
UNIT 6 CORPORATE LAWS - I

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6.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the evolution of corporate legislation in India;
- outline the basic framework of the Companies Act;
- explain the major changes that have taken place in company law after liberalisation; and
- describe the provisions of Sick Industrial Companies (Special Provisions) Act.

6.1 INTRODUCTION

The company form of business organisation has become increasingly more important with the growth of industry in India. The number of registered companies as at present are around 5 lakh, and 99% of these are in the private sector. Their regulation is of immense importance for protection of investor's interest and the public at large.

A large number of legislations govern and regulate their working directly or indirectly. While the Companies Act in India has evolved since 1850, other Acts are essentially the product of independent India. Industries (Development and Regulation) Act, 1951, Monopolies and Restrictive Trade Practices Act, 1969, and Sick Industrial Companies (Special Provisions) Act (SICA), 1985 have been some of the corporate legislations which lay down the legal parameters and the procedures for functioning of companies. Of course, companies are also required to comply with many other legislations which apply to all forms of business entities as explained in Unit 5. In this unit, you will learn about the evolution of company legislation in India, its basic framework and the major

changes that have taken place during 1999 to 2002, and the provisions of the Companies Amendment Bill, 2003. In addition, you will learn about the objectives, applicability and working of SICA, 1985.

6.2 EVOLUTION OF CORPORATE LEGISLATION

The company legislation in India has closely followed the company legislation in England. The first legislative enactment for registration of joint stock companies was passed in the year 1850 which was based on the English Companies Act, 1844. This Act recognised companies as distinct legal entities but did not introduce the concept of limited liability. The concept of limited liability, in India, was recognised for the first time by the Companies Act, 1857 which closely followed the English Companies Act, 1856 in this regard. The Act of 1857, however, kept the liability of the members of banking companies unlimited. It was only in 1858 that the limited liability concept was extended to banking companies also. Thereafter, in 1866, the new Act was passed for consolidating and amending the law relating to incorporation, regulation and winding-up of trading companies and other associations. This Act was based on the English Companies Act, 1862. The Act of 1866 was recast in 1882 to bring the Indian company law in conformity with the various amendments made to the English Companies Act of 1862. This Act continued till it was replaced by the Companies Act, 1913. The Act of 1913 had been passed following the English Companies Consolidation Act, 1908. It may be noted that since the Indian Companies Acts closely followed the English Acts, the decisions of the English Courts under the English company law were also closely followed by the Indian Courts. Till 1956, the business companies in India were regulated by this Act of 1913. Certain amendments were, however, made in the years 1914, 1915, 1920, and 1932. The Act was extensively amended in 1936 on the lines of the English Companies Act, 1929. Thereafter, minor amendments were made a number of times.

At the end of 1950, after independence, the Government of India appointed a Committee under the chairmanship of Shri H.C. Bhaba to go into the question of the revision of the Indian Companies Act with particular reference to its bearing on the development of Indian trade and industry. This Committee examined a large number of witnesses in different parts of the country and submitted its report in March, 1952. Based largely on the recommendations of the Company Law Committee, a Bill to enact the present legislation namely, the Companies Act, 1956 was introduced in Parliament. This Act, once again, largely followed the English Companies Act, 1948. The major changes that the Indian Companies Act, 1956 introduced over and above the Act of 1913 related to (a) the promotion and formation of companies; (b) capital structure of companies; (c) company meetings and proceedings; (d) the presentation of company accounts, their audit, and the powers and duties of auditors; (e) the inspection and investigation of the affairs of the company; (f) the constitution of board of directors, and the powers and duties of directors, managing directors and managers, and (h) the administration of company law.

6.3 COMPANY LAW - BASIC FRAMEWORK

Company Law is primarily contained in the Companies Act, 1956 comprising of 777 Sections and fifteen schedules (including the amendments till date). The provisions contained in the Act provide for: formation and registration of the companies; contents of memorandum, articles and prospectus; procedure for alteration of memorandum and articles of association; penalties for mis-statements in prospectus; shares and share-capital; various modes of acquiring membership; transferability, transmission, and forfeiture of shares; increase or reduction of share capital; rights of members; requirements for holding general body meetings including penalties for not holding; constitution of board of directors and their powers including restrictions thereon;

remuneration payable to managerial persons; removal of directors; accounts and audit; inspection and investigation; amalgamation, reconstruction, mergers and takeovers; prevention of oppression and mismanagement; and winding-up of companies.

The Act has not defined a company as such but, under Section 34(2), it has stated the effect of registration by identifying the features which a company requires as a consequence thereof of such as perpetual succession and a common seal. The Act has laid down procedural rules to be followed for the registration of a company, flotation / raising of capital and commencement of business including details regarding nature and contents of the documents to be filed with the Registrar of Companies, and procedure for any alteration therein. To a large extent, issue of shares and debentures by a company is governed by the guidelines issued in that respect by SEBI. But, the Companies Act has laid down certain general principles in that context which include the statutory provisions regarding listing of all public issues of shares and debentures, their allotment and the effects of irregular allotment. The Act also specifies rules for issue of shares at a premium, at a discount and also for issue of sweat equity, bonus shares and rights shares.

Effective management of companies is sought to be ensured by the Act not only by laying down the procedure for appointment of managerial personnel, but also by delineating the powers of the board of directors, and limiting certain powers which can be exercised only with the consent of the shareholders in general meeting. The Act has also laid down the liabilities of directors to the company as well as to the third parties, and fixed an overall limit on their remuneration for companies having profits and those having inadequate profits, and provided that in case of loss making companies, it can be paid as per slabs in schedule XIII.

The Companies meetings are required to be convened, constituted and conducted in conformity with the applicable provisions of the Companies Act and the relevant provisions of the Articles of Association of the companies.

