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Loans To Directors And Subsidiaries Under The New Companies Act

The regulations regarding a Company's ability to grant loans to its directors and other entities in which the directors may be interested in,has seen a remarkable shift under the regime introduced by the Companies Act, 2013. Under the Companies Act, 1956 the provisions relating to Loan to directors by a Company were governed by Section 295 which had a wider scope and included both loans and deposits. The provisions of Section 295 were not strictly regarding loans and were attracted even if the monies advanced to the directors were recorded or described as deposits as in both the cases the relationship created is one of the creditor and the debtor. Moreover, the guidelines issued for Section 295 established stringent norms for giving loans or corporate guarantee or furnishing security to the directors of the companies or their relations. These included a minimum rate of interest of at least 4 percent above the prevailing bank rate as the standard rate made public under Section 49 of the Reserve Bank of India Act, 1934 and the total amount of money loaned to the director including previous loans, if any not exceeding 25 times the gross salary drawn in the preceding 6 months prior to the making of the application. However this section only applied to Public Companies and Private Companies which were subsidiaries of a Public Company which meant that Private Companies which were not subsidiaries of a Public Company were allowed to lend money to their directors without any regulatory control. The restrictions on Public Companies could also be circumvented upon obtaining prior approval from the Central Government to enter into any of the transactions restricted under Section 295.

The regulatory regime under the new Companies Act, 2013 is game-changing to a large extent as Section 185 of the 2013 Act is applicable to both Private and Public Companies which vastly widens the ambit vis-à-vis the previous Act by extending the restrictions on granting loans to directors to Private Companies which are not subsidiaries of a Public Company for the first time. Section 185 states that no Company shall directly or indirectly, advance loan to any Director, or person in whom a director is interested, or give any guarantee or provide any security in connection with loan taken by Director or such other person. The explanation to the section lists the following classes of people as 'Persons in whom the Director is Interested'

- Any Director of Holding company of the Lending company;
- Any Partner or Relative of the abovementioned Directors;
- Any Firm in which any such Director or Relative is partner;
- Any Private Company of which any such Director is a Director or Member of Lending Company;
- Any Body Corporate (i.e. Company or LLP) at a general meeting of which not

less than 25% of total voting power may be exercised individually or jointly by any such Director/(s) of Lending company;

- Any Body Corporate, the Board of Directors of which is controlled by the any Director(s) of Lending Company.

Moreover, the possibility of entering into such a transaction with prior approval from the Central Government has also been removed. However, the 2013 Act introduces a new exemption which allows a company to lend money to the Managing or Whole-time Director by any scheme which has been approved by members through a special resolution or to facilitate conditions of service extended by the company to all its employees. There is also an exception for Companies which provide loans in the ordinary course of its business provided the interest charged is not less than the Bank rate declared by RBI.

The punishment for violation of Section 185 of the 2013 Act has also been substantially increased with the monetary fine for both the company and the director to whom the loan is advanced set at Rs 5 to 25 lakhs with an imprisonment of upto six months for the Director. This is a remarkable change from the Companies Act, 1956 which provided for a maximum fine of Rs 5,000 and no imprisonment or proportional in case the loan has been repaid. Moreover, there was no penalty prescribed under the 1956 Act which has been rectified in the 2013 Act.

Section 295 of the Companies Act, 1956 provides an exemption for loans advanced by a holding company to its subsidiary but Section 185 of the 2013 Act provides for no such exception which had led many to believe that holding companies would be prohibited from loaning money or issuing guarantees in favour of their subsidiaries. However, these doubts were clarified in the Companies (Meetings of Board and its Powers) Rules, 2014 where an exception was carved out for anyloan made, or any guarantee given or security provided by a holding company to its wholly owned subsidiary,which can only beutilized by the subsidiary company for its principle business activities. Section 186 of the Companies Act, 2013 covers regulations on inter-corporate investments and limits the amount of capital which can be loaned by a company to another company to a maximum amount of sixty per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more. Any loans greater than this amount need to be granted prior approval by means of a special resolution passed at a general meeting.

However, the Rules regarding Section 186 of the 2013 Act create an exception to the extent that loans or guarantees exceeding the statutory amount do not require a special resolution if granted in favour of a wholly owned subsidiary company or a joint venture company or used for the purpose of acquisition by way of subscription, purchase or otherwise of, the securities of a wholly owned subsidiary company. The only requirement that the Company must follow is to disclose the details of such loans or guarantee or security or acquisition to the members in the financial statement of the Company. This change brings the new section in line with the provisions of the erstwhile Act.Thus, the capability of a holding company to finance its subsidiary has not been affected by the new Act.

