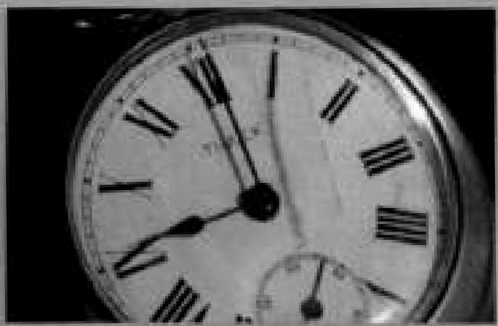
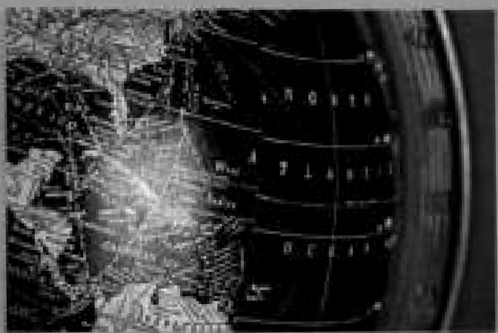
Naresh Chandra

लाइब्रेरी
कारपोरेट कार्य मंत्रालय

सत्यमेव जयते

Report of the Committee on Regulation of Private Companies and Partnerships






Ministry of Finance
Department of Company Affairs
July 2003

Naresh Chandra
Chairman
Committee on Regulation of Private Companies and Partnerships

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नई दिल्ली
Government of India
Ministry of Finance
Department of Company Affairs
New Delhi

31st July, 2003

Dear Mr. Minister,

I have the honour to submit the report of the Committee on Regulation of Private Companies and Partnerships set up by the Ministry of Finance, Department of Company Affairs *vide* Order dated 10th January, 2003.

While the Committee has endeavoured to take and consider the views of experts and others interested in the work entrusted to the Committee, I venture to suggest that the report may be made public to enable wider discussion of the Committee's findings and recommendations.

Yours sincerely,

N Chandra

(Naresh Chandra)

The Honourable
Shri Jaswant Singh,
Minister of Finance
New Delhi

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Executive Summary

1. The Companies Act, 1956 was rooted in an environment that spawned the license and permit raj in India. Though the Act has been amended on more than two dozen occasions, presumably to keep in tune with the changing and liberalised environment, doubts have been expressed lately on the continued validity of the very structure of the Act. The relevance or applicability of a large number of provisions to private companies, which are often not more than mere family enterprises, has been justifiably questioned.

2. The need for revisiting the law governing private companies, with a view to providing a simple and cost-effective framework, cannot be over emphasised. Keeping this in mind, the Government constituted this Committee in January, 2003 to suggest a more scientific and rational regulatory environment, the hallmark of which is the quality, rather than the quantity, of regulation, with particular reference to:

(a) The Companies Act, 1956; and

(b) The Indian Partnership Act, 1932.

3. Advantages conferred on business entities formed as companies are those of perpetual succession and limited liability. A degree of regulation is a natural concomitant of these privileges. The Committee is convinced that regulation should be the minimum necessary for small family type of concerns, which have little or no significant public interest. The suggestion that such entities be completely deregulated, on the ground of their being nothing but glorified partnerships is a tempting one, but the Committee recognises there should ordinarily be no privilege without a countervailing and proportionate accountability. There is clearly a need to strike a balance.

4. The Companies Act, 1956 places companies in three categories : public companies, private companies and private companies which are subsidiaries of public companies. It was argued before the Committee that companies need be classified only as public or private. However, the Committee, after detailed deliberations, came to the conclusion that for the law to remain meaningful in its application, there was a need for a further classification among private companies in applying various provisions of the Act. The new sub-classification within the category of private companies, should be that of a "small private company", small by virtue of its paid-up capital and free reserves, or turnover, or aggregated annual receipts to paid-up capital ratio. This new class of companies should be exempted from having to comply with such provisions of the Act as the Government may notify from time to time. This is in line with what the Government does for Government companies, by virtue of powers derived from section 620 C of the Act.

5. The Committee acknowledges that private companies cannot be seen in isolation or as self-contained entities. As is well known, some private companies can be quite big in terms of capital employed and/or turnover. Very often they have close relationships and significant transactions with public or listed companies. In fact, promoters of listed companies have often used private companies, which they own or control, indirectly, as vehicles to siphon-off funds of the listed companies. A dilemma occurs when private companies undertake activities, given their nature or size, that are really akin in scale to a public company. The scheme of erstwhile section 43A, converting private companies into public companies automatically, to address the problem, did not work well; as a result section 43A was finally made inoperative in December, 2000. The Committee, however, noted the need to address the issue of inter-relationships, and the possibility of misuse of private companies as vehicles of convenience, specially if regulation on such companies was further relaxed.

6. Section-by-section analysis undertaken by the Committee revealed that numerous requirements of compliance provided under the Act, meant primarily for public companies are unnecessarily applicable to private companies, including to private companies which are "small". This has added to compliance costs without adding value; and in the case of most of private companies, such requirements can be time-consuming and unduly burdensome.

7. The Committee believes that misuse of private companies by certain unscrupulous entrepreneurs should not force a majority of small private companies to having to face the extensive rigours of compliance with the law. Onerous and, at times, unnecessary compliance requirements have, in fact, inundated the offices of the RoCs with paperwork, which is difficult for them to handle or file, much less examine in any meaningful way.

8. Keeping in mind the above, the focus of recommendations of the Committee, in line with the terms of reference (Annex A) is on :

(a) providing adequate flexibility to companies/firms conducting, or intending to conduct business or provide professional services;

(b) providing a structural environment conducive to growth and prosperity of the entities, being mindful of the impact on various stakeholders, and effective regulation in a manner that minimises and deters exploitation of the liberalised provisions by unscrupulous elements; and

(c) simplifying and rationalizing entry and exit procedures (especially for non-functional companies).

Recommendations in Chapter 2 : Private Companies

9. The Committee has identified the following broad areas of reforms for private companies :

(a) specifying benefits/exemptions that can be extended to all private companies irrespective of size; and

(b) determining the criteria for a private company to qualify as a "small private company" (SPC) and extending extra benefits/exemptions to them.

Criteria for determining small private companies

10. Determining the definition of an SPC is of critical importance. It is recommended:

Recommendation 2.1 : Criteria for determining small private companies

- The current distinctions between private companies, public companies, and private companies that are subsidiaries of public companies, as provided in the Act need not be disturbed.
- However, 'small' private companies (SPC) may be distinguished and singled out for special treatment.
- A SPC would be a private company that :

  (a) has a paid-up capital and free reserves of Rs. 50 lacs or less, or as may be prescribed from time to time;
  (b) has an aggregated annual receipts from sales/services, not exceeding Rs. 5 Crores;
  (c) has other receipts not exceeding Rs. 5 Crores; or,
  (d) is registered as a SSI unit, notwithstanding its paid-up capital or aggregate annual receipts.

- If any SPC crosses the threshold limits provided either in (a), (b) or (c) above, it will be treated at par with other private companies, and exemptions available to a SPC will not be available to such companies for the financial year in which the threshold is crossed, and two financial years thereafter.

For the purposes of this recommendation, "other receipts" are any and all sums received by the company whether by way of security deposits, deposits, trade advances, other advances or any other sums by whatever name called (other than receipts from sales/services).

11. The Committee felt that section 13(1)(d) of the Companies Act, 1956 lacks clarity regarding the question of what constitutes incidental objects. This lack of clarity has caused companies to draft lengthy incidental objects clauses, in the nature of an umbrella provision. A standard format of incidental objects should be made available for use by all private companies.

Recommendation 2.2 : Standard form for incidental objects clause

- A standard format of incidental objects should be prescribed for all private companies who should then not be required to have any other "Incidental Objects". The proposed format for the incidental objects clause is:

"In connection with the main objects, the Company shall have the power to invest its funds in real property and securities, to borrow and make advances, to acquire, own, and dispose of real and personal property, and to do all other acts incidental and necessary, as may be prescribed, for the accomplishment of the purposes stated in the main objects clause."

- There should not be 'other objects clause' in the MoA in the case of SPCs.

12. To avoid stepping beyond the scope of the main objects, companies often list an unduly large number of main objects in the MoA. In such a situation, the sanction of members is no longer required, as per section 17 of the Act, even if the company decides to substantially change the nature and scope of its business. Allowing an SPC to have multiple objects is likely to lead to misuse.

Recommendation 2.3 : Objects clause

- Only companies that have a single main object will qualify as SPC, and enjoy the exemptions available to SPCs.
- Existing companies can amend their object clauses to a single main object clause, by following the procedure laid down in section 17 of the Act, if they want to avail of the benefits being offered to SPCs.

13. The Committee was apprised that considerable hardship was being faced currently in getting extension of validity of the instrument of transfer under section 108(1D) of the Act. This is avoidable in case of a private company.

Recommendation 2.4 : Validity of share transfer forms

- Section 108(1A)(b)(ii) of the Act be appropriately amended so that in the case of private companies the validity of the instrument of transfer of its shares is one year from the date of presentation before the prescribed authority.

14. In a private company, members are few and have substantial involvement in the management. In such a scenario, the consent of members by way of a special resolution is a formality, and therefore, the power to change the location of the registered office may be given to the board of directors, but the decision should be communicated to all the members.

Recommendation 2.5 : Shifting of registered office

- Unless otherwise provided in the articles of association of a private company (the "AoA"), a private company may shift its registered office with the approval of its board of directors, provided all members are notified of the decision before its actual implementation.

15. Register of members is to facilitate the determination of the entitlement of the members to dividend etc., which are matters of greater significance in public and listed companies. The Committee believes that the requirement of advertisements in newspapers about closure of the register of members is not necessary in case of private companies.

Recommendation 2.6 : Power to close register of members and debenture-holders

- Unless otherwise provided in the AoA, a private company should be exempt from having to give prior notice through an advertisement in a newspaper about the closing of its registers of members and debenture-holders.

16. Few private companies have foreign registers, and since private companies are unlikely to have wide public interest, the requirement of advertisement, as provided under section 158 of the Act, should, therefore, be dispensed with.

Recommendation 2.7 : Foreign registers

- Unless otherwise provided in the AoA, a private company be exempt from giving previous notice by an advertisement in a newspaper of the closing of its foreign register.
- The details of the foreign registers maintained by a private company should be mentioned in the annual return or directors' report.

17. Annual return provides *inter alia* that information regarding the capital structure, registered office, the board of directors, the members and debenture-holders and indebtedness of the company. All this information can be given instead in the directors' report. Ordinarily, disclosure by a private company of its members is not of importance as the private companies are closely held and controlled, and change in the share-holding is not a regular feature as it is in the case of listed companies.

Recommendation 2.8 : Requirement of annual return

- Private companies may be given a one time option to either file an annual return or include in the directors' report a compliance statement with respect to the provisions of section 3(1)(iii) of the Act, information as to unpaid dividends, if any, and the directors comprising the board, and changes in its members or their shareholding since the last AGM.
- Appropriate amendments be carried out to sections 159 and 217 of the Act to provide for such an option to a private company.

18. A company needs to follow a very detailed procedure for calling an extra-ordinary general meeting by members, in terms of section 169 of the Act, and for circulation of members' resolution under section 188 of the Act. These provisions are not so necessary in case of private companies, which are generally member-managed.

Recommendation 2.9 : Extra ordinary general meetings on requisition

- A private company should be allowed to provide in its AoA the manner and time- frame in which an extra ordinary general meeting of such company can be called on requisition of its member(s).
- However, this should, where approvals are concerned, be with reference to members entitled to vote, and not members present and voting.
- Appropriate amendments be made to sections 169 and 170 of the Act to give effect to this recommendation.

Recommendation 2.10 : Circulation of members' resolution

- A private company should be allowed to provide in its AoA the manner of circulation of members' resolutions.
- Appropriate amendments be made to sections 188 and 170 of the Act to give effect to the recommendation.

19. Under the Act, there are no provisions permitting written resolutions in lieu of general meetings. Holding general meetings, to pass such resolutions, is cumbersome and involves unnecessary expenditure. The Committee feels that this could be very burdensome on private companies.

Recommendation 2.11 : Written resolutions in lieu of general meetings

- Private companies may pass written resolutions by circulation. If passed by circulation, ordinary resolutions will require a simple majority of those eligible to vote and special resolutions will require three-fourth majority of those eligible to vote.
- Such resolutions should be recorded in the minutes book within 30 days of passing thereof. Further, resolutions thus passed should be taken note of in the very next meeting, and the minutes of the very next meeting must record that such resolutions are noted, and approved.
- Private companies will be required, as before, to hold annual general meetings; these cannot be done away with.
- However, if private companies have only two members, then they may even hold the annual general meeting by circulation. Resolutions passed in the meeting so held, should be recorded in the minutes book within 30 days of passing thereof.
- Written resolutions can be passed through various forms of electronic communication, provided there is compliance with the Information Technology Act, 2000 and other applicable laws.

20. The Committee believes that private companies should be free to deal with their managerial resources in the manner they deem fit, since public funds are not at stake.

Recommendation 2.12 : Prohibition on simultaneous appointment of different categories of managerial personnel

- The provisions of section 197A of the Act should not be applicable to private companies.

21. Sections 205 and 205A of the Act deal with the manner of calculation, and payment of dividend, aimed at protecting the interests of investors. These provisions are important in the case of listed companies. They seem to serve no real purpose in case of private companies.

Recommendation 2.13 : Dividend

- Private companies should be exempted from having to deposit the funds for dividend in a separate bank account and transferring the unpaid dividend amount to a special dividend account.
- Unless otherwise provided in the AoA, private companies should have the freedom to deal with the unpaid dividend until its transfer to Investor Education and Protection Fund pursuant to the provisions of sections 205B and 205C of the Act.
- Appropriate amendments be made to the Act and the (Transfer of Profits to Reserves) Rules, 1975 to give effect to this recommendation.

22. The Committee believes that the restrictions for payment of interest out of capital, in terms of section 208 of the Act, in case of companies where gestation period is very long, serve as an unnecessary hindrance, in case of private companies.

Recommendation 2.14 : Payment of interest out of capital

- Unless the AoA otherwise so provide, private companies should be exempted from the restrictions and the requirement of having to seek the approval of the Government, for payment of interest out of capital.
- The requirement of authorisation under the AoA to make such payments should continue to be retained in section 208 of the Act.

23. The anomaly in Section 257 of the Act, that seems to have arisen at the time of insertion of sub-section (1A) through the Act of 1960, without consequential amendment in the sub-section (2), needs to be removed.

Recommendation 2.15 : Right of other persons to stand for directorship

- Sub-section (2) of section 257 may be amended to provide that the provisions of the section shall not apply to a private company, unless it is a subsidiary of a public company.

24. SPCs should have the flexibility to hold board meetings as per business exigencies, as the volume of business transacted by these companies is significantly less than public companies.

Recommendation 2.16 : Board meetings

- The requirement related to Board meetings should be relaxed for SPCs. Unless otherwise so provided in the AoA, SPCs should be required to hold board meetings atleast once in a calendar year.
- The provisions of section 292 of the Act should not be applicable to an SPC.
- SPC should be allowed to provide in its AoA the manner for dealing with the matters mentioned in section 292 of the Act.

25. In private companies, most of the members are normally represented on the board itself either directly or through nominee directors, and accordingly, they should have freedom and flexibility to contractually determine in their AoA, the manner, terms and conditions on which sole selling agents can be appointed.

Recommendation 2.17 : Sole selling agents

- The provisions of sections 294 and 294AA of the Act should not be applicable to private companies.
- The AoA of private companies should provide for the manner, terms and conditions on which sole selling agents can be appointed.

26. The Committee believes that the requirements of the section 297 for broad sanction, are aimed at strengthening transparency and corporate governance measures, and, are therefore, of significance in the case of public companies alone.

Recommendation 2.18 : Sanction of the board for certain contracts

- The provisions of section 297 of the Act should not be applicable to private companies.
- The AoA of private companies should provide for the manner of, and restrictions with regard to, entering into contracts of the nature mentioned in section 297 of the Act.

27. The private companies are ordinarily member-managed companies and therefore separate disclosures to the members informing them of the terms of or variations in management contracts under section 302 are not required.

Recommendation 2.19 : Disclosure to members of director's interest in contract appointing manager, managing director

- The provisions of section 302 of the Act should not be applicable to private companies.
- Private companies should be required to get the terms of the management contracts or variations therein approved at the meeting of their board of directors unless the AoA of such companies provide for a different manner to deal with management contracts.

28. Private companies, generally being member-managed, should have the flexibility to decide the manner of appointment of alternate directors.

Recommendation 2.20 : Alternate director

- The provisions of section 313 of the Act should not be applicable to private companies.
- The AoA of private companies should provide for the manner of appointment of an alternate director.

29. The stiff competition prevailing in the business environment has set in the encouraging trend of companies having to be managed more professionally. This leaves less room for the management of a private company to fill in an office of profit by their kith and kin, unless they are capable of handling the responsibilities. The Committee believes that the provisions of section 314 of the Act acts as an obstacle to a private company in using the services of a capable person from within the family for managing the business.

Recommendation 2.21 : Director, etc. not to hold office or place of profit

- The provisions of section 314 of the Act should not be applicable to private companies.

30. The compensation that can be paid to the managerial personnel mentioned in section 318 of the Act in the event of loss of office, etc. should be contractually determined in case of a private company on the basis of contract law, *viz*. the law of damages. However, restrictions can be placed by the members in the AoA of such companies.

Recommendation 2.22 : Compensation for loss of office

- Section 318 of the Act be appropriately amended so that sub-section (4) of this section is not applicable to private companies.
- Private companies may provide for compensation for loss of office in the AoA of the company.

31. Nearly, 90% of the 6 lakh companies in India are private companies. According to the DCA, almost half of the companies do not even file their annual accounts and annual return. There is every likelihood that a very large number of such companies, have no operations and as such have not been carrying on any business. In addition, there are a large number of companies, particularly private companies, which have become defunct. In such cases, the promoters are no longer interested in the company. Such companies continue to exist on paper solely because putting them to permanent sleep (winding up) is costly and time-consuming.

32. The Committee noted that the procedure laid down for exercise of power by RoC under section 560 of the Act to strike off the name of a defunct company is painfully slow and, in spite of that, the question of liabilities that a company might be carrying was not adequately addressed. As a result, RoCs have rarely, if ever, used the power given in the section. Unfortunately, companies themselves do not have a remedy under this section.

33. The Government have, in the past, issued schemes for making exit simpler. The Committee is, however, of the view that the solution should be permanent, and made part of law, and that the scheme should be such that it enables a company to exit, if it so wishes, in less than four months time.

Recommendation 2.23 : Exit framework

- A simplified and quick exit scheme is needed for private companies.
- Such a scheme should be enshrined in law by necessary amendments to section 560 of the Act.
- The procedure involved in the simplified exit scheme should not take more than 120 days in any case.
- Infact, this may be extended to all companies.

Recommendations in Chapter 3: Limited Liability Partnerships

34. In an increasingly litigious market environment, the prospect of being a member of a partnership firm with unlimited personal liability is, to say the least, risky and unattractive. In India, some bodies of professionals have been prohibited from practicing under an incorporated form. The 'general partnership' or partnership *simpliciter* has traditionally been the entity of choice to provide services by professionals such as lawyers, accountants, doctors, architects, and company secretaries.

35. The Committee feels that with Indian professionals increasingly transacting with or representing multi-nationals in international transactions, the extent of the liability they could potentially be exposed to is high. Hence, in order to encourage Indian professionals to participate in the international business community without apprehension of being subject to excessive liability, the need for having a legal structure like the LLP is self-evident. Such an entity would provide the flexibility of a partnership and limiting at the same time, the owner's liability with respect to the LLP.

36. The Committee examined at length the case for extension of scope of LLP to trading firms and/or manufacturing firms. In the Committee's view, the scope of LLP should, in the first instance, be made available to firms providing professional services only. In particular, there is no special advantage that small private companies or SSI units might derive from being an LLP, especially in light of the fact that this Committee itself is recommending a considerable easing of regulation on private companies, specially SPCs.

Recommendation 3.1 : Application of the LLP regime

- Law may be enacted to provide for establishing Limited Liability Partnerships. The LLP form should be initially made available only to those providing defined professional services like lawyers, company secretaries, accountants and the like. To be eligible for this form of partnership, the profession must be governed by a regulatory Act that adequately controls and disciplines, errant professional conduct. Such professions may be notified by the Department of Company Affairs from time to time.
- LLP may be extended, at a later stage, to other services and business activities once the experience gained with the LLP form of organisation has been evaluated and tested.

37. An LLP must be incorporated by using a formal mechanism of filing the incorporation document with the RoC. Further, there should be no restrictions on the number of partners in an LLP.

Recommendation 3.2 : Incorporation, registration and partners

- Two or more professionals who wish to associate for the purpose of providing an identified professional service, may subscribe their names in an "incorporation" document in the prescribed form.
- The relations *inter se* the partners and between the partners and the LLP may be governed by individual agreements between the parties concerned. Such agreement must be filed with the RoC; changes made in the agreement will also have to be filed with the RoC.
- The LLP agreement should contain information as may be prescribed by the Department of Company Affairs.
- No limit be placed on the number of partners in an LLP. Any person may become a partner by entering into an agreement with the existing partners in the LLP. Further, when a person ceases to be a partner of an LLP he/ she should continue to be treated as a partner unless: (a) the partnership has notice that the former partner has ceased to be a partner of the LLP; or (b) a notice that the former partner has ceased to be a partner of the LLP has been delivered to the RoC. A partner having resigned from an LLP would continue to be liable for acts done by him during his tenure as member of the LLP.
- LLPs should be regulated and administered by the Central Government to ensure uniform standards, and since many of the State Governments might not have adequate infrastructure and expertise for ensuring effective regulation.