To prevent oppression and mismanagement, the Act has provided that the requisite number of members may apply to the Company Law Tribunal (earlier it was Company Law Board) for relief if the affairs of a company are being conducted in a manner prejudicial to the public interest or that the interest of the company. The Company Law Tribunal is empowered to pass necessary orders to end oppression and mismanagement as also to grant specific relief. The proposals involving compromise, arrangement, reconstruction or amalgamation are also required to be submitted to the Company Law Tribunal for approval. Besides, procedures have been laid down for the appointment of sole selling agents and purchase agents. The Act also provides for books of accounts to be maintained on accrual basis and according to double entry system and annually audited by external auditors.

The process of winding up of any company constitutes the phase whereby its legal personality as a corporation is brought to an end. The Company law Tribunal may order compulsory winding up of a company under circumstances which are specified in the Act, or if the Tribunal is of opinion that it is just and equitable that the company should be wound up as, for example, if there is a deadlock in management, or the substratum of the company has disappeared, etc. Depending on the nature of circumstances, a petition can be made for compulsory winding up by the company, its creditors, contributories, the registrar, the Central or State Government, or jointly by any of these parties. The general powers of the Tribunal have also been listed in the Act in the case of winding up. Regarding voluntary winding up of a company, which may be members' or creditors' voluntary winding up, the procedure to be followed have been duly laid down in the Act.

6.4 MAJOR CHANGES IN 1999-2001

The Companies Act has been amended several times since 1956. Many changes were made during 60's and 70's and major amendments took place in 1985 and 1988. But in the wake of economic reforms process initiated from July, 1991 onwards, the Government recognized that many provisions of the Companies Act had become anachronistic and were not conducive to the growth of the Indian corporate sector in the changing environment. Consequently, an attempt was made to recast the Act, which was reflected in the Companies Bill, 1993. The said Bill, however, was subsequently withdrawn. Later on, as part of continuing reforms process and in the wake of the enactment of the Depositories Act, 1996, certain amendments were incorporated by the Companies (Amendment) Act, 1996 and a working group was constituted to rewrite the whole Act.

6.4.1 Companies Amendment Act, 1999

Based on the report prepared by the Working Group and taking into account the developments that had taken place in corporate structure, administration and the regulatory framework the world over, the Companies Bill 1997 was introduced in Rajya Sabha on August 14, 1997 to replace the Companies Act, 1956. In the meantime, as part of reforms process and in view of the urgency felt by the Government, the President of India promulgated the Companies (Amendment) Ordinance, 1998 on October 31, 1998 which was later replaced by the Companies (Amendment) Act, 1999 to surge the capital market by boosting morale of national business houses besides encouraging FIs as well as FDI in the country. The amendments brought about a number of important changes in the Companies Act. These were in consonance with the then prevailing economic environment and to further Government policy of deregulation and globalisation of economy. The changes made vide Companies (Amendment) Act, 1999 can be summarised as follows

- 1 The corporate sector was given the facility to buy-back company's own shares.
- 2 Provisions relating to investments and loans were rationalized and liberalized besides the requirement of prior approval of the Central Government on investment decisions was dispensed with.
- 3 Companies were allowed to issue sweat equity in lieu of intellectual property.
- 4 In order to make accounts of Indian companies compatible with international practices, the compliance of Indian Accounting Standards was made mandatory and the provisions for setting up of National Committee on Accounting Standards was incorporated in the Act.
- 5 For the benefit of investors, provisions were made for setting up of Investor Education and Protection Fund
- 6 The facility of nomination by shareholders, debenture holders, etc. was introduced.

6.4.2 Companies (Amendment) Act, 2000

The year 2000 witnessed another bouquet of amendments in the form of Companies (Amendment) Act, 2000 in order to provide certain measures of good corporate governance and for ensuring meaningful shareholders' democracy in the working of companies. Accordingly, it introduced certain far-reaching changes and new concepts. These include:

- 1 **Minimum Paid-up Capital Requirement :** All companies other than associations not for profit are required to have a minimum paid-up capital.

Private Companies, since 13-12-2000, cannot be registered with less than Rs. 1,00,000 paid-up share capital and public companies must have a minimum paid up share capital of Rs. 5,00,000.

- 2 Small Depositors : In order to grant protection to small depositors, Sections 58AA and 58AAA were introduced. Provisions are designed to protect depositors who have invested upto Rs.20,000 in a financial year in a company.
- 3 **Shelf Prospectus/Information Memorandum** and Red-herring **Prospectus**: Financial institutions and banks which have to make repeated offers of securities in a year may instead of issuing prospectus, issue a 'Shelf Prospectus' which will have a shelf-life of one year. For any changes in-between, an 'information memorandum' containing those changes duly classified under appropriate heads need only be issued. Section 60A was designed to offer comfort to such institutions and also help reduce cost of issue.