In conclusion, the new regime in place with respect to loans to directors has a much wider scope as it includes private companies in its ambit and restricts loans to directors or persons in whom the director is interested except for an extremely limited set of exceptions including:

- the loan being a part of the conditions of service extended by the company to all its employees; or
- pursuant to a scheme approved by members vide special resolution.
- companies who are in the business of extending loans are also exempt from this regime.

By contrast, the provisions regarding loans or guarantees from holding to subsidiary companies initially seemed to have changed drastically but the latest Rules have addressed any concerns Companies might have had regarding financing of subsidiaries by bringing the provisions in line with the erstwhile Act.

Another Pro-Arbitration Approach of the Supreme Court

Whilst analyzing a recent issue in the case of *Reliance Industries Limited &Anr v Union of India [Civil Appeal No. 5765 of 2014 arising out of S.L.P. (C) No. 20041 of 2013]* on applicability of Part I of the Arbitration and Conciliation Act, 1996 on an Arbitration Agreement governed by English Law, the Supreme Court has held that application of the provisions Part I of the Indian Arbitration and Conciliation Act shall be excluded as they are inconsistent with the arbitration agreement signed by the parties. A brief description of the aforesaid judgment has been discussed below.

Facts

ONGC,Reliance and BG India Limited entered into contracts for the exploration and production of petroleum. A dispute arose from the terms of the contract concerning the payment of royalties, cess and service tax. The contracts were governed by Indian Law but contained an arbitration clause which stated that they were governed by the laws of England. London was agreed upon as the Seat of Arbitration. The tribunal passed as award concluding that the claims were arbitrable which was challenged by UOI in the Delhi HC under Section 34 of the Arbitration and Conciliation Act, 1996 (Act). The Delhi HC passed an award in favour of UOI leading to the present Appeal

Issue

Since the agreement was entered into prior to 6 September 2012 Indian Courts would exercise supervisory jurisdiction over foreign seated arbitrations unless parties had impliedly or expressly excluded the jurisdiction of Indian Courts. The main issue was whether the arbitration agreement being governed by British Law would lead to the exclusion of Part 1 of the Act.

Ratio

The Supreme Court held that as the arbitration agreement was governed by English law and since the parties had assigned London as the juridical seat of the arbitration, the parties did expressly agree to exclude Part I of the Act. This was supported by the fact that the arbitration proceedings were conducted in accordance with the UNCITRAL Rules and specified the Permanent Court of Arbitration as the appointing authority instead of the CJI under the Act. The Court also held that held that applicability of Part I of the Act is not dependent on the nature of challenge to the award. The SC referred to their decision in *Videocon Industries Ltd v Union of India &Anr* for support and reaffirmed that Indian Courts did not have any supervisory jurisdiction as the provisions of Part I of the Act had to be excluded as they were inconsistent with the arbitration agreement that is governed by English law.

DRAFT PRIVACY BILL, 2014

The Government of India has been attempting to draft legislation with the aim of protecting individuals against misuse of data by Government or private agencies to increase the standards of privacy protection in India and bring it in line with regimes with advanced standards of data protection since 2010. This is also in line with the decision of the Supreme Court in the case of *R. Rajagopal v. State of T.N.*, in which it was held that the Right to Privacy is implicit in the right to life and liberty under Article 21 of the Constitution of India which is a fundamental right.

Recently, the Government has proposed the draft of the Privacy Bill, 2014 ("**Draft Bill**"). The 2014 Bill specifically recognizes the Right to Privacy as a Fundamental Right in line with the Supreme Court's diktat on the same and extends the scope of its protection to all residents of India. The Draft Billlays down various 'Privacy Principles' for data handling which list the requirements and compliances to be met with regards to collection, processing, storage, retention and disclosure of the personal data. These principles include notice, choice and consent, collection limitation, purposes limitation, access and correction, disclosure of information, security, openness, and accountability. Thus, the data controller, whether it be the Government or a private agency will have to adequately inform citizens before collecting data, stating the reasons and only collecting as much information as is necessary. The time period for which the data is proposed to be stored will also have to be mentioned along with the security measures which have been undertaken to prevent any misuse of the data.

To enforce the provisions of the Draft Bill and penalize violations of the same, the Government has proposed the establishment of a Data Protection Authority of India ("Authority"). The Authority is also vested with many administrative duties such as monitoring and enforcing compliance of applicable provisions relating to data protection by all persons,auditing all personal data controlled by the data controller to assess whether it is being maintained in accordance with the Bill and to monitor developments in data processing and computer technology to ensure that such developments do not adversely affect protection of data relating to individuals. However, the Bill excludes Government Intelligence Agencies and Law Enforcement agencies acting for a limited set of purposes including protection of sovereignty, integrity or security of India; or strategic, scientific or economic interest of India among others from the jurisdiction of the Authority and vests the same with a court of competent jurisdiction.

