only by such Special Court.



Special Courts- (clause 396)

- For the speedy trial of offences, the Central Government to establish special courts
- Consist of single judge to be appointed in consultation with the Chief Justice of the High Court within whose jurisdiction the judge is to be appointed.
- Offences under this Act deemed to be non-cognizable within the meaning of Code of Criminal Procedure
- Offences, not being an offence punishable with imprisonment only or with imprisonment and also with fine, compoundable with the permission of the Court



Reference to sec 167 of Cr P C

- Sec 167 pertains to police custody for 15 days
- Though prosecution for offences to be done by the special court, detention is still to be ordered by Magistrate
- Special court may try offence under other laws also
 - Significant provision – as the accused may not have to face different courts
- However, an offence under the Companies Act cannot be tried by any other court



Winding up



Winding up- comparison with Companies (Second Amendment) Act, 2002

- Reflection of change brought in by Companies (Second Amendment) Act, 2002
 - Winding up subject to supervision of the Court removed; two modes of winding up recognized:
 - By the tribunal
 - Voluntary
 - Threshold limit for determining inability to pay debts raised from Rs. 500/- to Rs. 1 lac.



Differences with Second Amendment Act of 2002

- Members voluntary winding up and creditors voluntary winding up have been clubbed under “voluntary winding up”
- In the following circumstances, Tribunal cannot order winding up unless the Tribunal is of the opinion that it is just and equitable to order winding up:
 - Default in delivering statutory report to the Registrar/ holding statutory meeting
 - Non-commencement of business within one year of incorporation or suspension of business for one year
 - Number of member reduced below statutory minimum



Declaration of Solvency

- Scope of Declaration widened to included declaration to the effect that
 - The company has no debts; or
 - It will be able to repay debts in full from the proceeds of assets sold in winding up
- Ceiling of three years for the purpose of paying debts removed altogether
- Company having assets to attach a valuation report prepared by Registered Valuer to the Declaration



Other changes

- Company required to call two meetings:
 - Member's meeting
 - Creditor's meeting on the same day or the following day
- Appointing authority to have power to remove company liquidator- member or creditor as the case may be
- Role of Official Liquidator has been eliminated to a large extent- In the new Act, term used is "Company Liquidator"