Information Memorandum, as contemplated in Section 60B, is an attempt to recognize the book-building process as allowed under SEBI Guidelines since 1997. Information Memorandum is essentially a document designed to elicit demand for the securities and to ascertain the price and terms of the issue. It is a necessary ingredient of 'book-building process'. 'Red-herring Prospectus' is an incomplete prospectus and does not contain the information regarding price and quantum of securities.
- 4 Non-Voting Equity Shares : Section 86 was amended to allow issue of non-voting equity shares by public companies.
- 5 Passing of Resolutions through Postal Ballot : In order to encourage wider participation of shareholders, Section 192.4 has been introduced to allow members/shareholders to vote on a particular resolution through postal ballot. Through Rules made by the Central Government, postal ballot has been made mandatory for certain matters. Assent or Dissent to a resolution is required to be sent within 30 days.
- 6 Directors' Responsibility Statement : Directors' Report is to include a responsibility statement with respect to the following matters :
 - (i) whether accounting standards had been followed in the preparation of annual accounts and reasons for material departures, if any;
 - (ii) whether appropriate accounting policies have been applied and on consistent basis;
 - (iii) whether directors had made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs and profit and loss of the company;
 - (iv) whether the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
 - (v) whether the directors had prepared the annual accounts on a going concern basis.
- 7 Audit Committee : New Section 192.4 provides for constitution of an audit committee by every public company having a paid-up capital of Rs.5 crore or more. Audit Committee is to consist of at least 3 directors. Two-thirds of the members of the audit committee shall be directors other than managing or whole-time director. Recommendations of the audit committee on any matter relating to financial management including audit report shall be binding on the Board.

- 8 **Compliance Certification :** Section 383A was amended with respect to companies having a paid-up share capital of Rs. 10 lakh or more but less than Rs. 2 crore which are not required to employ whole-time company secretary, to file with Registrar of Companies a certificate from a secretary in whole-time practice as to whether the company has complied with all the provisions of the Act. A copy of this certificate shall also be attached to the Directors Report.
- 9 **Issue of Indian Depository Receipts :** Section 605A permits companies incorporated outside India, whether having a place of business in India or not, to issue Depository Receipts in India and thus raise capital funds from Indian public.

6.4.3 Companies (Amendment) Act, 2001

In the year 2001, the Act was amended to revise amended provisions of Section 77A relating to buy-back of shares allowing Board of Directors (instead of through special resolution) to buy-back shares upto 10% of the paid-up capital and free reserves provided not more than one such buy-back is made during a period of 365 days. Resolution for the buy-back shall be required to be passed at a meeting of the Board and not through circulation.

Check Your Progress A

- 1 Issue of shares and debentures by a company is governed only by the guidelines issued in that respect of SEBI. Do you agree ?
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- 2 State which of the following statements is True or False,
- Sweat equity can also be issued in lieu of intellectual property.
 - Small depositor refers to a depositor who has invested upto Rs. 10,000 in a financial year in a company
 - A company cannot issue non-voting equity shares.
 - A whole time company secretary must be appointed in case a companies has paid up capital of Rs. 2 crore or more.
 - The Company Law Tribunal can order compulsory winding up of a company only under circumstances that are specified in the Companies Act.
 - A special resolution must be passed in the AGM of the company if the buy back of shares exceed 10% of the paid of capital.
- 3 Explain the concept of compliance certificate as applicable to companies having a paid up capital of Rs. 10 lakh or more but less than Rs. 2 crore.
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6.5 MAJOR CHANGES IN 2002

Two Companies (Amendment) Acts were passed in 2002 called Companies (Amendment) Act, 2002 and Companies (Second Amendment) Act, 2002. The

Companies (Amendment) Act, 2002 provided for setting-up and regulation of cooperatives as body corporates under the Companies Act, 1956 to be called 'producer companies'. The objective of the Companies (Second Amendment) Act, 2002 has been to expedite the winding-up process of the companies, facilitate rehabilitation of sick companies and protection of workers interest. It proposed to rationalise the procedure relating to winding up so that resources could be utilised for better purposes rather than blocking them in sick undertakings and, thus, help in reducing the hardships to workers and other interested parties. It also provided for repeal of SICA and dissolution of Board for Industrial and Financial Reconstruction (BIFR). At the same time, it sought to establish a National Company Law Tribunal providing it with powers for expediting the winding up procedure.

6.5.1 Companies (Amendment) Act, 2002

With globalization and growing competition and emerging new opportunities, a need was felt to link institutions to rural economy and keeping that in view, the Government constituted a Committee consisting of experts led by Dr. Y.K. Alagh, an economist and a former Union Minister, to examine and make recommendations with regard to: (a) framing a legislation which would enable corporatisation of co-operatives as companies and conversion of existing co-operatives into companies, and (b) ensuring that the proposed legislation accommodates the unique elements of co-operative business within a regulatory framework similar to that of companies.

Based on the recommendations of Dr. Alagh Committee, Part IX A dealing specifically with producer companies has been added to the Act vide the Companies (Amendment) Act, 2002 and the provisions of this part have become operative w.e.f. 6th February, 2003. These provisions as contained in Sections 581A to 581ZT enable incorporation of cooperatives as companies on optional basis, and the other salient features are: (i) offer a statutory and regulatory producer owned enterprises to compete with other enterprises on a competitive footing; (ii) provide for the formation and registration of producer companies which include the mutual assistance and cooperative principles within the more liberal regulatory framework afforded by the company law with suitable adaptations; (iii) provide an opportunity to cooperative institutions to voluntarily transform as themselves into the new form of producer companies; (iv) member equity may not be publicly traded, but may only be transferred with the approval of the producer company's board of directors; (v) the conversion option by cooperative society to producer company can be exercised only if two thirds of the members of the concerned society vote in favour of a resolution to that effect; (vi) the new form of company is designated as '**producer company**' to indicate that only certain category of person can participate in the ownership of such companies, i.e., persons engaged in an activity connected with, or relatable to, primary produce; and (vii) the objects of a producer company have been defined to include, among other things, production, processing, manufacture and sale of primary produce as well as allied activities.

