

CLIENT UPDATE

INDIA PROPOSES A REVAMP OF ITS COMPANY LAW REGIME

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On December 18, 2012, the lower house of India's parliament cleared the Companies Bill, 2012 (the "Bill")¹, in a significant step towards replacing the more than 50-year old Companies Act, 1956 (the "Act"). For the Bill to be formally enacted into law, it is still required to be cleared by the upper house of parliament, where it is expected to be tabled in March 2013, and upon clearance, will be sent to the President of India for formal assent.

The Bill is seen as an important step in bringing Indian company law notably closer to global standards. It touches areas ranging from incorporation, fundraising, corporate governance, mergers, auditor rotation and investor protection. The main highlights (which may still be amended by the upper house of parliament) are:

INCORPORATION

- Private companies may be incorporated with up to 200 members, up from the existing limit of 50 under the current Act. However, a private company which is a subsidiary of a public company will be regarded as a public company, even if incorporated as a private company.

¹ A copy of the Bill can be found at: http://www.mca.gov.in/Ministry/companies_act.html

- A company will be regarded as a holding company of another, if the former holds more than 50% of the total share capital of the latter, *i.e.*, equity (voting and otherwise) and preference share capital.
- The Bill, while simplifying certain requirements for incorporation, has introduced new concepts of “One Person Companies” and “Small Companies” that enjoy relaxation of requirements relating to reporting, board meetings and other procedural matters.
- The concept of a “dormant company” which can be formed for a future project or to hold an asset or intellectual property has been introduced.

SHARE CAPITAL AND FUNDRAISING

- In the case of public companies, a contract restricting the transfer of shares will now be enforceable, doing away with uncertainty created by prior judicial decisions.
- Companies will be restricted from issuing shares at a discount, except in the case of “sweat equity” shares. “Sweat equity” shares are equity shares issued to directors or employees at a discount or for consideration other than cash, in return for their know-how, intellectual property or other value addition to the company.
- For equity fund raising on a private placement basis, stricter norms requiring the offer document to be filed with the regulators, depending on the number of offerees and/or the value of the offer, have been introduced.
- For public fund raising, stricter disclosure requirements and other investor protection measures have been introduced.

MERGERS / AMALGAMATIONS

- In an attempt to make mergers less time consuming and cost effective, mergers between holding companies and their wholly owned subsidiaries or between two or more small companies (as defined in the Bill) will no longer be required to obtain prior court / tribunal approval.
- Mergers of Indian companies with companies incorporated in certain yet-to-be specified foreign jurisdictions will now be permitted.
- If a listed company merges with an unlisted company, the surviving company has been given the option to remain unlisted. However, the listed company must provide its shareholders with an opportunity to exit for cash.

- In an effort to eliminate unnecessary litigation in relation to a scheme of arrangement, only those dissenting shareholders or creditors holding at least 10% of the share capital or 5% of the total outstanding debt will have the right to object.
- An acquirer (or a person / group of persons) holding 90% or more of the issued equity share capital of a company, may now acquire the minority shareholding of the company at a price determined by a registered valuer.

CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY

- Appointment of at least one director who is a resident of India, *i.e.*, has been present in India for at least 182 days in the previous calendar year, will be made mandatory for all companies.
- Maximum number of directorships of an individual in public companies will be reduced to 10 from the current 15.
- Public companies will now mandatorily be required to have independent directors on their boards with public listed companies required to have at least one-third independent directors. Such directors may not be given any stock options and their term in office cannot exceed two five-year terms. In addition, nominee directors will not be regarded as independent.
- The Bill has codified the duties of directors, specifically, the duty to act in good faith, avoid any direct / indirect conflict of interests with the company and to exercise due diligence and reasonable care in decision-making.
- Corporate Social Responsibility (“CSR”) will be made mandatory for a company with a net worth of INR 500 crores (approx. US\$100 million) or more, or a turnover of INR 1,000 crores (approx. US\$200 million) or more or net profits of INR 5 crores (approx. US\$1 million) or more during any financial year, giving rise to a requirement to spend at least 2% of a company’s average net profits of the preceding three financial years on social and charitable causes annually.

AUDITOR ROTATION AND INDEPENDENCE REQUIREMENTS

- The Bill provides for mandatory auditor rotation for listed and other prescribed companies every five years depending on whether the auditor is an individual or a firm. In addition, there will be a cooling-off period of five years after completion of such a term during which the auditor cannot be re-appointed.
- Approval of the appointment of auditors by the shareholders at every annual general meeting of the company will be made mandatory.

- A company's auditor may not directly or indirectly render any internal audit, investment advisory, management or similar services to the company, its holding company or its subsidiary.
- In the wake of recent accounting scandals, the auditor will be required to immediately report to the central government upon reasonable suspicion of any offence involving fraud which is being or has been committed against the company by its officers or employees.

INVESTOR PROTECTION

- "Class action" lawsuits will be introduced for the first time in India, where any class of members or depositors, in specified numbers, may initiate proceedings against the company if they are of the opinion that its affairs are being carried out in a manner unfairly prejudicial to the interests of the company, members or depositors.
- Fraud will be made a new ground for seeking the winding up of a company.

CONCLUSION

The Bill contains some significant changes to the current company law regime and its objective of providing greater transparency and better investor protection are praiseworthy. However, with the upper house of parliament yet to pass the Bill, it remains to be seen what ultimately makes its way to the statute books. In addition, the Indian government is yet to come out with the rules and regulations required to implement the Bill.

Please note that this firm is not qualified to advise on Indian law. This update is based on information that has been published in the press and from other sources in the public domain.

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Please do not hesitate to contact us if you have any questions.

January 14, 2013