38. As opposed to the concept of joint and several liabilities, applicable in general partnerships, the liability for partners in a LLP should be limited. However, the partners would still continue to be liable for their personal acts which are not done for and on behalf of the LLP, and were committed in a personal capacity; for example, if a partner knowingly commits a felony or tort involving the LLP. Provisions dealing with insolvency, winding up and dissolution of an LLP should be similar to those provided for private companies in the Companies Act, 1956.

Recommendation 3.3 : Limited liability

- Every partner of the LLP would be an agent of the LLP. However, an LLP would not be bound by anything done by a partner in dealing with a person if (a) the member in fact had no authority to act for the LLP by doing that act; and (b) the person knows that he has no authority or does not know or believe him to be a partner of the LLP.
- Where a partner of the LLP is liable to any person or entity as a result of his wrongful act or omission in the course of the business of the LLP, the LLP would be liable in such circumstances. However, the partner would be liable only to the extent of his/her contribution to the LLP.
- In the event of an act carried out by a LLP, or any of its partners, fraudulently, the liability would not be limited; it would, in fact, become unlimited as provided for in section 542 of the Companies Act, 1956.
- A partner shall not be liable for the personal acts or misconduct of any other partner.
- The provisions relating to insolvency, winding up and dissolution of companies as contained in the Companies Act, 1956 may be examined and suitably modified to conform to the philosophy of LLPs. The partners may have to contribute to the assets of the LLP in the manner provided for in this regard.

39. To protect the interest of persons who might have claims against an LLP, all LLPs should be compulsorily required to take out an insurance policy that would cover, to a reasonable extent, its liabilities as a body corporate.

Recommendation 3.4 : Compulsory insurance

- There should be insurance cover and/or or funds in specially designated, segregated accounts for the satisfaction of judgments and decrees against the LLP in respect of issues for which liability may be limited under law. The extent of insurance should be known to, and filed with the RoC, and be available for inspection to interested parties upon request.

40. The standards of financial disclosure as applicable to private companies should be made applicable to an LLP. The advantages gained from having the privilege of limited liability should be coupled with the responsibility of making adequate financial disclosure so as to minimise chances of fraud and mismanagement.

Recommendation 3.5 : Financial disclosures

- The standards of financial disclosures would be the same as, or similar to, that being prescribed for private companies subject to privilege already available between a professional and his or her client in maintaining confidentiality.

41. Any asset held by an LLP, or any tax chargeable on gains made shall be treated as held by partners or gains made by the partners, and not by the LLP itself. Under the LLP Act in UK, an LLP enjoys 'pass through' status and is not taxable as such. This Committee would like to recommend the same pass through status for LLPs in India.

Recommendation 3.6 : Tax treatment of an LLP

- The LLPs should be governed by a taxation regime that taxes the partners as individuals, rather than taxing the LLP itself, i.e., the LLPs should be treated in the same manner as the firm under the tax laws.

Recommendations in Chapter 4: The Indian Partnership Act, 1932

42. The Partnership Act provides a comprehensive framework for contractual relationships amongst partners, and the basis for a most popular form of organisation for small businesses. It is interesting to note that the Partnership Act has not been subject to any significant amendment since its enactment. Most of the organisations and individuals, who made presentations before the Committee did not have any major complaint about the existing regulatory regime, except for certain administrative aspects of the functioning of the offices of the Registrar of Firms in different States.

43. The Partnership Act does not contain provisions for registration of charges, analogous to those contained in sections 124 to 145 of the Companies Act, 1956. Consequently, partnership firms find it difficult to access finances on terms applicable to corporates as lenders find it very difficult to verify the charges already created on the properties of the firm. Similarly, third parties proposing to deal with the firm are not able to exercise due diligence. Being convinced of this, and being aware of the state of record-keeping in the offices of the Registrar of Firms, the Committee recommend as under :

Recommendation 4.1 : Registration of charges

- The Partnership Act should be appropriately amended to provide a legal framework for registration of charges, on the lines of the provisions of the Companies Act, 1956 or the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- Banks and financial institutions also should be permitted to file the papers for registration of charge, wherever they provide assistance against the security of asset/s. The firms can, of course, themselves get the charge/s registered. In either case, the documents would have to be authenticated by both the secured creditor and the lender.
- Charges should be registered either with the ROCs if the DCA is able to implement its comprehensive computerisation programme (DCA 21); alternatively, they can be registered with the Central Registry envisaged in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, if legally permissible and if the Registry is set up in time and has adequate reach across the country.

44. The partners are entitled to interest at the rate of 6% per annum under section 13(1)(d) of the Indian Partnership Act, 1932. This rate of interest was fixed in the year 1932, and has remained static. It would indeed be appropriate if Government is empowered to prescribe the rate of interest, to reflect, from time to time, realities of the market.

Recommendation 4.2 : Interest on capital

- Section 13(d) of the Partnership Act should be amended to provide that the rate of interest to a partner, on payment, or advance, in excess of his agreed share of capital shall be 6%, or as may be prescribed by the Central Government, from time to time.

45. The bar on suits under section 69 of the Partnership Act should be restricted only to suits in respect of rights arising out of contracts entered in the course of business. Accordingly, it is recommended that amendments, on the lines suggested by the Law Commission of India, be initiated.

Recommendation 4.3 : Bar on suits by unregistered firms

- Section 69 of the Partnership Act may be amended to the effect that 'a right arising from a contract' shall mean 'a right arising from a contract made in the course of business'. Amendments as suggested by the Law Commission should be expeditiously introduced in Parliament.

46. During the course of Committee's interaction with trade and industry, it was evident that banks, financial institutions and third parties are still reluctant to deal with partnership firms because the state of records of these firms, in various States, virtually rules out any sort of due diligence. The current state of affairs warrants radical measures and with urgency.

Recommendation 4.4 : Administration of partnership firms

- State Governments should be persuaded to computerise, within a given time-frame, all the records pertaining to partnership firms.
- Failing that, Government should consider taking over the administration of partnership firms, once DCA's computerisation programme (DCA 21) has been successfully implemented.

Recommendations from Chapter 5 : Other Recommendations

47. The scope of terms of reference requires the Committee to suggest a scientific and rational regulatory environment in the context of the Companies Act, 1956 and the Partnership Act, 1932. Thus, it extends to public companies as well, in addition to private or small private companies. This was further clarified and emphasised by Secretary, DCA's letter dated 5th March, 2003 (Annex 6). The Companies (Amendment) Bill, 2003 seeks to bring in more changes for promoting healthy growth of business entities. In step with the spirit of these changes, and the request made by the Secretary, DCA, the Committee has looked at some other aspects of the Act.

48. Representations made by trade and industry argued for fuller empowerment of the company and its board of directors, in order to enable them to attract and retain the best talent, with minimal, suitable checks and balances. On the contrary, current thinking in the developed countries seems to be that managers have been reckless at times in rewarding themselves. The Committee feels that there is a case for striking a balance and, therefore, recommends as under :

Recommendation 5.1 : Managerial remuneration

- Payment of managerial remuneration should be liberalised further for companies that are implementing projects that require long gestation periods (such as infrastructure projects, or insurance companies) even if there is inadequacy or absence of profits.

- Payment of managerial remuneration should similarly be liberalised further for companies that are being nursed back to health; this could be related, for example, to reduction in losses or increase in net worth.

- The existing disclosure requirements of remuneration, under section 217, should be limited to functional directors and relatives of directors or significant shareholders (holding more than 2% of the company's shares), and should not cover other employees. The Government may examine if it is of any benefit to have this information filed with the ROC, without making it a public document.

- Explanation II(b) in Schedule XIII be rewritten to clearly bring out the intent, and current practice, when managerial remuneration is sought to be increased under section 310 of the Act.

49. The Companies (Amendment) Act, 2000 included a private company which is a subsidiary of a public company as a separate category of companies, falling within the definition of 'public company'. The Act, however, retained various provisions, which were specifically applicable to such private companies. The Committee feels that the anomaly so caused needs to be removed to bring out clarity.

Recommendation 5.2 : Definition of public company

The Government may take note of the anomaly arising out of the insertion of clause (c) in section 3(1)(iv) defining a public company, through the Companies (Amendment) Act, 2000, and consider the need for appropriate amendment to remove the confusion that exists in interpretation and applicability of the provisions of the Act in relation to a private company which is a subsidiary of a public company. Either section 3(1)(iv)(c) can be altogether dropped or a suitable explanation provided below it to put the issue beyond doubt.

50. The recent *IL&FS Trust Company Limited and another vs. Birla Perrnichini Limited and Others (2003) 52 CLA 35 (Bom)* case, has amplified the principle of recording of shareholders' agreements in the AoA of a company. The director's overall fiduciary responsibility as different from the right of the shareholders who are parties to such agreements, already a subject-matter of several judgements, is a very complex issue. There is a need now to cut this gordian knot and to avoid incorporation of every element of the shareholder agreement, or pooling agreements.

Recommendation 5.3 : Principle of recording shareholders' agreements etc.

Suitable provisions should be made in the Companies Act, 1956 to provide that:

- the shareholding agreement is a binding agreement *inter se* parties;
- the company, when notified of any breach or demand for specific performance, shall not abet and shall be bound not to abet in the breach of the agreement. It shall, however, strictly comply with the letter and spirit of the Companies Act, 1956 and other laws, and consequently, submit to the decisions of the concerned Court or the National Company Law Tribunal or arbitrator; and
- the shareholders severally shall not have the right to use the company's funds to litigate the enforcement of the shareholder agreement or to defend the contractual right of any shareholder under the shareholder agreement.

51. The Committee believes that in order to attract professional and highly qualified individuals, to act as independent directors, on the board, they need to be paid adequate remuneration. Further, they should be exempted from certain civil and criminal liabilities, and onerous obligations and requirements. The Committee agrees with the views and the recommendations made by NCC-I in this regard.

Recommendation 5.4 : Independent directors

- The statutory limit on sitting fees should be reviewed, although ideally it should be a matter to be resolved between the management and the shareholders.
- In addition, loss-making companies should be permitted by special resolution to pay special fees to any independent director, subject to reasonable caps, in order to attract the best restructuring and strategic talent to the boards of such companies.
- Non-executive and independent directors should be exempted from criminal and civil liabilities as attracted under certain Acts, like the Companies Act, Negotiable Instruments Act, Provident Fund Act, ESI Act, Factories Act, Industrial Disputes Act, the Electricity Supply Act and SAFEMA.
- Though it is proposed to simplify the Act *vis-à-vis* private companies, the applicable laws other than the Act should also be appropriately streamlined to ensure that onerous obligations/requirements should not be imposed on the directors who are not in the whole-time employment of a private company and also ensure that no additional obligations/requirements are imposed on any of such directors. A *non-obstante* clause to the effect may be added.
- The Government may consider appropriate modification in the proposed section 252A sought to be inserted by the Companies (Amendment) Bill, 2003 on the lines of paragraph 5.21.

52. Another reason that discourages good persons from becoming independent directors, that was brought to the notice of the Committee, was the apparent inability of directors to exit on their resigning. Surely, no law or procedure should be such that it compels a person to remain a director, on record, even if he does not want to be, and continue to prosecute him or her for acts for which he is not liable. Action has to be taken to sort out this obvious anomaly.

Recommendation 5.5 : Resignation by non-executive directors

- Section 303(2) may be amended, or appropriate rules framed thereunder, to provide that a non-executive director may send his/her resignation in duplicate, to the company, and another duplicate set to the RoC including the proof of dispatch of the communication to the company. Upon receipt of this letter, the RoC should take it on record clearly noting this fact on the list of directors of the company. An acknowledgement of the receipt of the letter, together with action taken, should be sent to the director who has resigned with a copy to the company within a period of two weeks.
- In case the number of directors in a company, as a result of resignation of one director, falls below the statutory minimum, a reasonable period may be allowed to the company to additionally appoint another director. In this respect, the provisions of Regulation 75 of Table A of the Companies Act, 1956 are quite adequate.
- Law should also be amended to provide for a fine of 0.001% of the paid-up capital, subject to a minimum of Rs. 500 per day and a maximum of Rs. 5000 per day, for each day of delay in not forwarding Form 32 to the RoC, or for not meeting the other requirements of law, enabling registration of Form 32, from 10 days after receipt of resignation of independent director.

53. Prior approval of Government for certain contracts in which directors are interested, in case of companies having a paid-up capital of not less than Rs. 1 crore, should not be required normally. Many checks and balances already exist for safeguarding stakeholders' interest.

Recommendation 5.6 : Contracts in which directors are interested

- Section 297 of the Act should be amended to provide for prescription of rules.
- Government should frame rules in a manner that prior approval of Government is not normally required, subject to certain safeguards that would protect public/stakeholder interest.
- In any case, section 297 should not apply to private limited companies.

54. The Committee believes that the Act should provide for in-built flexibility not only in regard to the criteria for classification of SPCs, as dealt with in Chapter 2, but also in regard to applicability of the various provisions of the Act, having regard to the economic circumstances and corporate practices prevailing from time to time. The Government should be empowered to grant further relaxation to SPCs, and prescribe adequate safeguards, if circumstances so warrant.

Recommendation 5.7 : Flexibility for further simplification

- A suitable provision be added to the Act (perhaps as section 620D) to empower it to grant further relaxations to SPCs.
- Such a provision should also allow Government to prescribe adequate safeguards and imposition of fines in case the liberalised provisions are misused.
- Further, this section should provide that Government may withdraw any or all of the relaxations provided, if circumstances so warrant (as in the case of misuse etc.)

55. The Committee felt the need for providing adequate checks and balances to prevent situations where private companies may also be used as vehicles of convenience to circumvent the regulatory regime applicable to public companies. Cases of corporate fraud, including the capital market scams, suggest a strong possibility of such misuse. The Committee did not favour erstwhile section 43A, a concept which has been given a decent burial. It instead prefers a suitable mechanism in the law for blowing the whistle, as it were, if there is any unusual activity in the company—public or private.

Recommendation 5.8 : Safeguards against misuse

- A private company whose aggregated receipts during the financial year exceed 100 times its paid-up capital and free reserves, should be subjected to the regulatory regime applicable to public companies. However, this trigger will apply only if the aggregated receipts exceed Rs. 10 crores, in the manner given Recommendation 2.1.
- Section 192 should be amended to require a company – public or private – to file the prescribed particulars in case of certain transactions and events, as may be specified by Government, from time to time. Similarly, section 217 and the Schedule VI should be amended to provide for disclosure of information, as may be prescribed, in regard to such cases.

56. Given the repeated exploitation of small depositors, the Committee was initially of the view that the companies should be prohibited from accepting deposits from the public. The Committee is, however, reluctant in suggesting a total prohibition of a long-

standing practice without adequate public debate on the issue. However, the need to safeguard depositors cannot be ignored.

Recommendation 5.9 : Special safeguards in regard to public deposits

- Section 58A of the Companies Act and the rules made thereunder may be amended to suitably provide that the regulatory regime applicable to public deposits would be the same as applicable in case of secured debentures.

57. The Committee believes that if the professional firms in India have to benchmark themselves internationally and prepare for global competition, the number of partners that a firm can have should not be allowed to become a hurdle.

Recommendation 5.10 : Number of partners

- The existing limit on maximum number of partners i.e., 20 (for firms with unlimited liability) for firms carrying on business other than banking should be increased to 50, or such larger number as may be prescribed by the Government, from time to time, for a class or classes of partnerships.

58. The Committee believes that very small shareholders are an avoidable drain on the resources of their company. In some cases, the cost of keeping them informed and supplying them a copy of the annual report etc., might exceed the value of their total investment in the company. While it is a very popular thing to show great concern for the small shareholders, the fact remains that the system has failed to protect them and many small gullible investors have lost their savings. It might be better, therefore, for those in charge of public affairs to be transparent and frankly inform small investors to be more careful or seriously consider making investments through reputable financial institutions and mutual funds.

Recommendation 5.11: Very small shareholders

- Government may consider measures encouraging very small shareholders to sell their shares to the company or to allow the companies to buy back the shares from such small shareholders, having, to begin with, a total investment of Rs. 2,000/- (Rs. Two Thousand) or less. Mutual funds and financial institutions may also be encouraged to mop up the small number of shares by offering a fair price to them.

59. The Committee was apprised that the DCA receives a large number of applications seeking exemptions from the requirements of Part II of Schedule VI to the Act in regard to disclosure of quantitative details of sales and purchases of goods and materials, stocks, turn-over, etc. The DCA, more or less, routinely grants the exemption. In order to reduce the work load of the DCA and the compliance costs incurred by the companies for exemption, the Committee recommends that under sub-section (4) of section 211 of the Act, the Government should be empowered, to exempt a class of companies from the abovementioned disclosure requirements.

60. The Committee also noted that several holding companies are presenting consolidated financial statements apart from presenting their separate annual accounts. The Committee believes that in case where a holding company presents consolidated financial statements, it should not be required to attach accounts of subsidiaries to its own accounts under section 212. This would reduce the cost to companies which is ultimately cost to shareholders. The Committee, therefore, recommends that a company which presents consolidated financial statements should be exempted from attaching the accounts of subsidiaries to its own accounts.

Recommendation 5.12 : Accounts

- The Government may be empowered to also exempt a class of companies, under sub-section (4) of section 211 of the Act.
- The Act may be amended to enable adoption of consolidated financial statements, and in respect of companies that attach consolidated financial statements, the requirement of attaching the accounts of subsidiaries with their own accounts be done away with.

61. The Committee recognises that there are public companies desirous of making an exit but are not able to do so. Therefore, the Committee recommends :

Recommendation 5.13 : Simplified exit scheme for public companies

- The Government should prescribe a simple exit scheme for public companies under section 560 on the lines of the recommendations made by the Committee at paragraphs 2.54 to 2.59 in respect of private defunct companies.

62. The Committee was of the view that the requirement for approval of Government should be dispensed with wherever an efficacious alternative is available keeping in view the subject-matter involved. Accordingly, on being requested by the Secretary, DCA, in March, 2003 to examine certain provisions, the Committee recommends as under :

Recommendation 5.14 : Interim recommendations made to Government

- Section 205 may be amended to provide for approval of shareholders by special resolution instead of Government approval for payment of dividend out of reserves or profits earned in the earlier years, in case of companies incurring losses.
- The appointment of sole selling agents, in case of a company with a paid up capital of Rs. 50 lacs or more, should not require approval of Government under section 294AA.
- The existing requirement under section 295 for approval of Government should be dispensed with. Approval of shareholders by special resolution should suffice.
- Section 149 may be amended to avoid the requirement of obtaining certificate of commencement of business. Mere intimation of commencement of business to RoC should suffice. Additionally, the provision may not apply to Government companies.

In all the above cases, the Government may, however, consider building in safeguards, such as, concurrence of financial institutions, as provided in section 372A of the Act.

1

Introduction

1.01 The Companies Act, 1956 provides for the incorporation of companies in India, and seeks to address the governance, administrative and regulatory aspects of their functioning. The law recognises that in a company form of organisation, ownership is distanced from management, with the owners enjoying the privilege of limited liability. Thus arises the concept of shareholder or corporate democracy. In reality this gives rise to a situation in which senior management are more influenced by the person or persons controlling the majority of share-holding and less to the shareholders as a whole. It is in accordance with the principle of corporate democracy that the Act seeks to protect to some extent the interests of minority shareholders and other stakeholders, like creditors and debenture-holders.

1.02 The Act, codified and re-enacted the earlier company law on the basis of the Report of a High Level Committee known as the Bhabha Committee (1952). Prior to that, the companies were regulated by the Indian Companies Act, 1913. Some major amendments were made to the Indian Companies Act, 1913 even prior to 1947. The Act of 1956 was modelled on the UK Companies Act of 1948. The Act came in for some far-reaching amendments as a result of the findings of the Dalmia Jain Inquiry Commission headed by Justice Vivian Bose, which was set up under notification SRO No. 2993 of the Ministry of Finance (Department of Economic Affairs) on the 11th of December, 1956, the Companies Act Amendment Committee, 1957 headed by Justice (Retd.) Shri A. V. Visvanatha Sastri, and inputs from the then Attorney General for India Shri C.K. Daftary. Based on their recommendations, amendments were carried out through the Companies (Amendment) Act of 1960. Thereafter, Government constituted the Company Law (Amendment) Committee and major amendments were effected once again through the Companies (Amendment) Act of 1974 with effect from 1st of February 1975.

1.03 It is clear that the Act of 1956 was rooted in an environment that spawned the license and permit raj in India. Though the Act has been amended on more than two dozen occasions, presumably to keep in tune with the changing and liberalised environment, doubts have been expressed lately on the continued validity of the very structure of the Act. It has been argued that the Act is designed chiefly to address the requirements of public companies, with adaptations being provided, here and there, for private companies. The relevance or applicability of a large number of provisions to private companies, which mostly are nothing more than mere family enterprises, has been questioned with some justification.

1.04 On the other hand, it is equally true that to conduct or carry on a business, it is not necessary for a person or family to incorporate a company. It is perfectly legal, and possible, to conduct business as a proprietorship or partnership concern. In that case, the disclosure, compliance and filing requirements would be negligible. The very fact that a business is incorporated as a company indicates that the promoters of the business see advantage in becoming a company: the liability is "limited", unlike in a partnership/proprietorship concern; and, access to funds in the form of bank finance is much easier. Therefore, if a group of persons want certain advantages such as limited liability, and better access to public funds, then they should be prepared to discharge the greater accountability provided in the Act. A duly incorporated company is a juridical person, which the Government recognises and registers. Having done so, it would be difficult for the Government to distance itself entirely from the responsibility of monitoring it, and ensuring proper compliance with rules and regulations.

1.05 Yet, in an increasingly globalised and fiercely competitive environment in which companies function today, efficiency, productivity and control over costs are at greater premium. Each form or return to be filled, each register to be maintained, each entry made, and returns that are required to be filed that need to be sent to the RoC office add to costs. In the case of smaller companies, these costs can be prohibitive, especially when the inspector-raj flexes its muscle. It is quite clear that compliance costs have to be kept at reasonable level, and that, in our eagerness to regulate, we do not make our companies less competitive.