It may be noted [hat the nucleus of all the objects stated above seems to be 'primary produce'. This has been defined in Section 581A(J) meaning (i) produce of farmers arising from agriculture (including animal husbandry, horticulture, floriculture, pisciculture (raising fish), viticulture (growing grapes), forestry, forest products, re-vegetation, bee raising, and farming plantation products), or from any other primary activity or service which promoted the interest of farmers or consumers; (ii) produce of persons engaged in handloom, handicrafts, and other cottage industries; (iii) any product resulting from any of the above activities including byproduct of such products; (iv) any product resulting from an ancillary activity that would assist or promote (v) any of the aforesaid activities or anything ancillary thereto; and any activity which is intended to increase the production of anything referred to in (i) to (iv) or improve the quality thereof. Thus, broadly, the definition covers activities of, and related to, agriculture (of various forms) and handloom, handicraft and other cottage

industries which, till now, had been the domain of cooperative societies. Let us look at the **other** distinguishing features of producer companies.

- 1 **Formation and Registration of Producer Companies :** Any ten or more producers who are individuals or any two or more producer institutions or a combination of ten or more individuals and producer institutions may form and incorporate a company as a produces company. In this context the term 'produces' means any person engaged in any activity connected with any primary produce, and the term 'producer institution' means a producer company or any other institution having only producer(s)/producer company(ies) as its members whether incorporated or not, having any of the objects referred to in Section 581B and which agrees to make use of the services of the producer company(ies) as provided in its articles.
- 2 **Status of Private Limited Company :** On registration, the producer company shall become a body corporate as if it is a private limited company without, however, any limit to the number of members thereof and without use of the word private as part of its name. As per Section 581F, name of a producer company shall end with the words 'Producer Company Limited'.
- 3 **Membership and Voting Rights of Members:**
 - (a) Where the membership consists solely of individual members, the voting rights shall be based on a single vote for every member, irrespective of his shareholding or patronage of the producer company.
 - (b) In a case the membership consists of producer institutions only, the voting rights of such producer institutions shall be determined on the basis of their participation in the business of the produces company in the previous year, as may be specified by Articles.
 - (c) In a case where the membership consists of individuals and producer institutions, the voting rights shall be computed on the basis of a single vote for every member. The Articles of any producer company may provide for the conditions, subject to which a member may continue to retain his member ship, and the manner in which voting rights shall be exercised by the members.

No person, who has any business interest which is in conflict with business of the producer company, shall become a member of that company.
- 4 **Benefits to Members :**
 - (a) Members shall not receive full value of the produce pooled or supplied. 'The withheld price' shall be paid later in cash or equity shares as per the decision of the board.
 - (b) Every member shall receive a limited return on the capital contributed by the members.
 - (c) Surplus, if any, after making (i) provision for limited return and reserves (as required under Section 581(ZI), (ii) providing for the development of the business of the producer company, and (iii) providing for common Facilities. may be distributed to members as bonus in proportion to their respective participation in business. This may be given in cash or by way of equity shares.
- 5 **Administration of Producer Company :**
 - (a) The producer company shall be administered by a board consisting of persons elected or appointed as directors and the board shall be

accountable to the members. Every producer company shall have at least five and not more than fifteen directors.

- (b) Subject to the provisions of this Act and articles, the board of directors of a producer company shall exercise all such powers and do all such acts and things, as that company is authorized so to do.
- (c) When the directors vote for a resolution, or approve by any other means, any thing done in contravention of the provisions of this Act or any other law for the time being in force or articles, they shall be jointly and severally liable to make good any loss or damage suffered by the producer company.

- 6 **Chief Executive and his Functions :** Every producer company shall have a full time Chief Executive, by whatever name called, to be appointed by the Board from amongst persons other than members. He shall be entrusted with substantial powers of management as the Board may determine, shall be ex-officio director of the Board, and such director shall not retire by rotation.
- 7. **Social Responsibilities:** The producer company shall actively cooperate with other producer companies (and other organizations following similar principles) at local, national or international level so as to best serve the interest of their Members and the communities it purports to serve.

6.5.2 Companies (Second Amendment) Act, 2002

Some of the major provisions made under the Companies (Second Amendment) Act, 2002 are summarised as follows :

- 1 **National Company Law Tribunal :** A new Section, 10FB provides for the constitution of National Company Law Tribunal. The Tribunal shall enjoy most of the powers conferred upon Company Law Board (which is proposed to be dissolved), Company Courts and BIFR under SICA. The proposed strength of the Tribunal is of 62 members and the President, The Tribunal shall work through Benches. The purpose of creation of the Tribunal, besides conferring upon it the powers of Company Law Board, Company Courts and BIFR, is to avoid multiplicity of litigation before various courts or quasi-judicial bodies or forums regarding revival or rehabilitation or merger and amalgamation, and winding up of companies. It may be noted that the Government has duly notified Section 10FB w.e.f. 14-2003 thereby enabling the constitution of National Company Law Tribunal.
- 2 **Rehabilitation and Revival Fund :** The Second Amendment Act provides that a cess of 0.005 per cent to 0.1 per cent of annual turnover shall be imposed on every company to form a Rehabilitation and Revival Fund. The cess shall be levied and collected by the Central Government but the Tribunal has been empowered to manage the Fund. The Fund will be used for the purpose of: (a) making interim payment of workmen's dues pending the revival or rehabilitation of the sick industrial company; or (b) payment of workmen's dues due to the workmen, referred to in sub-section (3) of Section 529, of the sick industrial company; or (c) protection of assets of sick industrial company; or (d) revival or rehabilitation of sick industrial company.
- 3 **Additional Grounds for Winding-up :** The Second Amendment Act introduces three new clauses in Section 433 providing additional grounds of winding-up by the Tribunal. These include: (i) failure on the part of company to file balance sheet, profit & loss account or annual return with the Registrar of Companies for five consecutive financial years; (ii) acting against the interests

of the sovereignty and integrity of India, the security of the State, friendly relations with foreign states, public order, decency or morality; and (iii) if the Tribunal is of the opinion that the company, being a sick company, is unlikely to become viable in future.

