THE COMPANIES ACT 2013, IMPLICATIONS AND COMPLICATIONS
26TH APRIL, 2014 | DELHI

SUMMARY OF ROUNDTABLE DISCUSSIONS WITH COMPANY SECRETARIES

RATIONALE

The Companies Act, 2013, and the Rules framed thereunder, are almost entirely in place. Their dates of effect have been notified and corporate India is expected to have commenced the process of making the changes and improvements necessary in order to be fully compliant with the new statutory framework.

Responses to the new enactment have been mixed. While the objectives underlying the changes have been generally welcomed as being consistent with the promotion of the interests of the stakeholders, especially in the context of some major corporate failures on the governance front, the unclear content of some of the sections, the perceived lack of internal consistency, and the attempt to undo some of the problems of the Act, through the Rules, inviting the possibility of excessive delegation, have met with legitimate criticism.

While the desirability of mandating Corporate Social Responsibility (CSR) occupied much of the mindspace prior to the coming into force of the Act, the seemingly disproportionate load on the Independent Directors seems to be dominating discussions post the enactment. Audit Committees too seem to have their fair share in the debates that are ongoing.

Corporate Governance, with its threshold requirement of compliance is clearly the underlying theme of the Act. Yet, the persons in the forefront of ensuring compliance, not only as a regulatory requirement but also as the bedrock of Governance, do not seem to be in focus. The role of the Company Secretaries as the conscience keepers of the Board and the persons responsible for ensuring compliance in letter and spirit, is admittedly more important than it has ever been.

Experienced Company Secretaries drawn from companies in different sectors, constitute the best forum to discuss their multifarious responsibilities, stated and unstated, under the new Act. The challenge of ensuring transparency in regard to inter-corporate transactions, the determination of which of the related party transactions are in "the course of ordinary business", and ensuring continuing engagement with diverse stakeholders can together pose a significant challenge. Revisiting internal compliance procedures to ensure their consistency with the prescriptive arrangement is also a major task. We also need to ensure that private companies are enabled to cope with the increased compliance burden that the new Act places on them.

DISCUSSIONS

Company Secretaries (CSs) are the first level of defence for companies and Boards.

Companies Act, 2013 (The Act)

- The Act presupposes complete distrust. There is too much focus on compliance.
- The Act does not have some of the desired provisions which are important for furthering the spirit of Corporate Governance.
- There are a lot of areas of conflict in the Act and its Rules and in some places, the Rules are incomplete.
- The cost of compliance has not been considered while drafting/ finalising the provisions of the Act. The implications of some of the provisions are huge, especially for smaller companies.
- Even if not properly communicated, the intention of the Act is important and should be considered.
- The Act assumes conflict between different stakeholders. It ignores the basic logic that while short-term objectives of different stakeholders may vary, the long term objectives are the same. All the stakeholders want the company to perform well.

Promoters

- Promoters do not want to be on the wrong side of law and hence, focus too much on compliance, often at the cost of business.
- The mindset and attitude of promoters is a problem. They focus only on maximising their own interests, often at the cost of the interests of other stakeholders. They want complete and absolute power, and in the process, they do not share information with any outsider.

Directors

- A number of Independent Directors (IDs) are inactive in Boardrooms. They sometimes consider Board memberships to be post-retirement sinecures.
- The Act has increased the role and responsibilities as well as liabilities of all the Directors, especially IDs. The protection provided to them has also gone down. Directors and Officers (D&O) Policy, often considered to be a source of protection, is not valid in case a fraud is alleged by the complainant.
- Contradiction in the Act starts with the manner in which an ID is defined. While an ID is supposed to be independent of ownership and management, she has been made responsible for some executive responsibilities, such as approving Related Party Transactions (RPTs) in Audit Committees (ACs).
- Boards today are under-performing. The problem starts with improper selection process of IDs. Companies do not give proper thought to the missing competencies at the Board level or the training required by Directors.
- Role of IDs *inter alia* includes:
    - To protect the interest of all stakeholders and not just the promoter shareholder.
    - To give the company's interest paramount importance.
    - To arbitrate in case of a conflict between the management and shareholders.
        - This provision forgets about other stakeholders and mentions only shareholders.
        - Further, "arbitrate" has a certain connotation under law and an ID is not equipped to handle this.
    - Schedule IV of the Act, which is supposed to state the role and function of IDs, seems to be based on the objective of promoting the confidence in institution of IDs, and not in companies.
- Liability of IDs:
    - Liability of IDs is limited to the information received by them from formal board processes. There is a huge difference between "What comes to the Board" and "What ought to come to the Board". Information that comes through Board processes, largely depends on the management. Management, in general, does not want to share too much information with the Board. In a number of instances, mindset / attitude of management is a problem. They often only consider the interest of the promoter shareholder.
    - The challenge before IDs is that they have to seek information in case the information provided to them by the management is insufficient. This raises challenges of its own such as:
        - Checking the adequacy and timeliness of the information.
        - Ascertaining the information that is required for decision making.
        - Asking for the required information.
    - However, IDs too lack the initiative to seek information or to try and understand the business of the company. Often IDs do not raise any substantive issues.
    - Also, even if IDs take a professional's advice on a matter of the Board, it does not reduce their responsibilities.
- The Act provides for terms of a maximum of 5 years for IDs and Auditors (with ratification in every Annual General Meeting (AGM) for auditors). Annual ratifications negate the need for terms of 5 years.
- Nominee Directors:
    - Nominee Directors are not independent as per the Act. The company would have to induct newer IDs to get the arithmetic right. However, as per institutional investors and venture

capitalists who nominate nominee Directors, they are the only Directors who are truly independent since the promoter/ Chairperson has no role in their appointment.