1.06 The need for revisiting the law governing private companies, with a view to providing a growth-oriented, simple, efficient and cost-effective framework, cannot be over-emphasised. Keeping this in mind, the Government has constituted this Committee (**Committee**) to suggest a scientific and rational regulatory environment, the hallmark of which is the quality, rather than the quantity, of regulation, with particular reference to:

(a) The Companies Act, 1956; and

(b) The Indian Partnership Act, 1932.

A copy of the Government Order No. 11/3/2003-CL.V dated 10th January of 2003 issued by the Ministry of Finance and Company Affairs, Department of Company Affairs, Government of India constituting the Committee is enclosed at **Annex 1**.

1.07 The evolution of the concept of private companies, and the law with respect to them, is quite interesting. Before the Indian Companies Act, 1913, the term "private company" was used largely in descriptive manner as a connotation for a company, which raised its capital privately. The then prevailing law did not make any distinction between public companies and private companies, and all the companies registered with limited liability were subject to the same rights and obligations. The Indian Companies Act, 1913, which was based on the UK Companies Act, 1908, recognised, for the first time, the concept of "private limited company". The object was to provide an alternative form of organisation to small traders and family concerns that did not invite public investment. This helped them maintain some privacy about their business affairs, as in a partnership or sole proprietorship, and at the same time, get the benefit of limited liability and legal personality with perpetual succession. The Indian Companies Act, 1913, defined a "private company" (inserted by Act XXII of 1936) as a company which by its articles–

(a) restricted the right to transfer the shares, if any;

(b) limited the number of members to fifty not including persons who were in the employment of the company; and

(c) prohibited any invitation to the public to subscribe to the shares, if any, or buy debentures of the company.

1.08 These characteristics of a private company continue on the statute book. However, compliance requirements and prohibitions have been increasing, over the years, as the Government tried to address the issues of accountability and corporate governance from time to time, particularly when private companies were used as vehicles of convenience for siphoning funds by the big players in the market. The new compliance requirements were more rigorous whenever these were prescribed as a reaction to frauds and scams that occurred in the corporate sector.

1.09 The "private company" under the Act can, perhaps, be seen as an alternative form of organisation different from sole proprietorship concerns, which are free from regulation, and from partnership firms, which are subject to very little regulation under the Indian Partnership Act, 1932 (**Partnership Act**). As stated earlier, the advantages conferred on business entities formed as companies under the Act are those of perpetual succession and limited liability, and a degree of regulation is a natural concomitant of these privileges. The question is one of degree. The Committee is convinced that regulation should be the minimum necessary for small family type of concerns, which have little or no significant public interest. The suggestion that such entities be completely deregulated, on the ground of their being nothing but glorified partnerships is a tempting one, but the Committee recognises the need to strike a balance. There should be no privilege ordinarily without a countervailing and proportionate accountability.

1.10 In terms of application of various provisions, the Act contemplates three types of companies: public companies, private companies and private companies which are subsidiaries of public companies. It was argued before the Committee that one of the difficulties in following, and complying with the law was this multi-layered classification, and that companies need be classified only as public or private. On the other hand, there is the view that there should be graded application of the various provisions of the Act based on the use of or access to public money. Thus, listed companies should be the most regulated, followed by public companies (unlisted) which access public money, and then by public and private companies which neither use public money as deposits nor take credit from banks or financial institutions. While there is merit in a simple two-category classification, it became clear to the Committee, as it examined section after section of the Act, that having just these two categories would be impractical. The Committee came to the conclusion that for the law to remain meaningful in its application, there was a need for a further classification among private companies (apart from a private company which is a subsidiary of a public company) in applying various provisions of the Act. The new sub-classification within private companies, in view of the Committee, is of a private company which may be called 'small' by virtue of its paid-up capital and free reserves, or turnover, or aggregated annual receipts to paid-up capital ratio. This new class of companies could be exempted from having to comply with such provisions as the Government may notify. This issue is discussed in greater detail in Chapter 2.

1.11 In its deliberations, the Committee had the benefit of views of a large cross-section of stakeholders, professional bodies, trade and industry associations and other organisations. Their list is given in **Annex 2**.

1.12 As is well-known, some private companies can be quite big, both in terms of capital employed and turnover. While there is no demand, as such, to exempt all private companies from the rigours of compliance, we were informed on the contrary that there is a demand, both from industry associations, and some regulators, that large private companies should be subjected to greater disclosure and compliance requirements. In other words, a case is, in fact, being made out to bring large private companies, at par with listed companies insofar as compliance and disclosure requirements are concerned. It may be noted that by virtue of an amendment carried out in section 3(1)(iii), by Companies (Amendment) Act, 2000, a private company has to, by its articles, amongst other things, prohibit any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

1.13 The Committee realises and acknowledges that private companies cannot be seen in isolation or as a self-contained entity. Very often they have close relationships and significant transactions with public or listed companies; sometimes they function in keen competition with them. In fact, promoters of listed companies have often used private companies, which they own or control, directly or indirectly, as vehicles to siphon-off funds of listed companies. If there were inadequate controls on such private companies, the interests of small shareholders and creditors in the affected public company could be jeopardised even further.

1.14 However, the Act recognises that private companies are not at par with public companies, and distinguishes among the two in terms of compliance and filing requirements. We believe that before the Act was amended in 1960, the Companies Amendment Committee went into this question in detail; and that, in 1985 and 1996, the question of further liberalising the regime for private companies was examined and given up. As things stand, private companies already enjoy a large number of exemptions under the Act, as listed in **Annex 3.**

1.15 The exemptions, in fact, are more in number, because exemption from one single section automatically means exemption from several others in some cases. For example, private companies are exempted from issuing prospectus when raising capital [section 70(3)]; as a result, they are exempt from the application of sections 63 and 68 of the Act; in fact, they are exempt from almost all sections pertaining to issue of capital. Similarly, registration of a private company is simpler than a public company because it need not :

(a) obtain consent of directors to act as such in Form 29;

(b) obtain certificate of commencement of business; and

(c) file the statement in lieu of prospectus with Registrar of Companies in Schedule IV to the Act.

1.16 Most of the above exemptions are not applicable to private companies which are subsidiaries of public companies. Thus, as stated earlier, the Act splits private companies into two categories: private companies *per se* and private companies which are subsidiaries of public companies. In spite of this, a dilemma occurs when private companies undertake activities, given their nature or size, that are really more akin in scale to a public company. The problem of how such companies should be treated was sought to be addressed by the insertion of section 43A in the Act. The object of the amendment, as brought out in the notes to the Bill for the Companies (Amendment) Act of 1960, was described as under :

> *"The amendment proposed implements the recommendation - - - that private companies which employ public money to an appreciable extent should be subject to the same restrictions and limitations as to disclosure and otherwise as applied to public companies."*

1.17 This amendment was based on the Report of the Companies Act Amendment Committee (1957). To demonstrate that it has not been easy to distinguish private companies as small businesses from private companies having considerable public interest, it is worthwhile quoting paragraph 23 of the said Report which reads as under:

> *"23. Private companies are exempted from the operation of several sections of the Act and enjoy certain privileges, principally on the ground that they are family concerns in which the public is not directly interested. It is, however, well known that there are many private companies with large capital doing extensive business and controlling a number of public companies. This is made possible because funds of other companies, public and private, are invested in such private companies. As public money is invested in such companies there is no*

reason for treating such companies, as private companies. The problem of private companies has always been somewhat difficult. On the one hand, there are genuine private companies which are nothing but glorified partnerships and, on the other, there are private companies whose operations, financial and industrial, are far wider than those of many public companies. To meet this problem, the Cohen Committee created the category of exempted private companies but the relevant provisions in the English Act are very complicated. It was strongly urged upon us that the several exemptions granted to and the privileges enjoyed by private companies should be withdrawn, as they are abused. But to withdraw them from all private companies may cause hardship to genuine small private companies. At the same time, there is no doubt that private companies, which employ public money directly or indirectly to a considerable extent, should be subject to the same restrictions and limitations as to disclosure and otherwise as apply to public companies."

1.18 In practice, however, the scheme of converting private companies into public companies, automatically as it were, did not work well; as a result, section 43A was amended twice, first in 1974 and again in 1988. It nevertheless became apparent that no amount of fine tuning could actually make this section an effective tool to identify larger private companies for differential treatment. As a result, section 43A was made inoperative in December, 2000. However, private companies were restrained at the same time from accepting deposits from persons other than shareholders, directors or their relatives, by virtue of an amendment in the definition of a private company under section 3(1)(iii) of the Act.

1.19 It has been stated before the Committee that three major factors/qualifications should be kept in mind while prescribing liberalised norms for private companies. First, the liberalised provisions will have to be limited to "small" private companies; small, in terms of paid-up capital or turnover or both; it can then be considered whether any, or some, of liberalised provisions can be extended to other (larger) private companies as well. The reason for this approach has been brought out in paragraphs 1.12 and 1.13 above. Secondly, the liberalisation may be optional, in the sense that smaller private companies may or may not utilise the extra benefits/exemptions instead of stipulating that all SPCs shall be governed by the liberalised regulatory regime. The idea is to let the smaller private companies comply with some of the provisions of the Act if they want to do so to satisfy some stakeholders. For example, private companies are exempt from issuing a prospectus, or filing a statement in lieu thereof (section 70 of the Act) for raising capital. But, if the company wishes to do so, it may have the option of filing the prospectus/statement in lieu thereof. Thirdly, exempted private companies that have financial dealings - by way of inter-corporate deposits, trade advances, loans, investment or any other clever derivation thereof – with public or listed companies, will have to be treated quite separately, in order to avoid siphoning of funds from the latter.

1.20 The Department of Company Affairs (DCA) has itself suggested that further liberalisation can be considered in the areas listed below :

(a) a simpler annual return, that merges the balance sheet with the annual return;

(b) annual filing of documents as against event-based filing;

(c) exemptions from some requirements of MAOCARO;

(d) a simpler disclosure statement (Schedule VI);

(e) exemption from restrictions on employment of relatives (section 314);

(f) exemption from obtaining permission to appoint sole-selling agents (section 294AA);

(g) allowing private companies to have contracts with companies in which directors are interested (section 297);

(h) simplify procedure for deletion of names of defunct companies (section 560);

(i) simplify procedure for winding up (chapter 6 of part VII);

(j) prescribe for fewer than four board meetings (section 285);

(k) simpler format for articles of association (Table A);

(l) allow buy-back of shares (section 77);

(m) no restrictions on sweat equity (section 79A);

(n) prescribe fewer statutory registers (various sections);

(o) simplify procedure for reduction of capital (sections 100-103);

(p) allow payment of interest out of capital (section 208);

(q) allow issue of shares at a discount (section 79); and

(r) ease time limit for delivery of instrument of transfer of shares [section 108(2)].

1.21 It is now widely recognised that numerous requirements of compliance provided under the Act, meant primarily for public companies, are unnecessarily extended – due to the structure of the Act – to private companies, including to private companies which are "small". As public investment in these companies is minimal, and financial institutions, including banks, have the skills and professionalism to protect their interests, this is not adding value to the management of assets in the corporate sector at all. To the contrary, it has added to compliance costs which, in the case of a large number of private companies, can be time-consuming and unduly burdensome. It may be noted that almost 83% of the private companies have a paid-up capital of below Rs.25 lakhs, and about 92% have a paid-up capital of less than Rs. 50 lakhs*. It has been convincingly argued before the Committee that misuse of private companies by

* Source : Economic Intelligence Service – Corporate Sector, May, 2002 published by Centre for Monitoring Indian Economy Private Limited (CMIE).

certain unscrupulous entrepreneurs should not force such a large majority of small private companies to face the extensive rigours of compliance laid down in the law. The Committee is also conscious of the fact that compliance requirements have inundated the offices of the Registrars of Companies (**RoCs**) with paperwork, which is difficult for them to handle or file, much less examine in any meaningful way. Quality of regulatory work has suffered. There is no doubt that the DCA's regulatory effectiveness would increase manifold if its paperwork was limited to public companies, in which public and stakeholders' interest is substantial, without getting bogged down with papers received from a large number of private companies as returns, etc.

1.22 Keeping in mind the above and that legal reforms are integral to the economic process, the Committee has made recommendations to address the need :

(a) for providing adequate flexibility to companies/firms conducting, or intending to conduct, business or providing or intending to provide, professional services;

(b) for providing a structural environment that is conducive to the growth and prosperity of the entities, being mindful of the impact on various stakeholders, and effective regulation, in a manner that minimises and deters exploitation of the liberalised provisions by unscrupulous elements; and

(c) to simplify and rationalise entry and exit procedures (especially for non-functional companies).

1.23 Apart from this introduction, the Report has four more chapters. Chapter 2 deals with private companies and the concessions that may be extended to them and exit framework for defunct companies; Chapter 3 makes recommendations regarding limited liability partnerships; Chapter 4 contains recommendations on the Indian Partnership Act, 1932; and, the concluding Chapter 5 makes other, but related, recommendations for Government's consideration.

2

Private Companies

2.01 The Committee recognises that after economic liberalisation, a more dynamic business environment calls for entrepreneurs to have a free hand to manage their business in an efficient manner, without wasting resources on non-essentials. Such resources can be conserved, to a considerable extent, by addressing concerns which arise from certain avoidable regulatory measures. Businesses should have an open but accountable environment to operate in, to maximise resource utilisation. One of the areas in which reform is required is the regulatory regime governing private companies in India. Drawing a distinction between private and public companies for the purpose of regulation is an important issue of contemporary relevance. While this distinction has been recognised, it has not yet resulted in a fully facilitative regime for private companies. The law reflects a "common minimum standard" approach in order to regulate both types of companies, instead of regulating each category differently. The justification for such differential treatment lies in the fact that while public companies involve public funds and interest, as they have access to equity contributions and deposits from the public, in the case of private companies such public interest is minimal. The argument has greater force for private companies that are really small in terms of paid-up capital and/or turnover.

2.02 The Committee has recognised certain broad areas of reforms for private companies in two classes. These are:

(a) determining the criteria for a private company to qualify as a small private company, and extending extra benefits/ exemptions to them; and

(b) specifying further benefits/exemptions that can be extended to all private companies irrespective of size.

2.03 There are four possible ways of implementing the reforms recommended by the Committee. These are :

(a) by inserting a new chapter in the Act to establish a regulatory framework for small private companies; or

(b) enactment of a separate statute to deal specifically with private companies; or

(c) by amending the relevant sections of the Act under which extra benefits/exemptions may be given to all private companies; or

(d) inserting a new section in the Act (similar to the existing sections 620 to 620C of the Act), for empowering the Government to modify any of the provisions of the Act in their application to small private companies from time to time.

2.04 The Government may decide on the method of implementing the recommendations of the Committee. The Committee feels the last option (d) in paragraph 2.03 above may be the quickest, and as efficacious as the other three, and recommends the fourth method.

Criteria for determining small private companies

2.05 Determining the definition of small private companies is of critical importance in simplifying and easing their regulation. Pursuant to the liberalisation of conditions for foreign direct investment in India and the prevailing lacklustre stock market environment, private companies of bigger size have, and will, come up in future to exploit economic opportunities. Public interest would, in such cases, assume significance by the very nature of their size and resource utilisation. The Committee feels that this is an important element which should not be ignored while suggesting the distinguishing criteria/indicators for defining a small private company.

2.06 The many scams that have rocked the market in recent years amply demonstrate that managements/directors of listed companies have often used shell private companies as fronts or conduits to park or siphon off funds from listed companies, something that is tantamount to defrauding stakeholders, especially the small minority shareholders. The Committee is alive to the problem that, in easing the regulatory regime for private companies, it might create loopholes that would facilitate the unscrupulous to exploit facilitative or well-meaning reform and provisions. In making recommendations, the Committee has endeavoured to prescribe simpler compliance and filing requirements for private companies which are genuinely small businesses, and which find the current requirements of compliance both expensive and onerous. These advantages should not extend to companies that are merely masquerading to be small private companies, waiting to be used as fronts or conduits for diversion of funds by unscrupulous promoters and managements.

2.07 The Committee is aware of the possibility that the paid-up capital with [or without] free reserves, and turnover could serve as criteria for determining a small private company. However, using one or more of the aforesaid determinants to define a small private company may be misleading. For example, there are companies which have a huge turnover, but a nominal paid-up share capital. Similarly, there are some companies with a large capital base but little turnover. Accordingly, the Committee suggests that even if a particular private company satisfies the criteria prescribed for a small private company, still such company should satisfy the test that its cumulative annual receipts do not exceed a prescribed multiple of its paid-up capital and free reserves (say 100 times) or a prescribed threshold for cumulative annual receipts. This aspect has been dealt with in detail in Chapter 5. Further, the Committee suggests that private companies which are registered as small-scale units (**SSIs**) should qualify as small private companies irrespective of the aforesaid criteria of paid-up capital, annual receipts from sales/services, or annual receipts from other services, but subject to its meeting the test in relation to the prescribed multiple of its paid-up capital and free reserves.

2.08 The Committee suggests that the aforesaid criteria and test will have to be self-administered by the companies. In other words, if a company exceeds, in any financial year, the limits set, then beginning that financial year itself it will not avail of the benefits/exemptions available to small private companies.

Recommendation 2.1 : Criteria for determining small private companies

- The current distinctions between private companies, public companies, and private companies that are subsidiaries of public companies, as provided in the Act need not be disturbed.
- However, 'small' private companies (SPC) may be distinguished and singled out for special treatment.
- A SPC would be a private company that :
  (a) has a paid-up capital and free reserves of Rs. 50 lacs or less, or as may be prescribed from time to time;
  (b) has an aggregated annual receipts from sales/services , not exceeding Rs. 5 Crores;
  (c) has other receipts not exceeding Rs. 5 Crores; or,
  (d) is registered as a SSI unit, notwithstanding its paid-up capital or aggregate annual receipts.
- If any SPC crosses the threshold limits provided either in (a), (b) or (c) above, it will be treated at par with other private companies, and exemptions available to a SPC will not be available to such companies for the financial year in which the threshold is crossed, and two financial years thereafter.

For the purposes of this recommendation, "other receipts" are any and all sums received by the company whether by way of security deposits, deposits, trade advances, other advances or any other sums by whatever name called (other than receipts from sales/services).

Standard form for incidental objects clause

2.09 Section 13(1)(d) of the Act requires that the Memorandum of Association (MoA) of a company must state its main objects, objects which are incidental or ancillary to the attainment of the main objects (incidental objects) and the other objects. The Committee is of the opinion that there is a lack of clarity regarding the question of what constitutes incidental objects. This clarity has caused companies to draft lengthy incidental objects clauses, in the nature of an umbrella provision.

2.10 The incidental objects must have a reasonable, proximate connection to the main objects specified; otherwise, there should be a categorical provision for the activity in question in the main objects clause. The Committee is of the opinion that a standard printed format of incidental objects should be made available for use by all private companies and in the case of SPCs, there should not be other objects clause as presently required under section 13(1)(d) of the Act.

Recommendation 2.2 : Standard form for incidental objects clause

- A standard format of incidental objects should be prescribed for all private companies who should then not be required to have any other "Incidental Objects". The proposed format for the incidental objects clause is:

  "In connection with the main objects, the Company shall have the power to invest its funds in real property and securities, to borrow and make advances, to acquire, own, and dispose of real and personal property, and to do all other acts incidental and necessary, as may be prescribed, for the accomplishment of the purposes stated in the main objects clause."

- There should not be 'other objects clause' in the MoA in the case of SPCs.

Objects clause

2.11 The requirement of the object clause in the MoA is to proclaim the main purpose of the company and to ensure that third parties dealing with the company and the members understand the objectives of the company. Any change in its core business activities would require an amendment of the documents of incorporation and, consequently, sanction of the members. Under section 17 of the Act, alteration of the object clause of a company requires a special resolution permitting such alteration. However, the alteration must be one, which can be 'advantageously or conveniently combined' with the existing business of the company. Further, restriction or abandonment of an object also requires a special resolution under section 17 of the Act besides other grounds for alterations mentioned in that section.

2.12 Any attempted departure from the main or other objects listed in a company's MoA is an action *ultra vires* of its constitution and hence, void *ab initio*. Such an action is incapable of being validated even by the unanimous consent of the members of the company. This has grave implications for all concerned, especially third parties involved in dealings with the company in question. Any person who enters into a transaction with a company, and that action of the company is later found to be *ultra vires*, has no remedy in law against the company.

2.13 To avoid stepping beyond the scope of the main objects, companies started listing an exceedingly large number of main objects in the MoA. While there have been divergent practices in the offices of the RoCs as to the number of clauses or objects that may be listed under 'Main Objects' in the MoA, there have been instances of companies listing upto a hundred objects. The Committee feels that such attempts have led to a situation whereby the sanction of members is no longer required, as per section 17 of the Act, even if the company decides to substantially change the nature and scope of its business.

2.14 It was brought to the notice of the Committee that the new law enacted in the United Kingdom for private companies was limited to companies having a single main object clause. The *rationale* is that if businesses are generally small, they are not likely to have more than a single main object. It may be noted that activities incidental or ancillary to the attainment of the single main object are, in any case, permitted. The Committee, consistently with its philosophy of extending concessions only to genuinely small businesses and not to front companies or conduits, felt that allowing an SPC to have multiple objects was likely to lead to misuse. If a company has several or multiple objects, it is, or is aspiring not to, remain small and therefore, should comply with the requirements of the Act as applicable to private companies.

Recommendation 2.3 : Objects clause

- Only companies that have a single main object will qualify as SPC, and enjoy the exemptions available to SPCs.
- Existing companies can amend their object clauses to a single main object clause, by following the procedure laid down in section 17 of the Act, if they want to avail of the benefits being offered to SPCs.

Validity of share transfer forms

2.15 In terms of section 108(1A)(b)(ii) of the Act, the validity of the instrument of transfer of shares of a private company is two months from the date of presentation before the prescribed authority.

2.16 The Committee believes that though under section 108(1D) of the Act, the validity of an instrument of transfer can be extended by the RoC, it would be appropriate to amend this section so that the validity of the instrument of transfer of shares in the case of private companies is one year from the date of presentation before the prescribed authority to avoid hardship to the persons in arranging the extensions under section 108(1D) of the Act.