- 4 **Inability to Pay Amount of Debt Raised** : Section 434 of the Companies Act prescribes that if a company is indebted for a sum exceeding Rs.500 and is unable to pay the same, it shall be deemed to be unable to pay its debts for the purpose of clause (e) of Section 433. This amount has been raised to Rs.1,00,000.
- 5 **Liquidators from Panel of Professionals** : With a view to professionalise the role of Official Liquidator, the Second Amendment Act provides that the Official Liquidator may be appointed from a panel of Chartered Accountants, Company Secretaries, Cost & Works Accountants and Advocates. The Official Liquidator could also be a body corporate, consisting of such professionals as may be approved by the Central Government. The Tribunal is authorised to regulate the terms and conditions of appointment of the Official Liquidator, transfer the case from one official liquidation to another, and proceed against the Official Liquidator for any professional misconduct.
- 6 **Enhancement of Powers of Official Liquidator** : The Second Amendment Act authorises the Official Liquidator to sell whole of the undertaking of the company as a going concern. He is also empowered under the Amendment Act to appoint security guards to protect the property of the company.
- 7 **Proceedings of Winding-up** : The Second Amendment Act provides for time limits for carrying out various activities in the winding-up process. Accordingly, the Official Liquidator is required to serve a notice to the directors, for submitting statement of affairs of the company, immediately on his appointment. Thereafter, he will take into custody the property of the company and appoint valuer to assess the assets. Within a period of 15 days from the date of receipt of Valuation Report, he is required to advertise for inviting bids for sale of assets of the company.

Official Liquidator is cast with the responsibility of submission of half yearly accounts to the Tribunal till the completion of winding up process.

Along with Second Amendment Act, a separate Act to repeal SICA has also been passed, viz., Sick Industrial Companies (Special Provisions) Repeal Act, 2002. The Act has the effect of abolition of BIFR, an authority for rehabilitation of sick industrial units. All the matters pending before the said authority will be transferred to National Company Law Tribunal. However, the SICA Repeal Act has not yet been notified.

6.6 COMPANIES (AMENDMENT) BILL, 2003

Companies (Amendment) Bill, 2003 was presented in Rajya Sabha on May 7, 2003. The Bill is based on recommendations of Naresh Chandra Committee on Corporate Governance and Joint Parliamentary Committee (JPC) on Stock Market Scam. Statement of objects and reasons as made out by the Finance Minister stated it to be a Bill to (a) facilitate good corporate governance, (b) prevention of shell companies, and (c) prevention of recurrence of vanishing companies. The highlights of the Amendment Bill, 2003 are summarised as follows:

- 1 Effect of Failure to increase share capital within **two** years: The Companies (Amendment) Act, 2000 had introduced the concept of minimum paid-up share capital for companies (Rs. 1 lakh for private companies and Rs. 5 lakh for public companies). Consequently, every company was required to comply with the requirement within a period of two years w.e.f. 13.12.2000 failing which the company would be considered as a defunct company within the meaning of Section 560 and its name to be struck off. A new proviso is now proposed to the effect that in such a case and also where the company is not carrying on business/operation, the liability of every director or manager or shareholder of such company shall become unlimited.
- 2 **Holding-Subsidiary** Companies : Section 4, after proposed change, shall read follows:
 - (a) A company shall be subsidiary of another, if that other
 - (i) controls the composition of its board of directors; or (ii) exercises or *controls more than one-half of its total voting power* [where securities (other than equity) carrying voting rights have been issued]; or (iii) holds *more than one-half* in value of its paid-up capital;
 - (b) No company which is subsidiary of another company shall become a holding company.
 - (c) A private company which is subsidiary of a body corporate incorporated outside India shall be treated as a subsidiary of a public company if:
 - (i) the foreign company, if incorporated in India would be a public company, and
 - (ii) 90% or more [100% as per existing provision] of the share capital of the private subsidiary is held by foreign company.
- 3 **Officer in Default** : The meaning of "Officer who is in default" is proposed to be widened so as to include the chief accounts officer, the share transfer agents, bankers and registrar to the issue, merchant bankers in respect of the issue or transfer of any securities of the company; debenture trustee, every employee receiving remuneration more than the remuneration of the managing director or any whole time director and holding either alone or jointly with spouse and dependent children two percent or more of the equity share capital of the company and any other director being a party to the contravention by consent, or connivance or neglect.
- 4 **Large Partnerships for Professionals** : Firms of professionals like advocates, chartered accountants, cost accountants, company secretaries, doctors, architects, etc. can form partnership firm with upto 50 partners.
- 5 **Vanishing Companies** : In order to identify the promoters, each subscriber and witness will submit two clear photographs duly signed along with proof of identity.
- 6 **Power of the Central Government to order Change of Name** : The Central Government has been empowered to direct any company to change its name. The order can be made: (a) on the ground of the *security of the State or public interest*; and (b) *within 12 months* of incorporation.
- 7 **Provisions Relating to Public Issues**: A Number of amendments in provisions relating to public issue of securities have been proposed. These are : (a) issue of prospectus to be made compulsory in case of all securities and that it **shall** not include 'Information Memorandum' issued under Section **60A** or **60B**; (b) advertisement of issue of securities shall be in the form of abridged prospectus;

(c) the minimum subscription is now proposed to be defined 'as stated in the prospectus'; (d) application money to be not less than 25% of the nominal value; (e) revision of norms for refund of application money in case of non-receipt of minimum subscription; (f) filing of statement in lieu of prospectus to be come non-operational. (g) revocation of application for shares and debentures; (h) maximum rate of interest on failure to be raised from 15% to 20%; (i) non unless a charge has been created on the assets of the company; (j) providing for buy-back of shares indirectly through stock brokers and revision of penalties for contravention of the provisions relating to purchase of own shares; (k) omission of redundant provisions relating to conversion of shares into stock, restriction on acquisition of shares u/s 108 A to 108 H, etc.