- Director on Board of subsidiary company
  - While there is a cap on the number of directorships that a Director can have, subsidiary companies, especially material subsidiaries, too would require IDs and a parent company might expect a Director to also be a Director on the Board of the subsidiary.

Agenda

- Management, especially Managing Director/ Chief Executive Officer (CEO), decides the agenda for Board and Committee meetings.
- Ideally, the agenda should be decided in consultation with the Chairperson, with her having a greater say in the decision/ finalisation.

Minutes

- Minutes should reflect the discussions at the meeting and should not be a mere record of the decisions taken.
- A related, and important, point is the need for timeliness of preparation and finalisation of minutes.

Audit Committee (AC)

- One of the major roles of an AC is to approve RPTs which are in the ordinary course of business and are at arms length pricing. However, both these criteria are subjective. In the future, it could be difficult to ascertain whether the decision of the AC was correct or not. When in doubt, it is better to take the decision to the shareholders.
- It is mandatory for the Chairperson of AC to attend the AGM. More than her physical presence, it is important to give a sense of comfort to the shareholders.

Nomination and Remuneration Committee (NRC)

- The role of NRC needs to be relooked and expanded.

Evaluation Exercise

- There are several unanswered questions in the Act regarding evaluation:
  - What are the basis on which Directors will be evaluated?
  - Who will conduct the exercise?
  - How would the process be minuted?
  - How should the process and the results be disclosed? This becomes particularly important since it could impact the Chairperson and/or Directors, especially in Public Sector Undertakings (PSUs) where Right to Information (RTI) may be used to seek answers on the process and its results.
- As per the Act, an ID's reappointment is dependent on the Board Evaluation result. However, it leaves some questions unanswered:
  - Should not the objective of an evaluation exercise be to suggest areas for improvement for Directors and not deciding whether or not she should continue on the Board?
  - If based on the result of Board evaluation a Director is asked to go, how should this be disclosed to the shareholders? A related question is whether it would adversely impact the reputation of the Director, after having been elected for a longer term?
- Evaluation of Chairperson
  - IDs might not be comfortable with evaluating the Chairperson since they might feel that an honest evaluation might backfire.
  - Executive Directors too would not be comfortable in evaluating the Chairperson.
  - The exercise is supposed to be done in the separate meeting of IDs. How would the views of Executive Directors (EDs) be taken in such a meeting?

- Also, there is a lack of clarity on who would communicate the result of the exercise to the Chairperson and in case required, how would her exit be operationalised, especially in the absence of a provision for Lead ID.

Related Party Transactions (RPTs)

- Provisions relating to RPTs should be examined afresh.
- The provision on RPTs provide for only minority shareholders' voting. It is lopsided. It should factor in that minority shareholders may invest in the stock of a company for short term gains while promoter directors are in the company for the long run. Further, minority shareholders might not know what to vote for and so quality of decisions might be adversely affected.

Corporate Social Responsibility (CSR)

- It is the only provision in the Act with Corex (Comply or Explain). Corex is a British concept where investors are better informed. Its practicability in India is questionable because shareholders might not ask the right questions and companies might not give complete or accurate information to them.
- Inadequate information on CSR is given to IDs also.
- The provisions on CSR specify that CSR must preferably be done in local areas/ areas around the head office of the company/ plant. It also specifies CSR activities that corporates should undertake. Less thought has been given to newer geographical regions with no industrialisation or to newer activities that might actually require CSR.
- Companies have no or limited flexibility on CSR spends. Further, even if the money is given to a Trust for CSR activities, responsibility of monitoring it lies with the company.

Stakeholders

- While the Act talks about stakeholders, including in the context of naming the Committee as the Stakeholder Relationship Committee (SRC), only the interests of holders of securities are expected to be looked into by the SRC.

Annual General Meetings (AGMs)

- The attendance of shareholders at AGMs is poor.
- Companies do not know how much information should be given to shareholders.
- Electronic voting at AGMs has limitations. There are procedural confusions such as whether each shareholder would have one vote or would the weighted average based on shareholding be considered.

Annual report

- Directors report is as much the responsibility of a CS, as it is of the Director.

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Given that our founder, Mr. M. Damodaran, introduced Clause 49 of the Listing Agreement, dealing with corporate governance in India, and has been a part of both public sector and private sector Boards, as well as performing and underperforming Boards, we offer experience based consultancy and courses on the journey from compliance through governance to performance. Further, given his success in turning around organisations that had been written off, we are uniquely positioned to offer courses on leadership, organisational transformation, and building winning teams.

EEPL has a number of highly experienced and renowned consultants and faculty members who have helped, and continue to help, us deliver programmes that have been well received.