Recommendation 2.4 : Validity of share transfer forms

- Section 108(1A)(b)(ii) of the Act be appropriately amended so that in the case of private companies the validity of the instrument of transfer of its shares is one year from the date of presentation before the prescribed authority.

Operations and management

Shifting of registered office

2.17 In terms of section 146 of the Act, companies are required to pass a special resolution to approve the relocation of their registered office outside the local limits of any city, town or village where such registered office is situated. A special resolution is a means to ensure that small and passive investors would be able to participate and in fact their consent would become important for effecting any change in the character of a company which includes *inter alia* its registered office.

2.18 In a private company, members are few and have substantial involvement in the management. Most of the members are normally represented in the board itself either directly or through nominee directors. In such a scenario, the consent of members by way of a special resolution is a formality, after the board of directors has approved of it. The Committee, therefore, feels that in a private company, the power to change the location of the registered office may be given to the board of directors, but the decision should be communicated to all the members.

Recommendation 2.5 : Shifting of registered office

- Unless otherwise provided in the articles of association of a private company (the "AoA"), a private company may shift its registered office with the approval of its board of directors, provided all members are notified of the decision before its actual implementation.

Power to close register of members and debenture-holders

2.19 In terms of section 154 of the Act, the register of members and debenture-holders can be closed only after giving seven days' notice through advertisement and for a maximum of 45 days, but not exceeding 30 days at a single point. The section seeks to protect the rights of members and other investors in companies. In private companies, shares and debentures are not issued through a public issue. Members have greater control and can protect their rights through contract, something investors in a public company are unable or incapable of doing. Furthermore, in a private company there are ordinarily only a few members who generally belong to the same family or are friends and there are also inherent restrictions agreed to amongst them on transferability of shares.

2.20 The closure of the register of members is usually resorted to facilitate the determination of the entitlement of the members to the dividends and to bonus and rights shares which are matters of much greater significance in public and listed companies. Therefore, the Committee believes that the requirement of advertisements in newspapers about closing of the aforesaid registers is not required in case of private companies.

Recommendation 2.6 : Power to close register of members and debenture-holders

- Unless otherwise provided in the AoA, a private company should be exempt from having to give prior notice through an advertisement in a newspaper about the closing of its registers of members and debenture-holders.

Foreign registers

2.21 In terms of section 158 of the Act, the foreign registers maintained by a company can be closed only after giving an advertisement in some newspaper circulating in the district wherein the foreign register is kept. The Committee believes that few private companies will have foreign registers and since in private companies there is unlikely to have wide public interest, the requirement of advertisement be dispensed with.

Recommendation 2.7 : Foreign registers

- Unless otherwise provided in the AoA, a private company be exempt from giving previous notice by an advertisement in a newspaper of the closing of its foreign register.
- The details of the foreign registers maintained by a private company should be mentioned in the annual return or directors' report.

Requirement of annual return

2.22 In terms of section 159 of the Act, an annual return is required to be filed by a company having a share capital with the concerned RoC within 60 days from the date of holding an annual general meeting **(AGM)**. A company is required to hold its AGM on or before the expiry of six months from the closing of its financial year unless extension of time in this regard has been granted by the RoC.

2.23 Annual return provides *inter alia* information as to the capital structure, the registered office, the board of directors, the members and the debenture-holders and indebtedness of the company. The information on these particulars is as on the date of the AGM. Ordinarily disclosure by a private company of its members is not of importance as these companies are closely held and controlled, and change in the share-holding is not a regular feature as in the case of listed companies because of restrictions on the transferability of shares and there being few members in private companies. Additionally, a company is under an obligation to file the particulars of change in the directors of the company with the concerned RoC within 30 days of such change. The RoC is also kept updated on the change in the registered office of a company.

2.24 Any change in the share capital or the indebtedness of the company between the date of the close of the financial year in relation to which the accounts are prepared and the date of the AGM is all available in an annual return. This updated information is generally not of public interest, in the case of private companies. Ordinarily, the annual accounts and the directors' report are approved by the board of directors some days before the date of holding the AGM. Therefore, the Committee believes that the aforesaid information may be given as of the date of the meeting of the board of directors approving the annual accounts in the directors' report.

Recommendation 2.8 : Requirement of annual return

- Private companies may be given a one time option to either file an annual return or include in the directors' report a compliance statement with respect to the provisions of section 3(1)(iii) of the Act, information as to unpaid dividends, if any, and the directors comprising the board, and changes in its members or their shareholding since the last AGM.
- Appropriate amendments be carried out to sections 159 and 217 of the Act to provide for such an option to a private company.

Extra ordinary general meetings on requisition

2.25 In terms of section 169 of the Act, a company needs to follow a very detailed procedure for calling an extra ordinary general meeting by members.

2.26 In all companies, the relationship between members and the company is determined according to the AoA agreed upon by the members. In a public company, there is reason for regulation of certain matters because otherwise the promoter-members may frame the AoA in a manner that the general investors may not be able to ever call for an extra ordinary general meeting or circulate any resolution. It ought to be noted that private companies are generally member-managed and unlike a public company, the members participate in the preparation of the AoA. The Committee believes that private companies can therefore determine freely the particular numbers of its members or requisite percentage of shareholding held by members *entitled to vote* that would be adequate to call an extra ordinary general meeting.

Recommendation 2.9 : Extra ordinary general meetings on requisition

- A private company should be allowed to provide in its AoA the manner and time- frame in which an extra ordinary general meeting of such company can be called on requisition of its member(s).
- However, this should, where approvals are concerned, be with reference to members entitled to vote, and not members present and voting.
- Appropriate amendments be made to sections 169 and 170 of the Act to give effect to this recommendation.

Circulation of members' resolution

2.27 In terms of section 188 of the Act, an expensive procedure has been laid out for circulation of members' resolution, at a meeting of its members, on the request received by a company from the requisite number of members.

2.28 Private companies are member-managed and unlike a public company, most members are able to participate in the finalisation of the AoA. Accordingly, the Committee feels that private companies should have the freedom to determine under its AoA the manner for circulation of members' resolution.

Recommendation 2.10 : Circulation of members' resolution

- A private company should be allowed to provide in its AoA the manner of circulation of members' resolutions.
- Appropriate amendments be made to sections 188 and 170 of the Act to give effect to the recommendation.

Written resolutions in lieu of general meetings

2.29 Section 189 of the Act provides what constitutes an ordinary or a special resolution and the prescribed majority required for passing such resolutions at the meeting of the members of a company. Under the Act, there are no specific provisions permitting written resolutions. Holding general meetings to pass such resolutions is cumbersome and involves unnecessary expenditure. Moreover, non-conformance with the statutory requirements leads to invalidation of the resolution.

2.30 The Committee feels that this is excessively burdensome on private companies where more often than not, members are closely related and act informally. Adopting a procedure for 'written resolutions' will be expedient and simpler.

Recommendation 2.11 : Written resolutions in lieu of general meetings

- Private companies may pass written resolutions by circulation. If passed by circulation, ordinary resolutions will require a simple majority of those eligible to vote and special resolutions will require three-fourth majority of those eligible to vote.
- Such resolutions should be recorded in the minutes book within 30 days of passing thereof. Further, resolutions thus passed should be taken note of in the very next meeting, and the minutes of the very next meeting must record that such resolutions are noted, and approved.
- Private companies will be required, as before, to hold annual general meetings; these cannot be done away with.
- However, if private companies have only two members, then they may even hold the annual general meeting by circulation. Resolutions passed in the meeting so held, should be recorded in the minutes book within 30 days of passing thereof.
- Written resolutions can be passed through various forms of electronic communication, provided there is compliance with the Information Technology Act, 2000 and other applicable laws.

Prohibition on simultaneous appointment of different categories of managerial personnel

2.31 In terms of section 197A of the Act, no company can appoint or employ, at the same time, both a managing director and a manager.

2.32 Under the Act, a private company is not required to have either a managing director or a manager. In view of this fact, the Committee believes that private companies should be free to deal with their managerial resources in the manner they deem fit, since public funds are not at stake.

Recommendation 2.12 : Prohibition on simultaneous appointment of different categories of managerial personnel

- The provisions of section 197A of the Act should not be applicable to private companies.

Dividend

2.33 Sections 205 and 205A of the Act deal with the manner of calculation and distribution of dividend by a company, depositing dividend in a separate bank account, quantum of profit to be transferred to reserves prior to declaration of dividend and transfer of unpaid dividend to a special dividend account.

2.34 Dividend, once declared by a company, is required to be paid within 30 days and, in the meanwhile, to be deposited in a separate bank account within 5 days from the date of declaration. Unclaimed dividends are held by a company in trust for the members until their transfer to Investor Education and Protection Fund pursuant to the provisions of sections 205B and 205C of the Act. Such provisions are aimed at protecting the interests of investors and are important to listed companies. The members of private companies should be allowed to determine the manner of protection of their interests. Accordingly, the Committee believes that the requirement to open separate bank account can be dispensed with in the case of private companies as it seems to serve no real purpose.

2.35 Under the Act, even after allowing for depreciation all companies have to also transfer a portion of their profits to free reserves, before the remaining profits are available for distribution as dividend. The rationale is perhaps the same as saving for the rainy day. With respect to a private company, where there is no public interest involved, the State should not play a quasi – parental role and let the members decide what is beneficial for them and the company.

Recommendation 2.13 : Dividend

- Private companies should be exempted from having to deposit the funds for dividend in a separate bank account and transferring the unpaid dividend amount to a special dividend account.
- Unless otherwise provided in the AoA, private companies should have the freedom to deal with the unpaid dividend until its transfer to Investor Education and Protection Fund pursuant to the provisions of sections 205B and 205C of the Act.
- Appropriate amendments be made to the Act and the (Transfer of Profits to Reserves) Rules, 1975 to give effect to this recommendation.

Payment of interest out of capital

2.36 In terms of section 208 of the Act, payment of interest out of capital on the shares issued for the purpose of raising money to defray the expenses of the construction of any work or building, or provision of any plant which cannot be made profitable for a long period can be made only after complying with certain requirements as provided in section 208 of the Act, including the approval of the Government.

2.37 In a private company, the members have substantial interest in the actual management of the company. They are aware of the policies of the company, having been responsible for their formulation. The Committee believes that the restrictions, and the approvals to be obtained, serve as an unnecessary hindrance to the independence of management of the affairs of such private companies. Moreover, payment of interest in cases where the gestation period is very long serves as an incentive for investment in plant and machinery.

Recommendation 2.14 : Payment of interest out of capital

- Unless the AoA otherwise so provide, private companies should be exempted from the restrictions and the requirement of having to seek the approval of the Government, for payment of interest out of capital.
- The requirement of authorisation under the AoA to make such payments should continue to be retained in section 208 of the Act.

Right of other persons to stand for directorship

2.38 Section 257 of the Act deals with the right of persons other than retiring directors to stand for directorship. Sub-section (1) provides that a person who is not a retiring director shall be eligible for appointment to the office of a director if a notice signifying his candidature is sent to the company not less than fourteen days before the general meeting. Under section (1A), the company is required to inform its members of the candidature of the person by serving individual notices. In terms of sub-section (2), the provisions of the sub-section (1) are not applicable to a private company, unless it is a subsidiary of a public company.

2.39 Interpretation of the different provisions as aforesaid, would mean that while the main provision contained in sub-section (1) is not applicable to a private company which is not a subsidiary of a public company, consequential provisions contained in sub-section (1A) are applicable to such companies. The anomaly seems to have arisen at the time of insertion of sub-section (1A) through the Act 65 of 1960 without consequential amendment in the sub-section (2). The anomaly needs to be removed.

Recommendation 2.15 : Right of other persons to stand for directorship

- Sub-section (2) of section 257 may be amended to provide that the provisions of the section shall not apply to a private company, unless it is a subsidiary of a public company.

Board meetings

2.40 In terms of section 285 of the Act, there is a requirement for holding four meetings of the board of directors of a company in a calendar year. Furthermore, certain matters are required to be dealt with only at a meeting of the board of directors of a company, as provided in section 292 of the Act.

2.41 Holding of four board meetings in a calendar year is a cumbersome requirement for small private companies, as business transacted by these companies is significantly less than public companies. They are also mostly managed by the member-directors. SPCs should thus have the flexibility to hold board meetings according to business exigencies. These companies would in any case have to hold board meetings for matters mandated by the Act.

Recommendation 2.16 : Board meetings

- The requirement related to Board meetings should be relaxed for SPCs. Unless otherwise so provided in the AoA, SPCs should be required to hold board meetings atleast once in a calendar year.
- The provisions of section 292 of the Act should not be applicable to an SPC.
- SPC should be allowed to provide in its AoA the manner for dealing with the matters mentioned in section 292 of the Act.

Sole selling agents

2.42 Section 294 of the Act which deals with the appointment of sole selling agents by a company provides *inter alia* for the approval of the members of the company to the appointment of a sole selling agent made by the board, and powers to the Government to examine *suo motu* whether the appointment of a sole selling agent is prejudicial to the affairs of the company. Further, in terms of section 294AA of the Act, approval of the Government is required for appointment of sole selling agent by a company when the proposed sole selling agent holds substantial interest in such company. Where such company has a paid-up capital of Rs. 50 lakhs or more, the approval of both the Government and the members is required for the appointment of sole selling agents.

2.43 In private companies, most of the members are normally represented in the board itself either directly or through nominee directors. Accordingly, the Committee believes that freedom and flexibility should be given to members in private companies to contractually determine in their AoA, the manner, terms and conditions on which sole selling agents can be appointed. No purpose is served by specifying that the agents can only be appointed in general meeting or in certain cases with the approval of the Government. Interference by, and approval of the Government, are an avoidable hindrance to the efficient utilisation of the resources of such private companies.

> **Recommendation 2.17 : Sole selling agents**
>
> - The provisions of sections 294 and 294AA of the Act should not be applicable to private companies.
> - The AoA of private companies should provide for the manner, terms and conditions on which sole selling agents can be appointed.

Sanction of the board for certain contracts

2.44 In terms of section 297 of the Act, sanction of the Board is required for certain contracts in which directors and the specified categories of persons are interested. Further, where the paid-up capital of a company is Rs. 1 crore or more, the approval of the Government to enter into such contracts is also required.

2.45 The Committee believes that the requirements of section 297 of the Act are aimed at strengthening transparency and corporate governance, and are therefore of significance in the case of public companies alone.

> **Recommendation 2.18 : Sanction of the board for certain contracts**
>
> - The provisions of section 297 of the Act should not be applicable to private companies.
> - The AoA of private companies should provide for the manner of, and restrictions with regard to, entering into contracts of the nature mentioned in section 297 of the Act.

Disclosure to members of director's interest in contract appointing manager, managing director

2.46 In terms of section 302 of the Act, a company is required to send to every member of such company, within the prescribed period of entering into a contract or of varying of the contract in relation to appointment of managers or managing directors, an abstract of the terms of the contract or variation, together with a memorandum clearly specifying the nature of concern or interest of the director in such contract or variation.

2.47 The Committee believes that as private companies are ordinarily member-managed companies, there is no need to make separate disclosures to the members informing them of the terms of or variations in management contracts. In case of such companies, the approval to such management contracts, or variations therein, given by the board of directors of such companies should suffice.

Recommendation 2.19 : Disclosure to members of director's interest in contract appointing manager, managing director

- The provisions of section 302 of the Act should not be applicable to private companies.
- Private companies should be required to get the terms of the management contracts or variations therein approved at the meeting of their board of directors unless the AoA of such companies provide for a different manner to deal with management contracts.

Alternate director

2.48 Subject to the provisions of section 313 of the Act, the board of directors may, if authorised by the AoA, or by a resolution passed by a company in general meeting appoint an alternate director to act for a director during his absence for a period of not less than 3 months from the State in which the meetings of the board are ordinarily held.

2.49 The Committee believes that since private companies are ordinarily member-managed, it would be advisable that the private companies should provide in their AoA the manner of appointing an alternate director.

Recommendation 2.20 : Alternate director

- The provisions of section 313 of the Act should not be applicable to private companies.
- The AoA of private companies should provide for the manner of appointment of an alternate director.

Director, etc. not to hold office or place of profit

2.50 In terms of section 314 of the Act, no director of a company or the persons specified therein can hold any office or place of profit in a company except with the consent of the members accorded by a special resolution. Further, section 314 of the Act requires the approval of Government for payment of remuneration, exceeding the prescribed limits, to persons specified therein for holding any office or place of profit in the company.

2.51 With stiff competition prevailing in the present day business environment, the trend, in any case, is of managing businesses more professionally. This leaves little room for the management of a private company to fill in an office of profit with their kith and kin, unless they are capable of handling the responsibilities. Such a provision acts as an obstacle to a private company in using a capable person from within the family for managing the business.

Recommendation 2.21 : Director, etc. not to hold office or place of profit

- The provisions of section 314 of the Act should not be applicable to private companies.

Compensation for loss of office

2.52 In terms of section 318 of the Act, no payment may be made as compensation for loss of office, or consideration for retirement from office, or in connection with such loss or retirement, except to a managing or whole-time director, or to directors who hold the office of managers subject to the limits on compensation provided in sub-section 4 of section 318 of the Act.

2.53 The Committee believes that in the case of private companies, compensation that can be paid to the managerial personnel mentioned in section 318 of the Act in the event of loss of office, or as consideration for retirement from office, or in connection with such loss or retirement, should be contractually determined on the basis of contract law, *viz.* the law on damages. However, restrictions can be placed by the members in the AoA of such companies.

Recommendation 2.22 : Compensation for loss of office

- Section 318 of the Act be appropriately amended so that sub-section (4) of this section is not applicable to private companies.
- Private companies may provide for compensation for loss of office in the AoA of the company.

Exit framework for defunct companies

2.54 Presently, there are over 6 lakh companies registered with the Registrar of Companies throughout the country. Nearly, 90% of these companies are private companies. In other words, there are over 5 lakh private companies in the country. According to the DCA, almost half of the companies do not file their annual accounts and annual return. There is every likelihood that a very large number of such companies, who have not been filing their annual return and annual accounts, have no operations and have not been carrying on any business.

2.55 In other words, there are a large number of companies, particularly private companies, which have become defunct for various reasons. Promoters create a company with a specific purpose, which they intend to achieve through the medium of a company. However, after the incorporation of the company, there could be a change in the circumstances, e.g. failure of a proposed joint venture, failure to obtain finance, differences among the promoters, change in Government policy, etc. In such cases, the promoters are no longer interested in the company incorporated by them. As the rationale for creating the company itself ceases to exist, it becomes a shell company and survives only on paper.

2.56 Then there are companies created for specific projects and after their completion, such companies do not carry on any business and become defunct. The prime example of this category of companies could be found in the construction industry. Builders, while developing plots for construction purpose, create a separate company for development of each project and after completion of the project, the company ceases to have any operations and merely continues to exist on the shelf. In addition, there could be various other reasons due to which companies cease to carry on business and become defunct over a period of time. A very large number of such companies have few assets and generally, no third party liabilities. They continue to exist on paper solely because putting them to permanent sleep (winding up) is a costly and time-consuming process.

2.57 Under section 560 of the Companies Act, the Registrar has the power to strike off the name of a company which is not carrying on business or in operation. The Committee noted that the procedure laid down even for this summary power was excruciatingly slow and, in spite of that, the question of liabilities that a company might be carrying was not adequately addressed. As a result, RoCs have rarely, if ever, used the power given to them in this section. Unfortunately, companies themselves do not have a remedy under this section; and if a company decides to close down, it has to follow the lengthy and judicial process of winding up. A need to have a simplified exit scheme, at least for small private companies, is clearly established.

2.58 Such a scheme should require only the following limited paperwork :

(a) an application in a prescribed form;

(b) copy of the latest audited balance sheet;

(c) an affidavit from at least two directors swearing that there are no liabilities on the company; and

(d) an indemnity bond from these two directors, should there be any undisclosed liabilities that may be found later.

2.59 The Committee noted that the Government have, in fact, issued a scheme for simple exit in the meanwhile, more or less along the above lines. However, the Committee believes that the solution should be permanent, and in law, and that the scheme should be such that it does not take more than four months for a company to exit, if it so wishes. Accordingly, it is recommended that :

Recommendation 2.23 : Exit framework

- A simplified and quick exit scheme is needed for private companies.
- Such a scheme should be enshrined in law by necessary amendments to section 560 of the Act.
- The procedure involved in the simplified exit scheme should not take more than 120 days in any case.
- In fact, this may be extended to all companies.

3

Limited Liability Partnerships

Introduction and Scope

3.01 A Limited Liability Partnership **(LLP)** is a form of business entity which permits individual partners to be shielded from joint liability created by another partner's business decision or misconduct. In an increasingly litigious market environment, the prospect of being a member of a partnership firm with unlimited personal liability is, to say the least, risky and unattractive. Indeed, this is the chief reason why partnership firms of professionals, such as accountants, have not grown in size to successfully meet the challenge posed today by international competition. This makes an LLP a most suitable vehicle for partnerships among professionals such as lawyers and accountants. A LLP enters into contracts in its own name in the same way as a limited company, but its members have the advantage of limited liability similar to the shareholders of a company. Thus, in the event of a business failure or a tortuous complex of disputes and claims, the liability would be limited to the partner responsible. There would be no recourse to attach the personal assets of the other members, except the member who was personally responsible to negligent. Similarly, a partner's liability is not limited when the misconduct takes place under his supervision or control. In other words, an LLP only protects a partner from liability arising from the incorrect decision or misconduct of other partners or any of its employees not under his control. The partnership is not relieved of the liability of its other obligations as a partnership.

3.02 Major accountancy firms, wanting to limit the liability of an individual partner to acts specifically related to that partner, launched a campaign for the creation of the LLP vehicle in the UK in the 1980s. As a result, the UK Companies Act, 1989 was amended to allow accountancy firms to work as limited liability companies. The joint and several liabilities of general partners, however, remained. In the 1990s, the accountancy firms in the UK again campaigned to end this, and to secure proportional liability in the LLP. This led to the passing of the Limited Liability Partnership Act, in the year 2000.