8 Dividends : The following amendments have been proposed

- a) Dividend shall not be declared unless arrears of depreciation for last 10 years are provided as well as past losses, if any, are fully provided for.
- b) Interim dividend shall not be revoked.
- c) Past profits shall be distributable only with: (i) the consent of all directors (ii) prior approval of financial institutions (iii) special resolution of shareholders.
- d) Transfer to Reserves shall not exceed 10% in a Financial Year.
- e) Dividends shall be paid only in the bank accounts of the shareholders.

A number of other amendments have been proposed in respect of (i) holding the annual general meeting of companies; (ii) preparation of annual accounts; (iii) appointment of auditors and restrictions on them in matter of providing certain services other than audit to companies whose accounts they are to audit; (iv) composition of the board of directors, the qualifications and disqualifications of independent directors, the retiring age of directors, and the manner of exercise of board's powers; (v) removal of director or an auditor; and (vi) composition of audit committee; etc.

It may be noted that the Companies (Amendment) Bill, 2003 has **not** become the law. **Hence the position stated above remain only the proposed position.** However, a draft Bill on the new company law is in the process of finalisation to revise the 50 year old Companies Act, 1956 and is likely to be placed before the parliament very soon. It is based on the report submitted in May, 2005 by a 17 member panel set by the Central Government under the chairmanship of Dr. J. J. Irani. It contains most amendments proposed in the Companies (Amendment) Bill, 2003 and includes, inter alia, the provision for a minimum of one third of the total number of directors to be independent directors in listed companies and those which accept public deposits. According to Dr. Irani, the panel felt the presence of a good number of independent directors will improve corporate governance.

Check Your Progress B

- 1 Fill in the blank with suitable word(s).
 - (a) The Companies (Amendment) Act, 2002 provides an opportunity to _____ to transform themselves into a producer company.
 - (b) The objects of a producer company have been defined to include, among other things, production, processing, manufacture and sale of _____ as well as _____ activities.
 - (c) Any two or more _____ can form and incorporate a producer company.
 - (d) A producer company on registration shall become _____ company.

- (e) The National Company Law Tribunal is to replace the Company Law Board, _____ and BIFR.
- (f) Professionals like chartered accounts, doctors, etc. can form partnership firm with upto _____ partners,

2 State the rules relating to declaration of dividends out of past profits as proposed in the Companies (Amendment) Bill, 2003,

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3 How does voting right of a member of producer company differ from the voting right of a member of the other types of companies.

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6.7 SICK INDUSTRIAL COMPANIES (SPECIAL PROVISIONS) ACT (SICA), 1985

The Sick Industrial Companies (Special Provisions) Act (SICA), 1985 was passed in 1986 and came into effect in May 1987. Let us have a brief idea about its need, objectives, applicability and working.

6.7.1 Need for SICA

The need for SICA, 1985 was explained in the Statement of Objects and Reasons for the enactment of the Sick Industrial Companies (Special Provisions) Act, 1985 which read as follows:

The ill-effects of sickness of industrial companies, such as, loss of production, loss of employment, loss of revenue to the Central and State Governments and locking up of ingestible funds of banks and financial institutions are of serious concern to the Government and the society at large. The concern of the Government is accentuated by the alarming increase in the incidence of sickness in industrial companies. It has been recognized that in order to fully utilize the productive industrial assets, afford maximum production of employment and optimize the use of the funds of the banks and financial institutions, it would be imperative to revive and rehabilitate the potentially viable sick industrial companies as quickly as possible. It would also be equally imperative to salvage the productive assets and realize the amounts due to the banks and financial institutions, to the extent possible from the non-viable sick industrial companies through liquidation of those companies.

It has been the experience that the existing institutional arrangements and procedures for revival and rehabilitation of potentially viable sick industrial companies are both inadequate and time-consuming. A multiplicity of laws and agencies makes the adoption of a coordinated approach for dealing with sick industrial companies difficult. A need has, therefore, been felt to enact in public interest a legislation to provide for timely detection of sickness in industrial companies and for expeditious determination by a body of experts of the preventive, ameliorative, remedial and other measures that

would need to be adopted with respect to such companies and for enforcement of the measures considered appropriate with utmost practicable despatch."

6.7.2 Objectives of SICA

Preamble to SICA states that the Act is passed to make special provisions for (a) securing timely detection of sick and potentially sick companies owning industrial undertakings; (b) speedy determination by a board of experts of the preventive, ameliorative, remedial and other measures which need be taken in respect of such companies; (c) expeditious enforcement of the measures so determined; and (d) matters connected therewith or incidental thereto. Supreme Court in *Namit R Kamani v. R.R. Kamani* AIR 1989 SC 9 correctly explained the object of SICA as: (a) affording maximum protection to employment; (b) optimize the use of funds and available productive assets; (c) realizing amounts due to banks, institutions, creditors; and (d) provide efficient authority consisting of experts for expeditious determination of measures to avoid time consuming procedures. In this case, it was held that SICA is a piece of benevolent legislation meant to provide preventive, ameliorative and remedial measures and should be construed liberally to achieve that purpose.

6.7.3 Applicability and Coverage of SICA

SICA extends to whole of India. Its provisions apply to all industrial companies in the industries specified in the First Schedule to the Industries (Development and Regulation) Act, 1951. It may thus be noted that for an establishment to be covered under SICA, it must be owned by a company registered under the Companies Act. Besides, it must be covered under First Schedule to the Industries (Development and Regulation) Act, 1951.