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RBI notifies new directions for NBFCs

The Reserve Bank of India (RBI) vide its Notification No. DNBS.(PD) 275/GM(AM)-2014 dated May 26, 2014 has laid down 'Non-Banking Financial Companies (Approval of Acquisition or Transfer of Control) Directions, 2014', whereby RBI has tightened merger rules for non-banking finance companies (NBFC), requiring them to obtain the RBI's written permission to acquire or merge with any similar entity, in order to ensure their fit and proper management. Previously, only deposit-taking non-bank finance companies required approval for a takeover or merger.

LLPs registered under LLP Act, 2008 are 'Indian Party'

The Reserve Bank of India (RBI) vide its circular dated May 19, 2014

[RBI/2013-14/595 A.P. (DIR Series) Circular No.131] has notified a Limited Liability Partnership (LLP), registered under the Limited Liability Partnership Act, 2008 (6 of 2009), as an "Indian Party" under clause (k) of Regulation 2 of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004, thereby bringing LLPs under the ambit of the said Regulations.

AD Banks to approve ECBs

The Reserve Bank of India (RBI) on May 16, 2014 notified a circular [RBI/2013-14/594 A.P. (DIR Series) Circular No.130] as a measure of simplification of the existing procedure, thereby delegating powers to AD Banks to approve certain cases pertaining to ECBs under the automatic route.

Registered members of Professional Bodies to verify documents before filing with MCA

The Ministry of Corporate Affairs has allowed registered Members of the professionals bodies (the ICAI, ICSI and the ICOAI) to authenticate correctness and integrity ofdocuments being filed by them with the MCA in electronic mode. Details ofdocuments required to be certified have been given in the notification dated28/04/2014 available on the MCA portal.

Clarification on requirement of

PAN by foreigners

On account of difficulties being faced by foreign nationals while filing incorporation forms (INC-7), due to mandatory requirement of submission of PAN details of intending directors at the time of filing the application for incorporation, the Ministry of Corporate Affairs clarified that PAN details are mandatory only for those foreign nationals who are required to possess "PAN" in terms of provisions of the Income Tax Act, 1961 on the date of application for incorporation.

Status Quo order on Sun-Pharma vacated by Court

The Andhra Pradesh High Court vacated status quo order it had issued earlier on Sun Pharma-Ranbaxy merger process, paving way for the pharma giants to become a single entity.A petition in this regard was filed by two investors requesting the High Court to restrain the BSE and the NSE from giving any clearance to the scheme of amalgamation or merger between Sun Pharma and Ranbaxy, alleging that there was heavy trading of Ranbaxy stock before announcement of the merger.

Government proposes to raise FDI in defence sector to 100%

In a major policy initiative, the Government is proposing to raise FDI in defence sector to 100 per cent through the approval route. The Confederation of Indian Industries (CII) fully endorsed the government's move to raise the bar on foreign investment in the defence sector up to 100 per cent through the approval route, however, it has to be seen if finally 100% is allowed.

Government to regulate ‘wilful defaulters’

With an objective to ensure recovery of bad debts, Government is working on a new legislation for ‘wilful defaulters’ that seeks to link the jail term with the value of the default. Government is planning to establish special tribunals for high value cases and special courts for wilful defaulters, who will face criminal charges.

Evidence of a hostile witness Cannot be discarded

The Supreme Court of India in ‘Paulmeli and Anr.Vs. State of Tamil Nadu tr. Insp. of Police’ observed that the evidence of a hostile witness cannot be discarded as a whole, and relevant parts thereof which are admissible in law, can be used by the prosecution or the defence.

Section 5-A of the Land Acquisition Act, 1894 confers a valuable right

The Apex Court in Union of India (UOI) and Ors. vs. Shiv Raj and

Ors. observed that Section 5-A of the Land Acquisition Act, 1894 confers a valuable right in favour of a person whose lands are sought to be acquired. The hearing given to a person must be an effective one and not a mere formality. Formation of opinion as regard the public purpose as also suitability thereof must be preceded by application of mind having due regard to the relevant factors and rejection of irrelevant ones. The State in its decision making process must not commit any misdirection in law. Section 5-A of the said Actconfers a valuable important right and having regard to the provisions, contained in Article 300A of the Constitution of India has been held to be akin to a fundamental right.