3.03 Under the LLP Act of 2000 of UK, a LLP has been defined as a body corporate, with a legal personality independent of its members without restriction on the number of partners, and with each partner's liability limited to the contribution made and liability accepted by that partner to the LLP. The law relating to general partnerships was made inapplicable to LLPs. An LLP is required to register the deed of incorporation with the Registrar. The subscribers to the incorporation documents are the initial members/partners; any other person may become a member by entering into an agreement with the existing members. Any change in the agreement, or indeed in the partnership, have to be duly intimated to, and registered with, the Registrar.

3.04 Every member is an agent of the LLP, and the LLP is responsible for the actions of its members, unless a particular member lacks the authority to act for the LLP for doing what he has done. In that case, the liability would be of that individual, and would be unlimited. The Committee noted that in this regard, the Texas LLP statute does not relieve a general partner from liability for the partnership's non-malpractice contractual and tort liabilities; the partners are insulated only from the vicarious responsibility for the partnership's malpractice-type liability. The Texas LLP statute has served as a model for many other LLP statutes in the USA. In some states of the USA, the LLP regime is more liberal. For example, the State of Delaware, famous for its *laissez-faire* approach to company law, has established a regime where any obligation of a LLP, whether arising in contract, tort or otherwise, is solely the obligation of the LLP. A partner is not personally liable, directly or indirectly, by way of indemnification, contribution, assessment or otherwise for such an obligation solely by reason of being or acting as a partner. Interestingly, the Delaware law also provides for, and permits, foreign limited liability partnerships: a prospect not likely to be welcomed by any body of professionals in India.

3.05 In India, some bodies of professionals have been prohibited from practicing under any incorporated form. The 'general partnership' or partnership *simpliciter* (**General Partnership**) has traditionally been the entity of choice to provide services by professionals such as lawyers, accountants, doctors, architects, and company secretaries.

3.06 It was strongly represented before the Committee that in an increasingly competitive and litigious business environment, there are several disadvantages attaching to the general partnership form. The larger implications of unlimited liability firms responsibilities were first seen in the 1990s, when many US law firms went insolvent in the wake of a $980 billion Loan and Savings scandal as a result of suits decreed in malpractice litigation. Not only were the firms' assets completely liquidated, under standard principles of partnership law, the partners were jointly and severally liable for the entire liabilities of the partnership. The prospect of being a partner in a partnership with unlimited personal liability is, as stated before, not an attractive proposition.

3.07 The Committee feels that with Indian professionals increasingly transacting with or representing multi-nationals in international transactions, the extent of the liability they could potentially be exposed to is extremely high. Hence, in order to encourage Indian professionals to participate in the international business community without apprehension of being subject to excessive liability, the need for having a legal structure like the LLP is self-evident. Provisions which restrict the number of partners to twenty prevent the growth of professional firms to the large entities operating on an international scale. Such inhibiting conditions have to be removed. Otherwise, Indian professionals may well get excluded from taking their rightful place in the international community, that their skills otherwise entitle them to.

3.08 It would be seen from discussions, in paragraphs 3.01 to 3.04 above, that, in a legal perspective, an LLP is a hybrid between a company and a partnership, but much closer to the private company form. The Committee believes that, to encourage greater professionalism and create commercially efficient, vehicles for providing service of the highest quality, it is essential to create a regulatory regime that would govern the formation of such a hybrid entity between the partnership *simpliciter*, or general partnership, and a private limited company, that is, an LLP. Such an entity would provide the flexibility of a partnership (allowing the owners to adopt whatever form of internal organization they prefer), and limiting at the same time, the owner's liability with respect to the LLP. Given the wide acceptability of the limited liability company, a partnership of recognised professionals should be given the choice to opt for a more suitable legal entity, and conferred the privilege of limited liability, especially if sufficient safeguards are put in place. The fundamental difference between an LLP and a limited liability company lies in the internal structure (the management-ownership divide inherent in a company is not there in a partnership), and this difference does not impact on the issue whether to confer the privilege of limited liability on a partnership firm of professionals. Since LLPs are now accepted non-corporate entities in developed countries like the USA and UK, it is appropriate to enhance the global competitiveness of our professional firms by ensuring that India's company law is flexible enough to provide mechanisms and instruments which foster growth of large professional firms.

3.09 The broad areas of analysis with respect to LLPs are:

(a) application of the LLP regime;

(b) incorporation, registration and number of partners;

(c) limited liability;

(d) financial safeguards; and

(e) tax treatment of LLPs.

3.10 To recapitulate, the broad distinction between a General Partnership and an LLP is as under:

(a) ***General Partnership*** – The partnership *simpliciter* constituted under the Indian Partnership Act, 1932. Each of the partners is jointly and severally liable for any liability arising out of or in respect of the partnership.

(b) ***Limited Liability Partnership*** – The LLP is a separate legal entity with unlimited capacity where no member or partner is liable on account of the independent or unauthorised actions of one's partner, and whose liability is limited to the respective stake of each in the LLP. The members of an LLP would have the option to have a general partner or more with unlimited liability, but it would not shield the partners from legal liability arising out of their own personal acts which are not done for and on behalf of the LLP, that is, any act done beyond the acts and powers of the partners as laid down in the incorporation document. Further, a partner's liability is not limited when the misconduct is attributable to him or to an employee under the supervision or control of that partner. An LLP only protects a partner, other than a general partner from the liability arising from the misconduct or personal acts of other partners.

Application of the LLP regime

3.11 In the Committee's view, the scope of LLP should, in the first instance be made available to firms providing professional services, as opposed to trading firms and or manufacturing firms, for several reasons. Firstly, because Indian professional firms are precluded from practicing under any other legal form in view of the restrictions imposed by their respective regulatory laws; trading firms or manufacturing firms, however, have the option to carry on business as a private limited or public company under the Companies Act, 1956. Secondly, as the professionals are also governed and regulated by their respective professional, regulatory bodies, which also control and monitor professional conduct, extending the LLP structure only to professionals minimises the risk inherent in testing new waters. Thirdly, there is no special advantage that small private companies or SSI units would derive from being an LLP, especially in light of the fact that this Committee itself is simultaneously recommending a considerable easing of regulations on private companies, specially small private companies. It was felt that extending the LLP structure to professionals, in the first instance, would help evaluate its advantages and risks; and based on such evaluation and experience, the LLP form can be considered for extension to small scale manufacturing and/or trading firms as well in the future.

Recommendation 3.1 : Application of the LLP regime

- Law may be enacted to provide for establishing Limited Liability Partnerships. The LLP form should be initially made available only to those providing defined professional services like lawyers, company secretaries, accountants and the like. To be eligible for this form of partnership, the profession must be governed by a regulatory Act that adequately controls and disciplines, errant professional conduct. Such professions may be notified by the Department of Company Affairs from time to time.
- LLP may be extended, at a later stage, to other services and business activities once the experience gained with the LLP form of organisation has been evaluated and tested.

Incorporation, registration and partners

3.12 An LLP must be incorporated by using a formal mechanism of filing the incorporation document with the RoC. Further, there should be no restrictions on the number of partners in an LLP.

Recommendation 3.2 : Incorporation, registration and partners

- Two or more professionals who wish to associate for the purpose of providing an identified professional service, may subscribe their names in an "incorporation" document in the prescribed form.
- The relations *inter se* the partners and between the partners and the LLP may be governed by individual agreements between the parties concerned. Such agreement must be filed with the RoC; changes made in the agreement will also have to be filed with the RoC.
- The LLP agreement should contain information as may be prescribed by the Department of Company Affairs.
- No limit be placed on the number of partners in an LLP. Any person may become a partner by entering into an agreement with the existing partners in the LLP. Further, when a person ceases to be a partner of an LLP he/ she should continue to be treated as a partner unless: (a) the partnership has notice that the former partner has ceased to be a partner of the LLP; or (b) a notice that the former partner has ceased to be a partner of the LLP has been delivered to the RoC. A partner having resigned from an LLP would continue to be liable for acts done by him during his tenure as member of the LLP.
- LLPs should be regulated and administered by the Central Government to ensure uniform standards, and since many of the State Governments might not have adequate infrastructure and expertise for ensuring effective regulation.

Limited liability

3.13 As opposed to the concept of joint and several liability, applicable in general partnerships, the liability for partners in a LLP should be limited. In other words, the LLP would assume liability in the event that a partner of the LLP commits an act of commission or omission for and on behalf of the LLP, that results in such liability. The partners would be liable only to the extent of their respective agreed contribution to the LLP without any recourse to the personal assets of a partner. However, as discussed in paragraph 3.10 (b) of this Chapter, the partners would still continue to be liable for their personal acts which are not done for and on behalf of the LLP, and were committed in their personal capacity, for example if a partner knowingly causes the LLP to commit a felony or tort.

3.14 Provisions dealing with insolvency, winding up and dissolution of an LLP should be similar to those provided for private companies in the Companies Act, 1956. There should also be provisions detailing the liability of partners to contribute to the assets of the LLP in the event of its being wound up.

Recommendation 3.3 : Limited liability

- Every partner of the LLP would be an agent of the LLP. However, an LLP would not be bound by anything done by a partner in dealing with a person if (a) the member in fact had no authority to act for the LLP by doing that act; and (b) the person knows that he has no authority or does not know or believe him to be a partner of the LLP.
- Where a partner of the LLP is liable to any person or entity as a result of his wrongful act or omission in the course of the business of the LLP, the LLP would be liable in such circumstances. However, the partner would be liable only to the extent of his/her contribution to the LLP.
- In the event of an act carried out by a LLP, or any of its partners, fraudulently, the liability would not be limited; it would, in fact, become unlimited as provided for in section 542 of the Companies Act, 1956.
- A partner shall not be liable for the personal acts or misconduct of any other partner.
- The provisions relating to insolvency, winding up and dissolution of companies as contained in the Companies Act, 1956 may be examined and suitably modified to conform to the philosophy of LLPs. The partners may have to contribute to the assets of the LLP in the manner provided for in this regard.

Compulsory insurance

3.15 To protect the interest of persons who might have claims against an LLP, all LLPs should be compulsorily required to take out an insurance policy that would cover its liabilities as an LLP to a reasonable extent. This is necessary as such persons might not get any real relief, since there will be no access to the assets of partners of the LLP except to the extent of his/her liability in the LLP. This would deter the creation of shell LLPs or asset-thin LLPs. Further, an LLP should, on request by persons dealing with them, permit inspection of the register containing the number and names of partners, the pattern and extent of liability of partners, the amount of insurance coverage and other such matters.

Recommendation 3.4 : Compulsory insurance

- There should be insurance cover and/or or funds in specially designated, segregated accounts for the satisfaction of judgments and decrees against the LLP in respect of issues for which liability may be limited under law. The extent of insurance should be known to, and filed with the RoC, and be available for inspection to interested parties upon request.

Financial disclosures

3.16 The standards of financial disclosure as applicable to private companies should also be made applicable to an LLP. The advantages gained from having the privilege of limited liability should be coupled with the responsibility of making adequate financial disclosures so as to minimise the chances of fraud and mismanagement. This should be subject to such privilege as may be available to a professional in his relationship with his or her client in maintaining confidentiality, and it may be different for different professions.

Recommendation 3.5 : Financial disclosures

- The standards of financial disclosures would be the same as, or similar to, that being prescribed for private companies subject to privilege already available between a professional and his or her client in maintaining confidentiality.

Tax treatment of an LLP

3.17 Section 10 of the UK LLP Act lays down that a trade, profession or business carried on by an LLP, with the view to profit, shall be treated as carried on in partnership by its members and not by the LLP itself. Thus, any asset held by an LLP, or any tax chargeable on gains made shall be treated as held by the partners, or gains made by the partners, and not by the LLP itself. In other words, an LLP enjoys a pass-through status and is not taxable as such; the taxation liability falls on the partners in their individual capacity. In the USA, too, LLPs enjoy a pass through status for the purposes of taxation. The profits or losses of the LLP pass through the business and are reported on each partner's personal returns.

3.18 This Committee would like to recommend the same pass through status for LLPs in India. However, the Committee recognises that it has neither consulted, nor got the views of the Ministry of Finance (Department of Revenue) in this regard. While recommending a taxation regime similar to that obtaining in the USA and UK, the Committee urges the Department of Company Affairs to incorporate such a regime in consultation with the tax authorities concerned.

Recommendation 3.6 : Tax treatment of an LLP

- The LLPs should be governed by a taxation regime that taxes the partners as individuals, rather than taxing the LLP itself, i.e., the LLPs should be treated in the same manner as the firm under the tax laws.

3.19 Some members of the Committee considered proposals received from experts including the draft of possible legislation. The draft Bill produced by them was discussed in the Committee. Shri Shardul Shroff, member of the Committee, has given a draft of the Bill on LLPs. The Committee has sent a copy of the same separately to the DCA.

4

The Indian Partnership Act, 1932

Introduction

4.01 The Indian law of partnership in India is based on the provisions of the English law of partnership. Until the English Partnership Act of 1890 was passed, the law of partnership even in England was largely based on legal decisions and custom. There were very few acts of parliament relating directly to partnership. The Indian Partnership Act of 1932 (**Partnership Act**) was the result of a Report of a Special Committee consisting of Shri Brojender Lal Mitter, Sir Dinshaw Mulla, Sir Alladi Krishnaswami Iyer and Sir Arthur Eggar.

4.02 Prior to the enactment of the Partnership Act, the law relating to partnership was contained in Chapter XI (sections 239 to 266) of the Indian Contract Act, 1872 **(Contract Act)**. These provisions contained in the Contract Act were not found adequate. As a result, Chapter XI of the Contract Act was repealed and replaced by the Partnership Act of 1932. The Partnership Act is a comprehensive framework for contractual relationships amongst partners, and the basis for a most popular form of organisation for small businesses. It is interesting to note that the Partnership Act has not been subject to any significant amendment since its enactment. Most of the organisations and individuals, who made presentations before the Committee did not have any major complaint about the existing regulatory regime, except for certain administrative aspects of the functioning of the offices of the Registrar of Firms in different States.

4.03 The Committee also feels that the Partnership Act does not require any major change. However, some minor modifications to the law seem necessary to enable the partnership form of organisation to keep pace with the changing business environment.

Registration of charges

4.04 The Partnership Act does not contain provisions for registration of charges, analogous to those contained in sections 124 to 145 of the Companies Act, 1956. The Indian Banks' Association in their representation pointed out that this omission is a handicap to partnership firms who find it difficult to obtain finances on more or less the same terms as applicable to corporates since it is impossible for lenders to verify the charges already created on the properties of the firm. Similarly, third parties proposing to deal with the firm are not able to access relevant records for conducting due diligence. In order to facilitate financing and growth of small scale industries and businesses in India, it seems necessary to put in place a mechanism for registration of charges in respect of even partnership firms. Being convinced of this, and being aware of the inadequate state of record-keeping in the offices of the Registrar of Firms, the Committee recommends :

Recommendation 4.1 : Registration of charges

- The Partnership Act should be appropriately amended to provide a legal framework for registration of charges, on the lines of the provisions of the Companies Act, 1956 or the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- Banks and financial institutions also should be permitted to file the papers for registration of charge, wherever they provide assistance against the security of asset/s. The firms can, of course, themselves get the charge/s registered. In either case, the documents would have to be authenticated by both the secured creditor and the lender.
- Charges should be registered either with the ROCs if the DCA is able to implement its comprehensive computerisation programme (DCA 21); alternatively, they can be registered with the Central Registry envisaged in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, if legally permissible and if the Registry is set up in time and has adequate reach across the country.

Interest on capital

4.05 Section 13(d) of the Partnership Act allows payment, or advance beyond the amount of agreed share of capital, to the partners at an interest rate of 6% per annum. A suggestion was made to the Committee that since the rate of interest was fixed in the year 1932, and has remained static, though it should be linked with the lending rate of commercial banks at any given point of time. It would indeed be appropriate if the Government is empowered to prescribe the rate of interest, to reflect, from time to time, realities of the market.

Recommendation 4.2 : Interest on capital

- Section 13(d) of the Partnership Act should be amended to provide that the rate of interest to a partner, on payment, or advance, in excess of his agreed share of capital shall be 6%, or as may be prescribed by Government, from time to time.

Implied authority of partners

4.06 In terms of section 19 of the Partnership Act, the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm (hereafter referred to as the "implied authority"). However, section 19 of the Partnership Act lists out certain acts of a partner which, in the absence of usage or custom of trade to the contrary, cannot be done even under the concept of implied authority. These acts were based on the conditions prevailing in the 1930s.

4.07 The Indian Banks' Association, in their submission, stated that the implied authority for the acts not listed in section 19(2) of the Partnership Act is restricted to their conformity with usage and custom of trade. It is also necessary to recognise special course of dealings *inter se* partners and third parties.

4.08 The Committee debated the issue, and after lengthy deliberations, has come to the conclusion that section 19 of the Partnership Act is limited to acts which might be governed by the concept of implied authority. It does not, and cannot, cover acts that are allowed or prohibited by 'express authority', that is, acts allowed or prohibited by contract. Current jurisprudence supports this view. In *Chainraj Ramchand, Registered Partnership Firm of Bankers, by Partner Ramchand Lekhraj v. V.S. Narayanaswamy, AIR 1982 Mad. 326,* the Madras High Court has held that a partner cannot compromise any claim by the firm unless there is express authority given by all the parties. It was, therefore, felt that the suggestion made by the IBA could not be recommended.

Bar on suits by unregistered firms

4.09 Chapter VII of the Partnership Act deals with 'Registration of Firms' and sections 56 to 65 of the Act with the procedure for registration. Section 66 of the Partnership Act refers to inspection of register, section 67 of the Act to grant of copies to 'any person' and section 68 with 'rules of evidence'. The purpose of these provisions is to protect the interest of those who deal with partnership firms in various commercial transactions. Third parties who deal with a firm on its name or with a partner or managing partner as representative of the firm must be in a position to know who the partners are and what are their respective shares in the partnership, the details, if any, as to the capital investment by partners, and the details, if any, of the partnership property. That would enable them to have an idea of the competence, status and solvency of the partners of the firm.

4.10 In order to compel partners to register their partnership firms so that all relevant information could be obtained by inspection of the register or by obtaining a certified copy thereof, a suitable legal provision is needed. Under the UK Registration of Business Names Act, 1916, there was a penal provision and also a provision which created certain disability in respect of enforcement of certain rights in Courts. Under the Partnership Act, there is no penal provision as in the UK, but only a provision that creates certain disabilities in respect of enforcement of rights in Courts. This disability is contained in section 69 of the Partnership Act.

4.11 Sub-section (1) of section 69 of the Partnership Act bars suits by partners against an unregistered firm or against any person alleged to be or to have been a partner of such a firm. The bar applies to enforcement of (a) right arising out of a contract, or (b) right conferred by the Partnership Act. On the other hand, sub-section (2) of section 69 of the Partnership Act bars suits for enforcement of a right arising out of a contract by or on behalf of the unregistered firm against 'third parties'.

4.12 A question has arisen whether the words 'enforce a right under a contract' would include rights arising out of contracts with third parties not in connection with the day-to-day business or commercial transactions entered into by the unregistered firm.

4.13 The Law Commission of India, in its one hundred and seventy eighth report, taking into account certain judgements of the Supreme Court of India, and to avoid any uncertainty, had expressed a view that the bar should be restricted to suits by the unregistered firm (or claims to set off or other proceedings) in respect of rights arising out of contracts entered into in the course of business. It accordingly had proposed the addition of an explanation to section 69 of the Partnership Act to the effect that 'a right arising from a contract' shall mean a right arising from a contract made in the course of business.

4.14 The Committee agrees that section 69 of the Partnership Act, as it stands presently, puts a partner in an unenviable situation of first suing for dissolution, before he could proceed to recover monies under the contract. The bar on suits should be restricted only to suits in respect of rights arising out of contracts entered in the course of business. Accordingly, it is recommended that amendments in the Partnership Act, on the lines suggested by the Law Commission of India, be initiated.

Recommendation 4.3 : Bar on suits by unregistered firms

- Section 69 of the Partnership Act may be amended to the effect that 'a right arising from a contract' shall mean 'a right arising from a contract made in the course of business'. Amendments as suggested by the Law Commission should be expeditiously introduced in Parliament.

4.15 Banks, financial institutions and third parties are still reluctant to deal with partnership firms because the abysmal state of records of these firms, in various States, virtually rules out any sort of due diligence. State Governments should be persuaded strongly to computerise the records pertaining to partnership firms, on the same platform as envisaged for DCA 21. Failing this, the Government should consider taking over the administration of partnership firms, once DCA's computerisation programme has been successfully implemented.

Recommendation 4.4 : Administration of partnership firms

- State Governments should be persuaded to computerise, within a given time-frame, all the records pertaining to partnership firms.
- Failing that, Government should consider taking over the administration of partnership firms, once DCA's computerisation programme (DCA 21) has been successfully implemented.

5

Other Recommendations

Introduction

5.01 The scope of terms of reference requires the Committee to suggest a scientific and rational regulatory environment in the context of the Companies Act, 1956 and the Partnership Act, 1932. Thus, it extends to public companies as well, in addition to private or small private companies. This was further clarified and emphasised by Secretary, DCA's letter dated 5th March, 2003 **(Annex 5)** which suggested that the Committee, as part of its exercise, should also review those matters where companies (public or private) are required to approach the Government for approvals, and make recommendations, regarding the necessity of doing so.

5.02 The legal framework for the companies in India has been under regular review since early 1990s. This has resulted in a number of amendments to the Act. The Companies (Amendment) Bill, 2003 seeks to bring in more changes for providing a regulatory environment more conducive to the healthy growth of business entities, and at the same time, enhance the effectiveness of regulation, in order to check undue exploitation of the liberalised environment by unscrupulous elements. It is heartening to note that the Companies (Amendment) Bill, 2003 takes into account the interim recommendations of the Committee, dealt with later in this Chapter, on some of the specific issues referred by the DCA in March, 2003. In step with the spirit of these changes, and the request made by Secretary DCA, the Committee has looked at some other aspects of the Companies Act.