The First Schedule covers practically all industries and, hence, the Act in reality applies to all industries, except shipping industry. The Act applies to government as well as private undertakings. [Section 617 of the Companies Act defines Government Companies as those in which Central Government or State Government(s) or partly Central and partly State Government(s) together hold at least 51% shares in the company.]

However, the Act does not apply to: (i) cooperative societies and units owned by a trust; (ii) industries relating to ship and other vessels drawn by power; and (iii) small scale industries (SSI). Small scale industries are those having investment in plant and machinery less than Rs. 1 crore. The investment in machinery may be by ownership, lease or hire purchase.

6.7.4 Definition of Sick Industrial Company

Knowing that the main objective of SICA is to detect and take remedial measures in respect of sick industrial companies, now let us understand as to what is a sick industrial company.

The expression, 'sick industrial company', is defined under Section 3(1)(O) of the Act to mean an industrial company (being a company registered for not less than 5 years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

Thus, a company to qualify as sick industrial company must satisfy the following conditions:

- (a) It must be a company as per Section 3 of the Companies Act, 1956.

- (b) It must be an industrial company, i.e., it must own one or more industrial undertakings
- (c) It must have been in existence for not less than 5 years.
- (d) Its accumulated losses must not be less than its net worth.

It may be noted that in a situation where the company owning the industrial undertaking is less than 5 years old even though the industrial undertaking owned by it is much older with continuity of business, industrial licence, etc., the unit shall fall outside the purview of the SICA. Conversely, a new industrial undertaking of an old company may come within the purview of the Act. This is because the period of existence of an undertaking is of no relevance for the purpose of SICA.

6.7.5 Functioning of SICA

Let us now learn as to how does SICA work. You have noted that the main objective of SICA is to identify sick industrial units and undertake speedy measures to revive and rehabilitate those sick units. For accomplishment of these objectives, SICA provides for constitution of BIFR (Board for Industrial and Financial Reconstruction) and the same was constituted in 1987 as a quasi-judicial body.

When an industrial company becomes sick, it should make reference to Board (BIFR), which will make an enquiry and decide whether the company is likely to come out of sickness. The Board will appoint an 'operating agency' to prepare a revival scheme for rehabilitation of the company. The scheme will be sanctioned by Board after inviting objections.

Whether a company has become sick can be decided only after accounts have been finalized and audited. After the accounts are finalized, the board of directors of the sick industrial company must make a reference to BIFR within 60 days after finalization of accounts. If the board of directors are of the opinion that the company is a sick industrial company, it can make a reference even before finalization of accounts. The reference is made for determination of measures which shall be adopted with respect to the company. The reference can also be made by Central Government, Reserve Bank, State Government, Public Financial Institution, State level Financial Institution or any scheduled bank. [Section 15(2) of SICA].

You may note that BIFR does not have its own elaborate infrastructure. It functions through the operating agency which include (a) public financial institutions, (b) state level institutions, (c) scheduled banks, and (d) any other person as may be specified by general or special order of Board. It has appointed various institutions like IDBI, ICICI, IFCI and IRBI and various banks like SBI, CBI, PNB, BOB, BOI, UBI, Indian Bank, Canara Bank, etc. as 'operating agency'.

An operating agency may be asked to conduct an enquiry, prepare a scheme for rehabilitation of sick company or even implement the scheme. However, where after enquiry and consideration of all relevant facts and circumstances and after hearing all parties concerned, the Board comes to the conclusion that the net work of the company is not likely to become more than accumulated losses within reasonable time and the company is not likely to become viable in future and meet its financial obligations, it may recommend its winding-up to the High Court.

It may be noted that if, during the scrutiny or implementation of any scheme, the Board finds that any person who was involved in promotion, formation or management of the sick industrial company, had misapplied or retained any money or property of the sick industrial company, or (b) has been guilty of misfeasance, malfeasance or non-feasance or breach of trust in relation to the sick industrial company, it may order to him to

repay the money or restore the property (with or without interest) to pay compensation to sick industrial company. A new power conferred upon the BIFR vide Section 22A added by the Amendment Act of 1992 provides that the Board may direct that any of the assets of the company shall not be disposed of without the consent of the Board during preparation, consideration or implementation of the scheme but only till commencement of proceedings of winding up. Orders of BIFR are appealable before the Appellate Authority for Industrial and Financial Reconstruction' (AAIFRA). Such appeal should be filed within 45 days from the date of receipt of the order of BIFR,

Potentially Sick Company – In order to correct sickness at an early stage, SICA provides for remedial measures to be initiated right at a stage when the company is likely to become sick, i.e., is potentially sick. A potentially sick industrial company is one whose accumulated losses at the end of any financial year have resulted in erosion of 50% or more of its peak net worth during the immediately preceding four financial years. Whether a company has become potentially sick company can be known only after finalisation of its audited accounts (i.e., when audited accounts are adopted at the Annual General meeting (AGM). Within 60 days after finalisation of audited accounts, the company (or the operating agency) should report the fact of such erosion to BIFR which can then make an inquiry and ask an operating agency to make a report before taking further steps in the matter.

6.7.6 Proposal to Repeal STCA

SICA, has been amended twice – first in 1991 when government companies, as defined in Section 617 of the Companies Act, 1956, were brought within the purview of the Act and later in 1993 when a number of changes were effected in its various provisions. As stated earlier, the Companies (Second Amendment) Act, 2002 has incorporated provisions relating to sick companies conferring the authority to deal with industrial sickness upon the National Company Law Tribunal which shall also be responsible for ordering winding-up of companies. Accordingly, SICA is proposed to be repealed and is sought to be wound-up. But, since the relevant provisions of the Companies (Second Amendment) Act, 2002 have not been given effect to, SICA has not yet been repealed.