5.03 The Committee has discussed various provisions of the Act, applicable to public companies with special emphasis on the procedural aspects and the matters requiring Government approvals. Individuals and the organisations which made presentations, also brought to notice of the Committee some of the provisions of the Act applicable to public companies, which require a fresh look. The Committee was also concerned with the use of private companies as a conduit for siphoning funds, and in that perspective, recommendations for in-built safeguards that minimise and check exploitation of the simplified regime.

Managerial remuneration

5.04 The Act provides requisite autonomy to the companies for appointment of managerial personnel. The appointment, if made in terms of Part I of Schedule XIII to the Act does not require approval of Government. Similarly, for payment of managerial remuneration, the approval of Government in case of companies having profits is not required if it is in accordance with section I of Part II of Schedule XIII. In case of companies having no profits or inadequate profits, the approval of Government is not required, excepting when the payment is in terms of paragraph 1 (C) of section II of Schedule XIII. In short, approval of Government is required only if a company has losses or inadequate profits and that, too, if payment of remuneration is above that given in Schedule XIII of the Companies Act, 1956.

5.05 The provisions of Section II of Part II of Schedule XIII have been simplified and rationalised to a great extent vide Government's Notifications issued in January, 2002. These, at the same time, also provide adequate safeguards such as requirements of approval of the Remuneration Committee, and a special resolution of shareholders, after full disclosure of relevant information and facts.

5.06 Representations made by some of the eminent corporate managers, senior bank officials, management consultants, and trade and industry associations argued for fuller empowerment of the company and its board of directors, in order to enable them to attract and retain the best talent, with minimal, checks and balances. This is also considered necessary to provide a level playing field to India Inc. in the global business environment. It was further argued that sufficient disclosures are required to be made in the Directors' Report in terms of section 217(2A) for employees (including managerial personnel), and in the financial statements under paragraph 4 of Part II of Schedule VI and Accounting Standard (AS) 18, (Related Party Disclosures). These should put different stakeholders on guard, and act as an effective check. Additionally, in most of the loan agreements, lenders also ensure that their voice is taken into account in relation to payments of remuneration to managerial personnel. The fear that those in charge of management of the companies would walk away with unreasonable amounts of remuneration and privileges in an unbridled manner might not be well founded.

5.07 The DCA has pointed out that it receives a sizeable number of requests for approval of managerial remuneration and at any given point of time, about 300 applications remain in the pipeline. It was also observed that the determination of managerial remuneration depends upon the facts and circumstances which vary from case to case, and the question as to what should be the reasonable amount of remuneration could best be judged by the company itself. Companies having projects that have long-term gestation periods were said to be a case in point, where even well-managed projects in the initial years cannot generate profits.

5.08 On the other hand, the contrary view was also presented. It was stated that wisdom of de-controlling managerial remuneration completely seem to be now coming into question. Current thinking in the developed countries, as culled from various articles in newspapers and journals in this regard (an illustrative news item quoting Warren Buffett, is enclosed as **Annex 6**) seems to be that top-level managers have been reckless at times in rewarding themselves. In India, it was stated, this problem would get exacerbated by the fact of there are a large number of promoter-managers and there exists a strong element of 'family' control of even listed companies. Apprehension was also expressed that a totally unregulated regime could very well be the loophole for the next scam. It was suggested that the proposal to leave managerial remuneration to special resolutions, rather than Government control, if they fell outside even Schedule XIII, was tantamount to there being no regulation at all; that, in fact, it amounted to breaching the limit set in section 198 of the Act.

5.09 It was argued before the Committee that provisions of section 217 that require disclosure of remuneration paid to employees (above a certain level) were rooted in the command and control regime, and seem anachronistic in the present context. It was pointed out that this disclosure served little purpose, except perhaps in the poaching of employees by competitors offering higher levels of remuneration. On the other hand, it was stated that promoter-directors often rewarded their kith and kin with exorbitant salary packages, totally disproportionate to their qualifications or training. It was felt that it would still be in the interest of various stake-holders to know the cost to the company of functional directors, and relatives of directors or significant shareholders of the company. However, remuneration of other employees should be treated as confidential information and not published, though it could continue to be reported to the ROCs.

5.10 It was pointed out to the Committee that Explanation II(b) in Schedule XIII was unclear in bringing out the intent and that DCA was, in fact, implementing it in the correct sense, though a strict interpretation of the language would seriously limit raising managerial remuneration even when effective capital has increased. There is a need to rewrite this explanation in line with the intent and practice being followed by the DCA.

5.11 The Committee is of the view that there is a case for striking a balance between further relaxation in the regulation of managerial remuneration and safeguarding stakeholder interest. It is, therefore, recommended:

Recommendation 5.1 : Managerial remuneration

- Payment of managerial remuneration should be liberalised further for companies that are implementing projects that require long gestation periods (such as infrastructure projects, or insurance companies) even if there is inadequacy or absence of profits.
- Payment of managerial remuneration should similarly be liberalised further for companies that are being nursed back to health; this could be related, for example, to reduction in losses or increase in net worth.
- The existing disclosure requirements of remuneration, under section 217, should be limited to functional directors and relatives of directors or significant shareholders (holding more than 2% of the company's shares), and should not cover other employees. The Government may examine if it is of any benefit to have this information filed with the ROC, without making it a public document.

- Explanation II(b) in Schedule XIII be rewritten to clearly bring out the intent, and current practice, when managerial remuneration is sought to be increased under section 310 of the Act.

Definition of public company

5.12 Prior to the Companies (Amendment) Act, 2000 (the "Amendment Act"), where a private company was exempted, in several sections of the Act, it was provided that the exemption would not apply to private companies which were subsidiaries of public companies. These sections include, sections 77(2), 108A, 166(2), 170(1), 176(3), 182, 198, 204(6), 255, 256, 257, 259, 262(1), 263(1), 265, 269, 293, 295, 300, 309, 310, 311, 316, etc. Throughout the Act, a private company which was a subsidiary of a public company was thus, put in the same position, more or less, as a public company.

5.13 Through the amendment to section 3(1)(iv) of the Act, the Amendment Act included a private company which is a subsidiary of a public company in the definition of 'public company'. The 'public company' has now been defined to mean a company which—

(a) ....;

(b) ....;

(c) is a private company which is a subsidiary of a company which is not a private company.

5.14 The Amendment Act, while including a private company which is subsidiary of a public company in the definition of 'public company', retained the provisions of the Act, which were specifically applicable to such private companies. Thus, the definitional provisions of the Act stipulate for two types of companies, *viz.*, a public company and a private company. The various provisions, however, continue to recognise a private company which is a subsidiary of a public company. Had the Amendment Act intended for only two classes of companies, then it would have simultaneously also provided for amendment to various provisions of the Act. The fact that these sections have been retained in the Act without any change is acknowledgement of the scheme of the Act that deals with a private company, which in certain cases becomes a subsidiary of a public company. Thus, when a private company becomes a subsidiary of a public company, it retains its inherent character as a private company. If such a company is to be, by definition, treated as a public company, then should it not shed its character of a private company. Further, a public company cannot then incorporate a private company as its subsidiary. The Committee feels that the anomaly that has been caused by the amendment made in the definition of the 'public company' needs to be corrected.

Recommendation 5.2 : Definition of public company

- The Government may take note of the anomaly arising out of the insertion of clause (c) in section 3(1)(iv) defining a public company, through the Companies (Amendment) Act, 2000, and consider the need for appropriate amendment to remove the confusion that exists in interpretation and applicability of the provisions of the Act in relation to a private company which is a subsidiary of a public company. Either section 3(1)(iv)(c) can be altogether dropped or a suitable explanation provided below it to put the issue beyond doubt.

Principle of recording shareholders' agreements etc.

5.15 The principles governing voting agreements, pooling agreements and shareholders' agreement is now the subject-matter of several judgements after the celebrated VB Rangaraj case. The recent *IL&FS Trust Company Ltd. and another Vs. Birla Perrnickini Ltd. and others [2003]52 CLA 35 (Bom)* case has amplified the principle of recording of shareholder agreements in the AoA of a company. The issue of the *vires* doctrine of affirmative votes, special quorum needs in joint ventures has not been examined.

5.16 A shareholder's agreement, or a pooling agreement *inter se* shareholders is in truth an agreement to conduct business in a particular way or method, including voting at board's and general meetings in a predicated way. The director's overall fiduciary responsibility, including responsibility to the minority or the company's right as different from the right of the shareholders who are parties to such agreements, is a very complex issue.

5.17 The Committee feels that there is a need now to cut this gordian knot and to avoid incorporation of every element of the shareholder agreement or pooling agreements.

Recommendation 5.3 : Principle of recording shareholders' agreements etc.

Suitable provisions should be made in the Companies Act, 1956 to provide that:

- the shareholding agreement is a binding agreement *inter se* parties;
- the company, when notified of any breach or demand for specific performance, shall not abet and shall be bound not to abet in the breach of the agreement. It shall, however, strictly comply with the letter and spirit of the Companies Act, 1956 and other laws, and consequently, submit to the decisions of the concerned Court or the National Company Law Tribunal or arbitrator; and

- the shareholders severally shall not have the right to use the company's funds to litigate the enforcement of the shareholder agreement or to defend the contractual right of any shareholder under the shareholder agreement.

Independent directors

5.18 The Committee on Corporate Audit and Governance (hereinafter called as "NCC 1"), in its Report submitted to the Department of Company Affairs, Ministry of Finance and Company Affairs, in November, 2002 dealt with in detail various aspects concerning the independent directors and made certain recommendations. Based on the recommendations made by the Committee, a number of provisions have been proposed in the Companies (Amendment) Bill, 2003, to facilitate good governance.

5.19 The Committee believes that in order to attract professional and highly qualified individuals, to act as independent directors, on the board, they need to be paid adequate remuneration, and exempted from certain civil and criminal liabilities. The apprehension of getting involved in tortuous litigation on mere technical association as a director on the board is a great disincentive in taking on directorship. The High Court of Judicature at Bombay has recently, in the case of *Homi Phiroze Ranina. Vs. State of Maharashtra*[1] held that non-executive directors cannot be made to undergo the ordeal of a trial for offence of non-compliance with a statutory provision unless it can be established *prima facie* that they were liable for the failure on part of the company.

5.20 The Committee respectfully agrees with the views expressed above and the following recommendations made by NCC-1 in its Report, in this regard :

Remuneration of non-executive directors :
(Ref: Recommendation 4.9 of Report of NCC-1)

"The statutory limit on sitting fees should be reviewed, although ideally it should be a matter to be resolved between the management and the shareholders.
In addition, loss-making companies should be permitted by the DCA to pay special fees to any independent director, subject to reasonable caps, in order to attract the best restructuring and strategic talent to the boards of such companies."

Exempting non-executive directors from certain liabilities :
(Ref: Recommendation 4.10 of Report of NCC-1)

"Time has come to insert provisions in the definitions chapter of certain Acts to specifically exempt non-executive and independent directors from such criminal and civil liabilities. An illustrative list of these Acts are the Companies Act.

[1] A copy of the judgement is enclosed at **Annex 7**.

Negotiable Instruments Act, Provident Fund Act, ESI Act, Factories Act, Industrial Disputes Act and the Electricity Supply Act."

5.21 Further, the proposed section 252A under the Companies (Amendment) Bill, 2003 disqualifies a person who is or has been a supplier, vendor or customer of the goods or services of the company for appointment as an independent director. This requirement is not practical, as it seeks to disqualify a person irrespective of value or substance of the relationship so arising. The NCC-1, in its Report, seeks to disqualify only a significant supplier, vendor or customer of the company.

5.22 It was brought to the notice of the Committee that rules and regulations framed by various Ministries, State Governments, Governmental authorities and regulators have provided for stipulations, which are against the concept and practice of the independent directors. For instance, in terms of the Haryana Value Added Tax Rules, 2003 information required about the directors (in case of private companies) includes particulars of all immovable properties, their approximate value, and details of other businesses in which the director has an interest. The details are required from all the directors including independent directors. **The Committee believes that seeking of such disclosures should be restricted to managing/whole-time directors only, if considered necessary. Extending such requirements to independent directors (directors who are not in the whole-time employment of a private company) may prove to be a deterrent to attracting suitable individuals to sit on the boards of companies and this may be counter-productive to the spirit and thrust of the Act towards better corporate governance.** Similarly, competent, law-abiding and self-respecting persons are not likely to be attracted to the Board if they are under constant threat of prosecution, for acts or defaults over which they have no control. It has to be recognised that in this country the harassment of long winded court proceedings, with repeated appearances, is punishment enough – even if the person is honourably discharged at the end of these proceedings. Courts have also expressed their anguish over such harassment to independent directors, where their culpability, or otherwise, is determined at the end of the trial. For instance, in a recent judgement as referred at paragraph 5.18, the Bombay High Court has held that :

> *"12. Unless the complaint disclosed a prima facie case against the applicants/accused of their liability and obligation as Principal Officers in the day-to-day affairs of the Company as Directors of the Company under section 278-B, the applicants cannot be prosecuted for the offences committed by the Company. In the absence of any material in the complaint itself prima facie disclosing responsibility of the accused for the running of the day to day affairs of the Company process could not have been issued against them. The applicants cannot be made to undergo the ordeal of a trial unless it could be prima facie showed that they are legally liable for the failure of the Company in paying the amount deducted to the credit of the Company. Otherwise, it would*

be travesty of justice in providing them and ask them to prove that the offence is committed without their knowledge."

Recommendation 5.4 : Independent directors

- The statutory limit on sitting fees should be reviewed, although ideally it should be a matter to be resolved between the management and the shareholders.
- In addition, loss-making companies should be permitted by special resolution to pay special fees to any independent director, subject to reasonable caps, in order to attract the best restructuring and strategic talent to the boards of such companies.
- Non-executive and independent directors should be exempted from criminal and civil liabilities as attracted under certain Acts, like the Companies Act, Negotiable Instruments Act, Provident Fund Act, ESI Act, Factories Act, Industrial Disputes Act, the Electricity Supply Act and SAFEMA.
- Though it is proposed to simplify the Act *vis-à-vis* private companies, the applicable laws other than the Act should also be appropriately streamlined to ensure that onerous obligations/requirements should not be imposed on the directors who are not in the whole-time employment of a company and also ensure that no additional obligations/requirements are imposed on any of such directors. A *non-obstante* clause to the effect may be added.
- The Government may consider appropriate modification in the proposed section 252A sought to be inserted by the Companies (Amendment) Bill, 2003 on the lines of paragraph 5.21.

Resignation by non-executive directors

5.23 Another reason that discourages good persons from becoming independent directors, that was brought to the notice of the Committee, was the apparent inability of directors to exit on their resigning, unless the company cooperated with them. Thus, if a person unwittingly becomes a director of a company which he discovers to be indulging in unsavoury activities, and wants to resign, he finds it difficult to do so if the company does not forward Form-32 to the RoC for registration. The situation is even more piquant when the resignation of such a director reduces the number of directors from the minimum required under the Companies Act; in such cases, the RoC may not register Form 32 unless accompanied by a proposal for the required second or third director, as the case may be. Surely, no law or procedure should be such that it compels a person to remain a director, on record, even if he does not want to be. Acton has to be taken to sort out this obvious anomaly.

Recommendation 5.5 : Resignation by non-executive directors

- Section 303(2) may be amended, or appropriate rules framed thereunder, to provide that a non-executive director may send his/her resignation in duplicate, to the company, and another duplicate set to the RoC including the proof of dispatch of the communication to the company. Upon receipt of this letter, the RoC should take it on record clearly noting this fact on the list of directors of the company. An acknowledgement of the receipt of the letter, together with action taken, should be sent to the director who has resigned with a copy to the company within a period of two weeks.
- In case the number of directors in a company, as a result of resignation of one director, falls below the statutory minimum, a reasonable period may be allowed to the company to additionally appoint another director. In this respect, the provisions of Regulation 75 of Table A of the Companies Act, 1956 are quite adequate.
- Law should also be amended to provide for a fine of 0.001% of the paid-up capital, subject to a minimum of Rs. 500 per day and a maximum of Rs. 5000 per day, for each day of delay in not forwarding Form 32 to the RoC, or for not meeting the other requirements of law, enabling registration of Form 32, from 10 days after receipt of resignation of independent director.

Contracts in which directors are interested

5.24 Under section 297(1), prior approval of Government is required in case of companies having a paid-up capital of not less than Rs. 1 crore, for certain contracts in which particular directors are interested. The requirement for obtaining Government approval was inserted by the Companies (Amendment) Act, 1974. Since then, the business and regulatory environment has changed considerably. There is an obvious need to have a fresh look.

5.25 This issue has to be viewed in the context that many checks and balances already exist for safeguarding stakeholders' interest. The interested directors are required to disclose their interest in any contract or agreement entered into or proposed to be entered into on behalf of the company (section 299). The sanction of the board of directors for certain contracts in which any director is interested, is required to be accorded by a resolution in a meeting of the board and not otherwise (section 297). Interested directors cannot participate in the proceedings and voting on the resolution (section 300). The Register of Contracts in which directors are interested is open to inspection by any member of the company (section 301). Further, failure on the part of any director to make disclosure of shareholding in certain companies is punishable with imprisonment for a term upto two years or with fine or with both (section 308). The Accounting Standard (AS) 18, Related Party Disclosures, mandates disclosure of all related parties and transactions with all related parties in the financial statements. The

Committee feels that the checks and balances, as aforesaid, are sufficient, and the requirement for Government approval may be dispensed with. Yet, in public companies, there is a need to safeguard public/stakeholder interest.

Recommendation 5.6 : Contracts in which directors are interested

- Section 297 of the Act should be amended to provide for prescription of rules.
- Government should frame rules in a manner that prior approval of Government is not normally required, subject to certain safeguards that would protect public/stakeholder interest.

In any case, section 297 should not apply to private limited companies.

Flexibility for further simplification

5.26 The Committee has sought to simplify the operation of law for private companies generally. The Report suggests a few additional relaxations in case of SPCs. The Committee believes that the Act should provide for in-built flexibility not only in regard to criteria for classification of SPCs, as dealt with in the Chapter 2, but also in regard to applicability of the various provisions of the Act, having regard to the economic circumstances and corporate practices prevailing from time to time. For instance, based on the experience gained after putting into practice various measures for corporate governance in generality, and the management practices followed in SPCs in particular, Government, at some stage, say after five years, may consider it appropriate to further relax the provisions of the Act in regard to the internal management of SPCs. It would also give to Government requisite flexibility to address specific hardships of any class of SPCs in relation to operation of any of the provisions of the Act, as are brought to its notice. The liberalised environment, at the same time, should not be subject to subversion by unscrupulous elements. Any abuse coming to the attention of Government should be capable of being redressed through administrative action as well as by issue of notification. [For example, if Government finds that the relaxation made in reducing the number of board meetings that should be held in a year, as recommended by the Committee, is being misused in order to exclude participation of director/s representing a section of shareholders.]

5.27 The Committee feels that the Act should, accordingly, empower Government to direct by notification in the official Gazette that any provision of the Act, as specified in the notification, shall or shall not apply to SPCs with such exceptions, modifications or adaptations. A copy of such notification should also be required to be laid, as soon as it is issued, before each House of Parliament. The Act already contains analogous provisions in regard to government companies (section 620) and Nidhis etc. (section 620A).

Recommendation 5.7 : Flexibility for further simplification

- A suitable provision be added to the Act (perhaps as section 620D) to empower it to grant further relaxations to SPCs.
- Such a provision should also allow Government to prescribe adequate safeguards and imposition of fines in case the liberalised provisions are misused.
- Further, this section should provide that Government may withdraw any or all of the relaxations provided, if circumstances so warrant (as in the case of misuse etc.)

Safeguards against misuse

5.28 The Committee finds the existing environment for private companies to be quite liberal, but has suggested further liberalisation to ease the regulatory regime. The Committee is aware of the need for providing adequate checks and balances to prevent situations where private companies may also be used as vehicles to circumvent the regulatory regime applicable to public companies. Cases of corporate frauds, including the capital market scams, suggest a strong possibility of such misuse. Suggestions made before the Committee for safeguards against misuse included a special regulatory regime for the private companies which have a significant 'public interest' component in terms of their size and/or exposure to public funds from banks/FIs.

5.29 The Committee did not favour in the above cases the 'artificial' conversion of private company into public company, a concept which has been given a decent burial. There is, however, a case for providing a suitable mechanism in the law for blowing the whistle, as it were, if there is any unusual activity in the company—public or private. The Committee considered different criteria that could be treated as a trigger for applying a stricter regime, as applicable on public listed companies, to be applied to private companies also in cases of misuse. The absolute criteria of the paid-up capital and free reserves, size of assets and/or the level of turnover were not considered as an appropriate and sufficient indicator for raising alarm to signal possible siphoning of funds. Siphoning of funds largely take place through the front private companies formed to act as a mere conduit for funds taken out of public companies. The relationship between the size of paid-up capital and free reserves to the gross receipts of the company is, therefore, considered to be more appropriate. The Committee, accordingly, suggests that the private companies whose aggregate receipts exceed 100 times of paid-up capital and free reserves, should be subjected to the regulatory regime applicable to public companies. In addition, an event based illustrative list of unusual events and circumstances, for example, transfer of funds from a public company to a private company, directly or indirectly, may be identified, and an obligation cast upon companies to file returns, on public record, in terms of section 192, whenever such events occur.

5.30 Furthermore, such companies may also be required to make relevant disclosures in the financial statements and the Directors' Report. For example, in cases of transfer of substantial funds from a public company to a private company which have been used directly or indirectly, for transactions in securities, the transferor and the transferee company may be required to make the following disclosures in the Directors' Report and under Schedule VI :

(a) nature of relationship between the public and the private company;

(b) amount of funds transferred, including the purpose, and terms and conditions thereof;

(c) manner in which the funds have been utilised by transferee company; and

(d) impact of the transaction on the profit and loss and the state of affairs, if any.