Check Your Progress C

- 1

Enumerate the conditions that a company has to satisfy in order to qualify as sick industrial company.

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- 2

Explain the concept of operating agency in the context of SICA, 1985

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6.7

LET US SUM UP

A host of legislations provide a legal framework within which companies in India operate. These legislations, commonly called corporate laws, *inter alia*, include the Companies Act, 1956, Industries (Development and Regulation) Act, 1951, Sick

Industrial Companies (Special Provisions) Act, 1985, and Monopolies and Restrictive Trade Practices Act, 1969. The first Companies Act in India was enacted in 1850 followed by the Acts of 1866, 1882, 1913 and the present Act of 1956. The

Companies Act, 1956 has evolved considerably over a period of all these years through minor and major amendments. Major amendments were made in 1999, 2000, 2001 and 2002 and 2003. The provisions contained in the Act provide for the formation and registration of companies, issues related to share capital, rights of members, holding of general body meetings, appointment and legal position of directors, accounts and audit, inspection and investigation, winding up, etc.

Companies (Amendment) Act, 1999 allowed companies to buy-back their own shares, subject, however, to certain conditions being satisfied. This was further liberalized by the (Amendment) Act, 2001. The Companies (Amendment) Act, 2000 introduced a large number of changes including minimum paid-up share capital of Rs. 1 lakh for private companies, protection and Rs. 5 lakh for public companies, protection of small depositors' interests, issuance of non-voting equity shares, voting through postal ballot, and the concept of audit committees comprising of a majority of independent directors.

In 2002, two amendment Acts were introduced. The first Amendment Act introduced the concept of 'producer company' which made room for corporatisation of primary produce cooperatives on optional basis. A minimum of ten individual producers or a minimum of two producer institutions can form a producer company. The Act provided detailed rules on their incorporation, membership and administration. The Companies (Second Amendment) Act, 2002 introduced changes of far reaching effect. It provided for the constitution of National Company Law Tribunal which would replace the Company Law Board, the Company Courts as well as the Board for Industrial and Financial Reconstruction and sought inclusion of provisions relating to sick companies in the Companies Act by replacing SICA.

Based on the recommendation of JPC on Stock Market Scam, the Companies (Amendment) Bill, 2003 was presented in Rajya Sabha on May 7, 2003 with the objectives of facilitating corporate governance and prevention of recurrence of vanishing companies. This Bill has not yet taken the shape of the Amendment Act. Infact, a draft Bill on the new company law is already in the process of finalisation and may be presented to the parliament very soon.

SICA, 1985 was enacted with the object of timely detection of industrial sickness and speedy remedial and corrective measures. BIFR has been created as a unified agency for the purpose. Board of directors of a sick company is under obligation to make reference to BIFR within 60 days of finalization of accounts. BIFR may appoint an operating agency to prepare a revival scheme for rehabilitation of the company. If BIFR forms an opinion that the sick company cannot be rehabilitated, it may recommend its winding-up to the High Court.

6.9 KEY WORDS

Arrangement : Reorganisation of the share capital of the company.

Buy- Back of Shares : Buying its own shares by the company as per the provisions of Sections 77A, 77AA and 77D of the Companies Act.

Independent Director : A non-executive director on the board of a company who has integrity, expertise and the independence to balance the interest of various stakeholders.

Information Memorandum : A document designed to elicit demand for securities and ascertain price and terms of issue in case of an issue through book-building.

potentially Sick Company : An industrial company whose accumulated losses at the end of any financial year have resulted in erosion of 50% or more of its peak net worth during the immediately preceding four financial years.

Reconstruction : A process involving (i) the transfer of undertaking of an existing company to another company usually incorporated for the purpose (the old company ceases to exist), (ii) the carrying on of substantially the same business by the same persons, and (iii) the rights of the shareholders in the old company are satisfied by allotment of shares in the new company.

Red-herring Prospectus : A prospectus which does not contain information regarding the price and quantum of securities offered.

Sick Industrial company : An industrial company (being a company registered for not less than 5 years) which has at the end of any financial year accumulates losses equal to or exceeding its entire net worth.

Sweat Equity : Equity shares issued by the company to employees or directors at a discount or for consideration other than cash by persons engaged in an activity.

Shelf Prospectus : A prospectus issued by any financial institution or bank for one or more issues of the securities specified in that prospectus. It is valid for one year.

6.10 ANSWERS TO CHECK YOUR PROGRESS

- A 2 (a) True (b) False (c) False (d) True (e) False (f) True
- B 1 (a) cooperatives
 (b) primary produce, allied
 (c) producer institutions
 (d) private limited
 (e) company courts
 (f) 50

6.11 TERMINAL QUESTIONS

- 1 Enumerate the major changes introduced in the Companies Act, 1956 vide the Companies (Amendment) Act, 1999.
- 2 "Companies (Amendment) Act, 2000 introduced a large number of changes in the Companies Act, 1956". Elaborate on the statement.
- 3 Write explanatory notes on the following
 - (a) Producer Companies
 - (b) Evolution of Corporate Legislation in India
 - (c) Basic Framework of the Companies Act
 - (d) Applicability and Coverage of SICA, 1985
- 4 Explain the salient features of Companies (Second Amendment) Act, 2002.
- 5 State some of the important amendments proposed under Companies (Amendment) Bill, 2003.
- 6 State the objectives of SICA, 1985 and explain the role of BIFR in respect of a sick industrial company referred to it.

<p>Note : These questions will help you to understand the unit better. Try to write answers for them, but do not submit your answers to the university for assessment. These are for your practice only.</p>