5.31 The recent steps towards corporate governance in listed companies which trigger large public disclosure requirements may be considered for being adopted *mutatis mutandis*, in respect of such companies (*vide* paragraph 36 of the Listing Agreement). This needs to be balanced, however, with the other consideration, that needless fetters should not be put on the free play of economic activity and growth.

Recommendation 5.8 : Safeguards against misuse

- A private company whose aggregated receipts during the financial year exceed 100 times its paid-up capital and free reserves, should be subjected to the regulatory regime applicable to public companies. However, this trigger will apply only if the aggregated receipts exceed Rs. 10 crores, in the manner given in Recommendation 2.1.
- Section 192 should be amended to require a company – public or private – to file the prescribed particulars in case of certain transactions and events, as may be specified by Government, from time to time. Similarly, section 217 and the Schedule VI should be amended to provide for disclosure of information, as may be prescribed, in regard to such cases.

Special safeguards in regard to public deposits

5.32 Under section 58A of the Act, Government has been empowered to prescribe, in consultation with the Reserve Bank of India, the limits upto which, the manner in which and the conditions subject to which, deposits may be invited or accepted by a company, either from the public or from its members. The Act also provides for various measures for safeguarding the interest of the depositors. Despite all this, there have been many cases in which depositors have lost their money or are not able to recover the interest and/or the principal sum. The perpetrators of fraud have been able to swallow the hard-earned money of the depositors, without being nabbed or punished.

5.33 Companies can mobilise short-term funds from the public, through several instruments such as debentures. The Committee was informed that India is perhaps unique in allowing companies to accept deposits; a function that normally falls in the domain of banks. Considering this and the repeated exploitation of small depositors, the Committee was initially of the view that the companies should be prohibited from accepting deposits from the public, and instead, depend on mobilisation of funds through the alternative source, that is, debentures. The Committee is, however, reluctant in suggesting a total prohibition of a long-standing practice without adequate public debate on the issue. However, the need to safeguard depositors cannot be ignored. It is, therefore, felt that deposits should be raised and regulated in the same manner as secured debentures issued by public companies.

Recommendation 5.9 : Special safeguards in regard to public deposits

- Section 58A of the Companies Act and the rules made thereunder may be amended to suitably provide that the regulatory regime applicable to public deposits would be the same as applicable in case of secured debentures.

Number of partners

5.34 The Partnership Act does not prescribe the maximum number of partners that a firm can have. Section 11 of the Companies Act, 1956, however, limits the number of partners to 10 for firms carrying on the business of banking, and 20, for others. The Companies (Amendment) Bill, 2003 proposes to enhance the limit of partners to 50, in case of firms carrying on certain professions. It was argued before the Committee that in most countries, there is no limit on the number of partners that a professional firm can have. A numerical limit fixed for professional firms in India would put them to disadvantage *vis-à-vis* their foreign counterparts affecting their competitiveness in the emerging global scenario. The other view expressed was that the further increase in the number of partners is not required in the Indian context, taking into account the current size of the firms in some of the professions. Practical difficulties are also expected to arise in enforcing unlimited liability of partners in large-sized firms.

5.35 The Committee believes that if the professional firms in India have to benchmark themselves internationally and prepare for global competition, the number of partners that a firm can have should not be allowed to become a hurdle. Therefore, there is a case for not stipulating any limit on the maximum number of partners in case of professions like chartered accountants, cost accountants, company secretaries, doctors and advocates. Considering, however, the present structure of professional firms in India, the Committee feels that Government should be empowered to enhance the limit of maximum number of partners, from time to time, for any of the professional classes cited above.

Recommendation 5.10 : Number of partners

- The existing limit on maximum number of partners *i.e.*, 20 (for firms with unlimited liability) for firms carrying on business other than banking should be increased to 50, or such larger number as may be prescribed by the Government, from time to time, for a class or classes of partnerships.

Very small shareholders

5.36 Some of the members of the Committee felt that the whole issue with regard to small shareholders had become a matter more of political debate than economic analysis. While it is a very popular thing to show great concern for the small shareholders, the fact remains that the system has failed so far to protect them, and many small gullible investors have lost their savings because they assumed that the system will protect them. Some even argue that it is extremely difficult to provide a well safeguarded system for properly informing a large number of individual small investors so that they could take proper decisions or review the performance and future prospects of the companies in which they might have invested. Is it fair, therefore, for those in Government or in public life or in the media to create a façade and present an illusory picture to the relatively uninformed investors chasing a mirage over the corporate desert? It might be better, therefore, for those in charge of affairs to be transparent and frankly inform small investors to be more careful or seriously consider making investments through reputable financial institutions and mutual funds.

5.37 It should be noted in this regard that very small shareholders are, in fact, an avoidable drain on the resources of their company. In some cases, the cost of keeping them informed and supplying them a copy of the annual report etc., might exceed the value of their total investment in the company. It might, therefore, be advantageous for all to provide a simple arrangement for very small shareholders to sell their shares to the company or to allow the companies to buy back the shares from each such small shareholder, starting with those who have a total investment of Rs. 2,000/-(Rs. Two Thousand) or less. Mutual funds and financial institutions may also be encouraged to mop up the small number of shares by offering a fair price to them.

Recommendation 5.11: Very small shareholders

- Government may consider measures encouraging very small shareholders to sell their shares to the company or to allow the companies to buy back the shares from such small shareholders, having, to begin with, a total investment of Rs. 2,000/-(Rs. Two Thousand) or less. Mutual funds and financial institutions may also be encouraged to mop up the small number of shares by offering a fair price to them.

Accounts

5.38 Section 211 of the Companies Act lays down the matters to be disclosed in the balance sheet and the profit and loss account of the companies. Detailed disclosure requirements are given in Schedule VI. The relevant portion of Schedule VI is enclosed at **Annex 8**. One of the requirements is the necessity to disclose quantitative details of sales and purchases of goods and materials, stocks, turn-over, etc. Sub-section (4) of section 211 of the Act empowers the Government to relax, in respect of any company, any of these requirements. The Committee was apprised that with regard to quantitative details, hundreds of applications are received in the DCA and these are more or less routinely agreed to. That being the case, it is difficult to appreciate why the prior concurrence of the Government should be required at all, especially by each individual company. This both increases the work load in the DCA, and the difficulties and the costs to the companies. It would be easier for both, if the DCA could give exemption to a class of companies also so that the need for prior approval by individual companies would be minimised.

5.39 Section 212 of the Act requires that the accounts of subsidiaries should be attached to the accounts of the holding company. In view of the fact that several companies are now presenting the consolidated financial statements in line with the accounting standards on consolidated financial statements issued by the Institute of Chartered Accountants of India, it is felt that this cost to the companies, and, ultimately to the shareholders can be avoided if the requirement of attachment of accounts of subsidiaries is done away with in respect of those holding companies which prepare and present the consolidated financial statements.

Recommendation 5.12 : Accounts

- The Government may be empowered to also exempt a class of companies, under sub-section (4) of section 211 of the Act.
- The Act may be amended to enable adoption of consolidated financial statements, and in respect of companies that attach consolidated financial statements, the requirement of attaching the accounts of subsidiaries with their own accounts be done away with.

Simplified exit scheme for public companies

5.40 Paragraphs 2.54 to 2.59 of the Report discuss the case for a simplified exit framework for defunct private companies. The Committee recognises the fact that there could be certain public companies which would like to exit but are not able to exit because of high costs involved in winding up. The Committee is of the view that a simplified exit scheme, on the lines similar to what it has recommended for private defunct companies should be in place to facilitate easy exit by such public companies.

Recommendation 5.13 : Simplified exit scheme for public companies

- The Government should prescribe a simple exit scheme for public companies under section 560 on the lines of the recommendations made by the Committee at paragraphs 2.54 to 2.59 in respect of private defunct companies.

Interim recommendations made to the Government

5.41 Secretary, Department of Company Affairs *vide* his letter dated 5th March, 2003 referred at paragraph 5.01 also requested the Committee to consider specifically the matters in respect of approvals required under section 205, 294AA, 295 and 149 of the Act.

5.42 Payment of dividend out of reserves or profits earned in the earlier years by the companies incurring losses requires approval of Government under section 205. Appointment of sole selling agent in case of a company with paid-up capital of Rs. 50 lakhs or more under section 294AA is subject to a special resolution and approval of Government. Grant of loan to directors require approval of Government under section 295. The Committee was of the view that the requirement for approval of Government should be dispensed with wherever a practical alternative was available keeping in view the subject-matter involved. The Committee accordingly, felt that in line with the proposals contained in the Companies Bill, 1997, approval of the shareholder by way of a special resolution should be sufficient in aforesaid circumstances.

5.43 The commencement of business under section 149 is required to be approved by a special resolution passed in a general meeting. The same is also required to be filed with the RoC who then issues a certificate which is conclusive evidence of entitlement of the company to commence business. The Committee felt that the mere intimation to the RoC may suffice and the requirement of obtaining the certificate could be avoided. The Committee also suggested that Government companies by virtue of their very nature, should be exempted from the application of the section.

5.44 In all the above cases, the Government may, however, consider, by way of abundant caution, building in safeguards such as concurrence of financial institutions, provided in section 372A of the Act.

5.45 The Committee, accordingly, forwarded its recommendations, as aforesaid, to the DCA, pending submission of its final report. A copy of the recommendations sent to Government is at **Annex 9**.

Recommendation 5.14 : Interim recommendations made to Government

- Section 205 may be amended to provide for approval of shareholders by special resolution instead of Government approval for payment of dividend out of reserves or profits earned in the earlier years, in case of companies incurring losses.
- The appointment of sole selling agents, in case of a company with a paid up capital of Rs. 50 lacs or more, should not require approval of Government under section 294AA.
- The existing requirement under section 295 for approval of Government should be dispensed with. Approval of shareholders by special resolution should suffice.
- Section 149 may be amended to avoid the requirement of obtaining certificate of commencement of business. Mere intimation of commencement of business to RoC should suffice. Additionally, the provision may not apply to Government companies.

In all the above cases, the Government may, however, consider building in safeguards, such as, concurrence of financial institutions, as provided in section 372A of the Act.

Acknowledgements

The Committee would wish to acknowledge the assistance and help it received from many quarters in completing its task.

All relevant information and records needed by the Committee were promptly supplied by the Department of Company Affairs. The Institute of Chartered Accountants of India were good enough to provide the services of Dr. Ashok Haldia to work as the Secretary to the Committee. This task he performed admirably. In this, he was supported by Shri Lalit Kumar and Ms. Anita Mehra of ICAI, who worked hard and long to provide the excellent secretarial support that the Committee received.

The ICAI also provided secretarial and other support for holding the meetings of the Committee in the premises of the Institute. Both at Delhi and Mumbai, the ICICI Bank made arrangements for meetings of the Committee. We are thankful to Smt. Kalpana Morparia, in particular, for the keen interest in getting our meetings organised successfully on these occasions.

The Committee was also supplied with all relevant documentation and background material by the ICAI, ICSI, and the ICWAI, who also presented valuable proposals and suggestions.

The Committee would like to record its high appreciation for the efforts put in by many professionals and experienced persons in meeting us, or sending us suggestions in writing. The material and suggestions provided by Nishith Desai & Associates, on limited liability partnership issues were particularly useful. The Committee would also like to acknowledge the research work done in papers prepared by M/s. Dua Associates and M/s. Amarchand & Mangaldas & Suresh A Shroff & Company, under the leadership of Shri C.R. Dua and Shri Shardul Shroff respectively, members of the Committee. The Committee would also like to acknowledge the painstaking work put in by Shri N.V. Iyer and Shri S.D. Israni on preparing papers on certain specific terms of reference to this Committee. Shri Ashok Kapoor prepared a paper on issues pertaining to the small-scale sector, which was found very useful by the Committee.

Some of our members made it possible for the Committee to utilise the services of selected executives from their respective organisations who did a commendable job. Specific mention may be made of the work put in by Shri Sanjeev Kaul and Shri Neeraj Kumar of Dua Associates, and Shri Vidya Sagar and Ms. Samira Khanna of ICICI Bank.

The Committee, excluding one member, wish to record its high appreciation of the hard work put in by Shri Rajiv Mehrishi, Joint Secretary who willingly took upon himself, the responsibility of being the focal point for collecting information from the various Government departments and other agencies and producing the bulk of the draft report for Committee's consideration. It is he who ultimately shouldered the responsibility for providing necessary logistic support to the working of Committee. The Committee benefitted greatly from his analysis and insights, based on direct experience of regulation of companies.

Signed this day, the 23rd July 2003 at New Delhi and Mumbai.

Shri C R Dua
Member

Shri S D Israni
Member

Shri N V Iyer
Member

Shri Ashok Kapoor
Member

Shri Rajiv Mehrishi
Member

Smt. Kalpana Morparia
Member

Shri Shardul Shroff
Member

Shri Ashok Haldia
Secretary

Shri Naresh Chandra
Chairman

Annex 1
Composition of and Terms of Reference to the Committee

No.11/3/2003-CL.V
GOVERNMENT OF INDIA
MINISTRY OF FINANCE AND COMPANY AFFAIRS
DEPARTMENT OF COMPANY AFFAIRS

5th Floor, A-Wing, Shastri Bhavan
New Delhi – 110 001
Dated: 10.01.2003

ORDER

1. The business environment is changing rapidly, underlining the need for providing adequate flexibilities to companies/firms conducting, or intending to conduct, business or providing or intending to provide, professional services. While keeping in mind the impact on various stakeholders, there is a need to provide a structural environment that is conducive to the growth and prosperity of the entities, and, at the same time is effective in regulating their activities in a manner that minimises and deters exploitation by unscrupulous elements. Smaller entities with few stake-holders should not be bogged down in unnecessary and meaningless paper work. There is also need to simplify and rationalise entry and exit procedures (especially for non-functional companies).

2. To suggest a scientific and rational regulatory environment, the hallmark of which is the quality, rather than the quantity, of regulation, the Government has decided to constitute a Committee to make recommendations in this regard with reference particularly to the following, amongst other, Acts:

(1) The Companies Act, 1956.
(2) The Indian Partnership Act, 1932.

3. The Committee would function under the Chairman and would devise its own procedures.

4. The Committee will submit its recommendations regarding small and private limited companies to the Ministry of Finance and Company Affairs, Department of Company Affairs, within 45 days of its first meeting. The Committee will complete its work within 90 days on all other issues.

5. The Committee shall consist of the following:

1.	Shri Naresh Chandra	Chairman
2.	Shri C.R. Dua	Member
3.	Shri S.D. Israni	Member
4.	Shri N.V. Iyer	Member
5.	Shri Ashok Kapoor	Member
6.	Shri Rajiv Mehrishi	Member
7.	Smt. Kalpana Morparia	Member
8.	Shri Shardul Shroff	Member
9.	Shri Ashok Haldia	Secretary

6. Secretarial assistance to the Committee will be arranged by Institute of Chartered Accountants of India.

Sd/-
(N.K. Vig)
Under Secretary to the Govt. of India

Copy to:-

1. All members of the Committee
2. PS to M (F&CA)
3. PS to MOS (F&CA)
4. All Officers in the DCA

Annex 2

Individuals/Institutions heard by the Committee

The Committee was inclined to have as widespread a consultation as possible. In this, it was limited by the constraints of time. However, it did invite a large number of individuals and institutions to place their views before it. The list of those who met the Committee is given below:

S. No.	Date & Venue	Institutions/Individuals
1.	07.02.2003 Mumbai	Shri M R Prasanna, Chairman, Legal Affairs Committee, BCCI
2.		Smt. M Sood, Joint Director, BCCI
3.		Shri Mahesh Thakkar, IMC
4.		Shri A S Ruia, IMC
5.		Shri S V Haribhakti, IMC
6.		Shri D M Popat, IMC
7.		Shri S S Vaidya, IMC
8.		Shri D C Tanna, IMC
9.		Shri Jitendra Sanghvi, IMC
10.	20-02-2003	Shri Pavan Kumar Vijay, President, ICSI
11.	New Delhi	Shri Chandra Wadhwa, Council Member, ICWAI
12.		Shri A P Kar, Director, ICWAI
13.		Shri Shankar Aggarwal, Joint Secretary, Ministry of Small Scale Industry
14.		Shri Nishith Desai, Nishith Desai Associates, Society of Indian Law Firms
15.		Shri Suman Jyoti Khaitan, PHDCCI
16.	06-03-2003	Shri Kamlesh Vikamsey, Council Member, ICAI
17.	New Delhi	Shri Anil Bhardwaj, Secretary General, FISME
18.		Shri Joy Kumar Jain, American Chamber of Commerce in India
19.	27-03-2003	Dr. Omkar Goswami, Chief Economist, CII
20.	New Delhi	Shri Arvind Joshi, CII
21.		Shri Jlam C Kamboj, CII
22.		Shri Rajesh Dubey, Deputy General Manager, SIDBI
23.	05-06-2003 New Delhi	Dr.(Smt.) Sheela Bhide, Joint Secretary, DCA

The Committee gratefully acknowledges the contribution made by the above and wishes to thank them for their time and effort.

While every care has been taken to make this list exhaustive, inadvertent omissions, if any, are deeply regretted.

Annex 3

List of exemptions available to private limited companies

S.No.	Section	Nature of exemptions
1.	70(3)	Statement in lieu of prospectus need not be delivered to the Registrar of Companies before allotting shares[1].
2.	77(2)	Financial assistance can be given to any one for purchase of or subscribing for its own shares or shares in its holding company.
3.	81(3)(a)	Further shares can be issued without passing special resolution or obtaining Central Government's approval and without offering the same necessarily to existing shareholders[1].
4.	90(2)	Provisions as to kinds of share capital (section 85), new issues of share capital to be only of two kinds (section 86), voting rights (section 87), and termination of disproportionate excessive voting rights in existing companies (section 89).
5.	149(7)	Business can be commenced immediately on incorporation without obtaining a certificate of commencement from Registrar of Companies[1].
6.	165(10)	It is not necessary to hold a statutory meeting and to send statutory report to shareholders and file the same with Registrar of Companies.[1]
7.	170(1)	Articles of a private company may provide for regulations relating to general meetings without being subject to the provisions of sections 171 to 186.
8.	198(1)	Any amount of managerial remuneration can be paid and the same is not restricted to any particular proportion/ percentage of the net profits.
9.	204(6)	Private company can appoint a firm or body corporate to an office or place of profit under the company.
10.	252(2)	Private company need not have more than two directors.

[1] Exemption/privilege under this section is also available to a private company which is subsidiary of a public company.

11.	255(1)	A proportion of directors need not retire every year.
12.	257(2)	Statutory notice, etc., is not required for a person to stand for election as a director.
13.	259	Central Government's sanction is not required to effect increase in the number of directors beyond 12 or the number fixed by articles of association.
14.	263(1)	In passing resolution for election of directors, all directors can be appointed by a single resolution.
15.	264(3)	Consent to act as director need not be filed with Registrar of Companies.
16.	266(5)	Restriction on appointment of advertisement of director as regards consent and qualification of shares does not apply.
17.	268	Central Government's sanction is not required to modify provisions relating to appointment of managing, whole-time or non-rotational directors.
18.	269(2)	Central Government's sanction is not required for appointment of managing or whole-time director or manager.
19–23.	275 to 278	Restrictive provisions regarding total number of directorships which any person may hold do not include directorships held in private companies which are not subsidiary of public company.
		Provision as to retiring age of directors does not apply.
24	292A	Provision as to Audit Committee does not apply.
25.	293(1)	The restrictions on powers of board of directors do not apply.
26.	295(2)	Prohibition against loans to directors does not apply.
27.	300(2)	Prohibition against participation in board meetings by interested directors does not apply.
28.	303(1)	Date of birth of a director need not be entered in the register of directors.
29.	309(9)	There is no No restriction on remuneration payable to directors.

30.	310	Any change in remuneration of directors does not require Central Government's approval.
31.	311	Any increase in the remuneration not being sitting fees beyond specified limit of directors on appointment or reappointment does not require Central Government's approval.
32.	316(1)	Number of companies of which one person may be appointed as a managing director.
33.	317(4)	Managing director not to be appointed for more than five years at a time.
34.	349, 350 & 355	Provisions relating to method of determination of net profits and ascertainment of depreciation do not apply.
35.	372A	There is no No restriction on making loans to other companies. No prohibition against purchase of shares, etc. in other companies.
36.	388A	Provision of sections 386 and 387, which restrict the number of companies of which a person can be appointed as manager, remuneration of the manager, etc. and also provisions of sections 269, 310, 311, 312 and 317, do not apply.
37.	409(3)	Central Government cannot exercise its power to prevent change in board of directors which is likely to affect the company prejudicially.
38.	416(1)	Persons can enter into contract on behalf of company as undisclosed principal and need not give intimation to the other directors.

Annex 4
List of documents submitted to/considered by the Committee

S. No.	Name
1.	Suggestions submitted by Nishith Desai & Associates
2.	Presentation made by ICWAI
3.	Presentation made by ICSI
4.	Presentation made by ICAI
5.	Comments made by Indian Banks Association
6.	Memorandum on Limited Liability Partnerships in UK & USA from Nishith Desai & Associates.
7.	Memorandum of suggestions from Indian Merchants Chamber
8.	Memorandum providing a brief overview on the regime for Limited Partnerships in the UK and in Delware, USA from Nishith Desai Associates.
9.	Comments made by FISME
10.	Recommendations received from General Electric International Operation Co. Inc. (GE India)
11.	Observations from PHDCCI
12.	Written representation from SIDBI
13.	Comments from CII
14.	Suggestions on managerial remuneration from Shri A S Ganguly, Chairman, ICI India Limited, Shri Omkar Goswami, Chief Economist, CII, Shri N R Narayana Murthy, Chairman and Chief Mentor, Infosys Technologies Limited, Dr. M B Athreya, M/s Athreya Management Systems and Shri Sunil Bharti Mittal, Chairman & Group Managing Director, M/s Bharti Enterprises, as forwarded by the Department of Company Affairs
15.	Submission made by Dr. Jinesh Panchali, Associate Professor, UTI Institute of Capital Markets

While every care has been taken to make this list exhaustive, inadvertent omissions, if any, are deeply regretted.

Annex 5
Copy of letter from Secretary, DCA

Vinod Dhall
Secretary

Government of India
Department of Company Affairs
Ministry of Finance and Company Affairs

D.O. No. 11/3/2003-CL.V
Dated 5 March, 2003

Dear Shri Naresh Chandra,

Please refer to order No. 11/3/2003-CL.V, dated 10 January, 2003 of Department of Company Affairs constituting a High Level Committee under your Chairmanship. We are grateful to you and the Committee for agreeing to undertake this important work.

2. While referring this matter to the Committee for its recommendations, it was visualised that the Committee, as part of the exercise, would also review those matters where companies (public or private) are required by the Companies Act/Rules to approach Government (DCA) for approvals and permissions with the view to see whether these procedures can be reformed/liberalised with relevant checks and balances. (Matters requiring approvals of the Central Government at present have been indicated in the background papers circulated for the preparatory meeting of the Committee held on 28 January, 2003). We would be grateful if the Committee could consider these matters and make recommendations to the Government. We would also be obliged if the Committee could consider giving an interim report specifically in respect of approvals required under sections 149, 205, 294AA, and 295 of the Companies Act, 1956.

With best regards,

Yours sincerely,

S/d

(Vinod Dhall)

Shri Naresh Chandra,
Chairman,
Naresh Chandra Committee,
4053, Pocket-4, Sector-C,
Vasant Kunj,
New Delhi.

Room No. 502, 'A' Wing, Shastri Bhawan, New Delhi – 110001.
Phones: 011-23382324, 23384017, Fax: 91-11-23384257, E-mail:
vinoddhall@sb.nic.in

Annex 6

An illustrative news item quoting Warren Buffett [Financial Times, London]

BUFFETT URGES SHAREHOLDERS TO REBEL AGAINST EXECUTIVE GREED

By Andrew Hill in Omaha, Nebraska

Warren Buffett launched a fresh assault over the weekend against greedy chief executives, complacent directors and pliable compensation consultants by urging investors to rebel against excessive executive pay.

The influential investor – one of America's richest men – told the shareholder meeting of Berkshire Hathaway, the investment and insurance group he chairs, there had been more misdirected compensation in corporate America in the past five years than in the previous century.

US chief executives " don't care whether their boards are diverse, or not diverse – they care about how much money they make", Mr. Buffett warned more than 10,000 shareholders and guests who gathered in Omaha for the meeting.

Mr. Buffett, 72, is one of the fiercest critics of US executive compensation and the abuse of stock option grants, which he blames for fuelling the corporate scandals of the past 18 months. Last year, he received a salary of only $100,000 and total annual compensation of just under $300,000.

He told shareholders that as owners of companies they had to "provide some countervailing force [against executives] or you will have what we had in the last 20 years -- that is, an enormous disparity in the rates of compensation between people at the top and people at the bottom, and a disconnect between people at the top and share owners who give them the money".

In a five-hour question-and-answer session on Saturday, Mr. Buffett and Charlie Munger, Berkshire's Vice-Chairman, again attacked the majority of US companies that do not treat stock option costs as expenses. They agreed, however, that the most common method of valuation – called Black Scholes – was not an effective way of valuing such performance incentives.

Shareholders gave the duo a rapturous reception, in sharp contrast to other annual meetings this year at which investors have castigated executives for poor performance, lax corporate governance and over generous pay and benefits. At many other meetings, investors have cast significant votes against management. During the meeting, Mr. Buffett said Berkshire, whose interests range from re-insurance to kitchenware and cowboy boots, would report record first quarter operating earnings of $1.7bn, on the back of strong results from the insurance operations. He said the non-insurance businesses were held back by the sluggish economy and he was pessimistic about the short-term outlook for NetJets, Berkshire's fractional jet ownership business.

Mr. Buffett said MidAmerican Energy, 80 per cent owned by Berkshire, "will look at some big deals this year". "We don't have any clear-cut preferences as to whether it would be a natural gas pipeline, a domestic utility or, conceivably, even a utility in some country we feel good about," he said.

Berkshire revealed recently that it owned 13 per cent of the publicly traded shares of Petro-China, the Chinese state-run energy group, but Mr. Buffett played down the significance of the announcement, saying it had been triggered by Hong Kong stock exchange rules.

Berkshire, which Mr. Buffett said had $16bn in cash on its books at the end of March, has been on the look-out for bargains since the stock market began its dive in 2000.

Last week, Berkshire announced it would buy McLane, a distribution business, from Wal-Mart, the retailer, for just under $1.5bn, a month after agreeing to buy Clayton Homes, the prefabricated housing business, for $1.7bn.

Annex 7

Judgment in the case of Homi Phiroze Ranina & Ors.

vs.

The State of Maharashtra & Ors.

IN THE HIGH COURT OF JUDICATURE AT BOMBAY
APPELLATE SIDE

CRIMINAL APPLICATION NO. 286 OF 1997

Mr. Homi Phiroze Ranina & Ors. ...**Applicants**

Vs.

The State of Maharashtra & Ors. ...**Respondents**

Mr. H.P. Ranina Advocate for the Applicants.

Mr. H.V. Mehta for Respondent no. 2 & 3
Mr. R.Y. Mirza, A.P.P. for the State

CORAM A.S. AGUIAR.J.

DATED : 4th FEBRUARY, 2003

JUDGEMENT:

The applicants seek quashing of the order dated 30.11.96 passed by the learned Additional Chief M..M., 47th Court, Bandra in cases Nos. 248-S to 251-S of 1993 and pray for their discharge in the said cases.

2. The brief facts of the case are: a complaint came to be filed by the Income Tax Officer, TDS VI, Bombay, against the present applicants/accused as well as M/s. Unique Oil India Ltd. of which the applicants/accused are Directors as well as against Shri L.K. Khosla, Chairman and Managing Director of accused no. 1 Company as well as Gayatri Khosla another Director and one Yogesh Khosla the whole time Director of accused no. 1 Company before the Additional Chief Metropolitan Magistrate, 47th Court, charging them under section 276-B r.w. 278-B of the Income Tax Act, 1961. Summons were issued to all the accused persons including the present applicants. On receipt of summons the applicants herein (accused nos. 4, 5, 6 and 7) filed applications, for discharge before the M.M.

Court on 31.10.1996. By his order dated 30.11.1996 the Magistrate rejected the discharge applications filed by the applicants/accused nos. 4, 5, 6 and 7.

3. The present application is for setting aside the said order which the applicants claim is passed on insufficient material. It is specifically contended that the lower Court has not taken into consideration the requirements of section 194-C, section 204 and 2 (35) of Income Tax Act. It is contended that the present applicants/accused are admittedly not the principal officers of the accused no.1 company and therefore not responsible for the failure on the part of the Company to deposit with the Central Government the taxes deducted at source by the Company from four Contractors namely (1) M/s. Allied Consulting Engineers (P) Ltd., (ii) M/s. Shrinivas Plates & Structural Pvt. Ltd. (iii) M/s. Excellite Insulators Pvt. Ltd. and (iv) M/s. Kanaiya Construction Company. Though the Company had deducted the tax payable by the said contractors while making payment to the Contractors the Company failed and neglected to remit the tax deducted to the Treasury within the stipulated time. Admittedly, there is delay in remitting the tax deducted to the Central Government. As required under section 194-C, the tax had to be credited to the Central Government by 7th May, 1989. However, the same was paid to the credit of the Central Government only on 30.5.1989. The tax deducted had to be credited to the Central Government within one week from the last date of the month in which deduction is made.

4. It is the contention of the applicants/accused that they are not the principal officers of the said Company Accused No. 1. They are only the non-executive Directors of the Company Accused No.2. L. K. Khosla is the Chairman and Managing Director and Accused No. 8 Yogesh Khosla is whole-time Director of the said Company and hence, the liability for deducting income tax and crediting to the Central Government is that of Accused No. 2, 8 and the Company, Accused No. 1. It is also contended that no notice was given by the Commissioner of Income Tax to the applicant/accused prior to his granting sanction to prosecute the accused under section 279(1) of the Act. Principles of natural justice require that the notice ought to have been given to the applicants by the Commissioner before according sanction.

5. The aforesaid submissions were made by the applicants before the learned Magistrate at the time of hearing their application for discharge. However, the learned Magistrate rejected the said contention by a speaking order. The learned Advocate, Mr. Ranina for the applicants/accused has submitted that the applicants being non-executive Directors are not concerned with the day-to-day affairs of the Company which are looked after by the Managing Director and whole-time Director. Admittedly no administrative responsibilities were shouldered by the applicants. Furthermore, applicant nos. 1 and 3 are also practising Advocates and therefore, they cannot by law act as full time Directors. They could only act as non-executive Directors not exercising any administrative powers or performing any administration duties.

6. Reliance is placed on sections 194-C, (1), 2 (35), 204 and 279 of Income Tax Act which cast liability on the Company and its principal officers for making payment of the amounts deducted to the credit of the Central Government. Sector 194 -C (1) makes the Company/Accused No. 1 responsible for making payment of amount deducted from the Contractors and crediting it to the Central Government. Section 204 (iii) states that persons responsible for crediting the said amount are the Company itself and the Principal Officer of the said Company. In order to attract the liability of the applicants for making the payment to the Central Government it was essential for the Respondents to show that the applicants were the Principal Officers of the said Company. Reliance is placed on section 2 (35) of the Income Tax Act which states who is the Principal Officer and makes it obligatory on the part of the Assessing Officer to serve notice on the said Officer of the Company of his intention to treat him as the Principal Officer of the Company.

7. It is submitted that in the present case no notice as such was served upon the applicants by the Assessing Officer disclosing his intention of treating the applicants/Directors as Principal Officers of said Company.

8. It is further contented that in the complaint filed by the Commissioner of Income Tax it was not enough for the complainant merely to state that the accused/Directors are in charge and responsible for the day-to-day management of the Company. What is required is that there must be an averment showing

the nature of the post and its duties and it must be indicated in the complaint, how the Director is in charge of and responsible for the conduct of business of the Company. In the case of **M.A. Uneerikutty and others** vs. **Deputy Commissioner of Income-Tax,** I.T.R .218, I.T.R. 606 Kerela High Court observed as follows:

> "By virtue of section 2 (35) of the Act, partners do not come within the definition of Principal Officer unless the Income-tax officer had served notice of his intention to treat them or any one of them as the Principal Officer of the firm connected with the management or administration. It seems necessary that the complainant must allege and show by some acceptable materials that the partners concerned were in charge of and responsible for the conduct of the business of the firm to make them also vicariously responsible along with it. A mere allegation to that effect will not be sufficient. There should be credible materials to show their active involvement in the conduct and management of the business of the firm. Short of stating that they were in charge of and responsible for the conduct of the business of the firm nothing had been mentioned in the complaints either about their role or as to the extent of their liability, which should not have been left to be inferred. At any rate the allegations seem too be insufficient to make them liable for the impugned act for which perhaps the firm and the Principal Officer, if any, alone would be liable."

9. The learned Magistrate in rejecting the application for discharge has observed that unless and until the prosecution has been given an opportunity to lead evidence, it cannot be determined at the stage prior to the framing of the Charge as to whether accused 4 to 7 applicants herein were not in charge of the conduct of the business of the company, and accordingly, held that the authority referred to by the applicants **viz. Shital N. Shah and others vs. Income-Tax Officer** (188 page 376 of I.T.R.) cannot be relied upon. In the said case the Madras High Court observed:

> "If the payer as a Company, the Company itself. including the Principal Officer thereof shall be the person responsible for paying."

Section 2 (35) specifies that the Principal Officer with reference to a Company would be any person on whom the Income Tax Officer has served a notice of his intention of treating him as Principal Officer. Admittedly no such notice was served upon the applicants. Despite the said observations of the Madras High Court in the case of **Shital N. Shah and others** vs. **Income-Tax Officer** (188 I.T.R. 376) the learned Metropolitan Magistrate has held that unless opportunity to the prosecution is given to lead evidence to substantiate or to prove that the accused nos. 4 to 7 were in charge and responsible for the conduct of the business of the accused no. 1 Company, this defence cannot be taken by the accused at this stage but the accused can raise this point at the time of framing of charge.

10. It must be fairly stated that at the time of hearing of the said application for discharge, the attention of the Court was not drawn to the case of **M.A Unneerkutty and others Vs. Deputy Commissioner of Income Tax,** (218 I.T.R. 606), Kerala High Court clearly states that it is necessary that complainant must lead and show some acceptable materials that the partners were incharge of and responsible for the conduct of the business of firm to make them also vicariously responsible along with it. A mere allegation to that effect will not be sufficient. There should be credible material to show their active involvement in the conduct and management of the business of the firm.

11. The complaint filed by the Commissioner of Income Tax states that accused nos. 2 to 9 at the material time were in charge of and responsible to accused no. 1 for the conduct of its business and therefore legally liable under section 194-C(1) r.w. section 204 of the said Act to deduct income tax and to pay the tax so deducted to the credit of the Central Government within one week from the last date of the month in which the deduction is made. Apart from the averment that accused/applicants were in charge of and responsible to the Company for the conduct of its business there is no material whatsoever which prima facie shows that the applicants/accused were in fact in charge of the affairs of the Company and responsible for the conduct of its business and day-to-day affairs.

12. Unless the complaint disclosed a prima facie case against the applicants/accused of their liability and obligation as Principal Officers in the day –to-day affairs of

the Company as Directors of the Company under section 278-B, the applicants cannot be prosecuted for the offences committed by the Company. In the absence of any material in the complaint itself prima facie disclosing responsibility of the accused for the running of the day-to-day affairs of the Company process could not have been issued against them. The applicants cannot be made to undergo the ordeal of a trial unless it could be prima facie showed that they are legally liable for the failure of the Company in paying the amount deducted to the credit of the Company. Otherwise, it would be a travesty of justice to prosecute them and ask them to prove that the offence is committed without their knowledge. The Supreme Court in the case of **Shyam Sundar Vs. State of Haryana** reported in A.I.R. 1984 page 53 held as follows:--

> "It would be a travesty of justice to prosecute all partners and ask them to prove under the proviso to sub-section (1) that the offence was committed without their knowledge. It is significant to note that the obligation for the accused to prove under the proviso that the offence took place without his knowledge or that he exercised all due diligence to prevent such offence arises only when the prosecution establishes that the requisite condition mentioned in sub-section (1) is established. The requisite condition is that the partner was responsible for carrying on the business and was during the relevant time in charge of the business. In the absence of any such proof no partner could be convicted."

13. In the light of the above discussion the application will have to be allowed.

The impugned order dated 30.11.1996 is set aside.

The applicants stand discharged in Case Nos. 248-S to 251-S of 1993.

(A.S. AGUIAR. J)

Annex 8

Extracts from Part II of Schedule VI to the Companies Act, 1956

Requirements as to Profit and Loss Account

"3. The profit and loss account shall set out the various items relating to the income and expenditure of the company arranged under the most convenient heads; and in particular, shall disclose the following information in respect of the period covered by the account:

(i) (a) The turnover, that is, the aggregate amount for which sales are effected by the company, giving the amount of sales in respect of each class of goods dealt with by the company, and indicating the quantities of such sales for each class separately.

(b) Commission paid to sole selling agents within the meaning of section 294 of the Act.

(c) Commission paid to other selling agents.

(d) Brokerage and discount on sales, other than the usual trade discount.

(ii) (a) In the case of manufacturing companies,-

(1) The value of the raw materials consumed, giving item-wise break-up and indicating the quantities thereof. In this break-up, as far as possible, all important basic raw materials shall be shown as separate items. The intermediates or components procured from other manufacturers may, if their list is too large to be included in the break-up, be grouped under suitable headings without mentioning the quantities, provided all those items which in value individually account for 10% or more of the total value of the raw material consumed shall be shown as separate and distinct items with quantities thereof in the break-up.

(2) The opening and closing stocks of goods produced, giving break-up in respect of each class of goods and indicating the quantities thereof.

(b) In the case of trading companies, the purchases made and the opening and closing stocks, giving break-up in respect of each class of goods traded in by the company and indicating the quantities thereof."

"(e) In the case of other companies, the gross income derived under different heads.

Note 1.—The quantities of raw materials, purchases, stocks and the turnover, shall be expressed in quantitative denominations in which these are normally purchased or sold in the market.

Note 2.—For the purpose of items (ii)(a), (ii)(b) and (ii)(d), the items for which the company is holding separate industrial licences, shall be treated as separate classes of goods, but where a company has more than one industrial licence for production of the same item at different places or for expansion of the licensed capacity, the item covered by all such licences shall be treated as one class. In the case of trading companies, the imported items shall be classified in accordance with the classification adopted by the Chief Controller of Imports and Exports in granting the import licences.

Note 3.—In giving the break-up of purchases, stocks and turnover, items like spare parts and accessories, the list of which is too large to be included in the break-up, may be grouped under suitable headings without quantities, provided all those items, which in value individually account for 10% or more of the total value of the purchases, stocks or turnover, as the case may be, are shown as separate and distinct items with quantities thereof in the break-up."

"4C.In the case of manufacturing companies, the profit and loss account shall also contain, by way of a note in respect of each class of goods manufactured, detailed quantitative information in regard to the following, namely:-

(a) the licensed capacity (where licence is in force);

(b) the installed capacity; and

(c) the actual production.

Note 1.—The licensed capacity and installed capacity of the company as on the last date of the year to which the profit and loss account relates, shall be mentioned against items (a) and (b) above, respectively.

Note 2.—Against item (c), the actual production in respect of the finished products meant for sale shall be mentioned. In cases where semi-processed products are also sold by the company, separate details thereof shall be given.

Note 3.—For the purpose of this paragraph, the items for which the company is holding separate industrial licences shall be treated as separate classes of goods but where a company has more than one industrial licence for production of the same item at different places or for expansion of the licensed capacity, the item covered by all such licences shall be treated as one class.

4D. The profit and loss account shall also contain by way of a note the following information, namely:—

(a) value of imports calculated on C.I.F. basis by the company during the financial year in respect of:—

(i) raw materials;
(ii) components and spare parts;
(iii) capital goods;

(b) expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;

(c) value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;

(d) the amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related;

(e) earnings in foreign exchange classified under the following heads, namely:—

(i) export of goods calculated on F.O.B. basis;

(ii) royalty, know-how, professional and consultation fees;

(iii) interest and dividend;

(iv) other income, indicating the nature thereof."

Annex 9

Interim recommendations made to Government

Vide letter No. 11/3/2003-CL.V dated 5.3.2003, (copy placed below) Secretary, Department of Company Affairs has asked the Committee to also examine matters where prior approval of the Central Government is required, under the law, with a view to seeing whether such approvals are really necessary. In the letter, Secretary, DCA has, in particular, sought early advice with respect to sections 149, 205, 294 AA and 295 of the Companies Act, 1956.

2. These four provisions of the Companies Act, 1956 were discussed in the meeting of the Committee held on 7.3.2003. It was pointed out that in the 1997 Bill changes in these sections had already been suggested. The existing provisions, and the provisions proposed in the 1997 Bill were brought out in a 'table' circulated in the meeting as follows:

Section No.	Subject	Existing provisions	Proposed provisions in the Companies Bill, 1997
149	Commencement of Business	At present commencement of business by a company has to be approved by a special resolution passed in a general meeting and the same is to be filed with the Registrar and Registrar will issue a certificate which will be a conclusive evidence that the company is entitled to commence business.	No need to obtain certificate from the Registrar by companies, mere intimation of the commencement will suffice. The provision of this section shall not apply to the Government companies.
205	Dividend to be paid only out of profits	In case of companies incurring losses payment of dividend out of reserves or profit earned in the earlier years, require the approval of the Central Government.	If there is inadequacy or absence of profits in any financial year, the company can declare a dividend out of accumulated profits transferred to the reserve only by passing a special resolution by the shareholders.
294AA	Appointment of sole selling agent	Appointment of sole selling agent by the Board of Directors subject to the approval of the company in the first general meeting held after the date on which the appointment is made and in	No approval of Central Government is required.

		the case of a company with paid up capital of Rs. 50 lakhs or more subject to the consent of the company by a special resolution and approval of the Central Government is mandatory.	
295	Loans to managing directors, etc.	Loans to the Directors require the approval of the Central Government.	It is proposed to dispense with the approval of the Central Govt. and loans can be given by passing a special resolution in a general meeting.

3. After detailed discussions, the Committee was of the view that adoption of the proposals in the 1997 Bill would be in order, and should be recommended to the Government. The Committee also felt the Government may consider, if it wishes to do so by way of abundant caution, building in the safeguards, such as concurrence of financial institutions, provided in section 372 A of the Companies Act, 1956.

4. If approved, the above recommendations may be conveyed to the Government (it is too short to merit an interim report), and included in the report of the Committee when that is finalised.

5. Submitted for approval please. This note sheet will be circulated in the next meeting of the Committee and, if considered necessary, made a part of the minutes of the meting.

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(Rajiv Mehrishi)
Member
9.3.2003

Approved
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Chairman

List of Abbreviations

AGM	Annual General Meeting
AoA	Articles of Association
BCCI	Bombay Chamber of Commerce and Industry
CII	Confederation of Indian Industry
DCA	Department of Company Affairs
ESI	Employees State Insurance
FISME	Federation of Indian Micro and Small & Medium Enterprises
Government	Central Government
IBA	Indian Banks Association
ICAI	Institute of Chartered Accountants of India
ICSI	Institute of Company Secretaries of India
ICWAI	Institute of Cost and Works Accountants of India
IMC	Indian Merchants' Chamber
LLP	Limited Liability Partnership
MoA	Memorandum of Association
MAOCARO	Manufacturing and Other Companies (Auditor's Report) Order, 1988
PHDCCI	PHD Chamber of Commerce and Industry
RoC	Registrar of Companies
SAFEMA	Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976
SIDBI	Small Industries Development Bank of India
SPC	Small Private Companies
SSIs	Small- Scale Industrial Units
UK	United Kingdom
USA	United States of America