Board Composition and Powers of the Board

Lesson 14

KEY CONCEPTS

■ Board of Director ■ Vigil Mechanism ■ Committees ■ Board Composition ■ Office of Profit ■ Related Party ■ Arm's Length Transaction ■ Omnibus Approval ■ Free Reserves ■ Inter-Corporate Loan

Learning Objectives

To understand:

- Board Composition, its Power and Restrictions
- Role of Board, which is responsible for the company's overall commercial performance as well
- Aims and objectives of Different committees constituted by the Board of the Company along with essential for its effective functioning
- Overview of Inter-Corporate Loans Investments, Guarantees and Security
- Related Party Transactions

Lesson Outline

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 149, 165, 177 to 188)
- The Companies (Meetings of Board and its Powers) Rules, 2014
- SEBI (LODR) Regulations, 2015
- Secretarial Standards (SS-I & SS-2)

INTRODUCTION

At the core of the corporate governance practices is the Board of Directors which oversees how the management serves and protects the long term interests of all the stakeholders of the company. The institution of Board or directors was based on the premise that a group of trustworthy and respectable people should look after the interests of the large number of shareholders who are not directly involved in the management of the company.

The shareholders and investors repose confidence on the Board of Directors as their representatives for conducting and monitoring the affairs of the company. The position of Board of Directors is that of trust as the Board is entrusted with the responsibility to act in the best interests of the company. The Board is accountable to the shareholders for creating, protecting and enhancing wealth, ensuring optimum utilisation of resources of the company, and reporting to them on the performance in a timely and transparent manner. The Board is ultimately responsible for ensuring compliance of various applicable laws in the best interests of stakeholders.

The Board generally performs three major roles in a company –

- provide direction (i.e. set the strategic direction of the company);
- control (i.e. monitor the management);
- provide support and advice (advisory role).

The board should comprise of independent minded directors. It should include an appropriate combination of executive directors, independent directors and non-independent non-executive directors to prevent one individual or a small group of individuals from dominating the board's decision making. The board should be of a size and level of diversity commensurate with the sophistication and scale of the organization. Appropriate board committees may be formed to assist the board in the effective performance of its duties. Truly independent boards are vital for effective governance.

As former UK Financial Reporting Council Chairman, Sir Christopher Hogg has noted, "Good boards are pretty uncomfortable places and that's where they should be."

Section 2(10) of the Companies Act, 2013 defines that "Board of Directors" or "Board", in relation to a company, means the collective body of the directors of the company.

In *Jatan Kanwar vs. Golcha Properties 1971 AIR 374*, it was held that the power of management of the company is vested in the Board of Directors as a result of the Companies Act as well as the Articles of Association of the company unless and until the general body by the policy of its Articles chooses to take them away, and substitute others more to its taste, the Board of Directors in its right continues to manage the affairs of the company. The decisions of the Board of Directors are to be taken by a majority.

BOARD COMPOSITION

Only Individuals as Directors- Section 149(1) of the Companies Act, 2013 provides that only an individual can become a director. As per clause (34) of Section 2 of the Act, "director" means a director appointed to the Board of a company. Therefore, an individual who is appointed to the Board of a company is a Director.

Thus, a director is a person appointed to perform the duties and functions of director of a company in accordance with the provisions of the Companies Act, 2013.

Minimum number of Directors: Section 149(1) of the Companies Act, 2013 requires that Board needs to have a minimum of:

(i) 3 Directors in case of a public company;

(ii) 2 Directors in the case of a private company; and

(iii) 1 Director in the case of a One Person Company.

Regulation 17 of the SEBI (LODR) Regulations, 2015 prescribes that the board of directors of the top 1000 listed entities (with effect from April 1, 2019) and the top 2000 listed entities (with effect from April 1, 2020) shall comprise of not less than six directors.

Explanation: The top 1000 and 2000 entities shall be determined on the basis of market capitalisation as at the end of the immediate previous financial year.

Minimum number of Directors in case of Producer Companies

Section 378(o) provides that Every Producer Company shall have at least 5 and not more than 15 directors:

Provided that in the case of an inter-State co-operative society incorporated as a Producer Company, such company may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.

Further, the Members who sign the memorandum and the articles may designate therein the Board of Directors, not less than five, who shall govern the affairs of the Producer Company until the directors are elected in accordance with the provisions of section 378P. The election of directors shall be conducted within a period of ninety days of the registration of the Producer Company.

Furthermore, in case of an inter-State co-operative society which has been registered as a Producer Company under sub-section (4) of section 378J in which at least five directors [including the directors continuing in office under sub-section (1) of section 378N] hold office as such on the date of registration of such company, the provisions of this sub-section shall have effect as if for the words "ninety days", the words "three hundred and sixty-five days" had been substituted.

Maximum number of Directors

Section 149(1) of the Companies Act, 2013 permits a maximum of 15 directors on the Board. However, a company may appoint more than 15 directors after passing a special resolution.

Government and Section 8 Companies are allowed to appoint more than 15 directors without passing special resolution. The Central Government has by separate notifications exempted Government Companies and Section 8 companies from the provisions of section 149 (1) (b) and first proviso of Section 149(1). Notification dated 05th June, 2015 & 13th June, 2017.

CASE LAW

In Re The Registrar of Companies, West Bengal (Appellant) Vs. Karan Kishore Samtani (Respondent) Company Appeal (AT) No.13 of 2019,dated 24/06/2020, (The National Company Law Appellate Tribunal) (NCLAT)

Number of Directorships by a Director-Minimum Fine

The Respondent was the Director, for more than 20 Companies till 31.03.2015. The Respondent tendered his resignation as the Director of the Company M/s Fabius Properties Pvt. Ltd. The same was accepted by the Board of Directors of the Companies on 29.12.2015. However, the intimation of his resignation was sent to the Registrar of Companies *vide* Form DIR-12 on 10.02.2016.

The Respondent has violated the provisions under Section 165(1) read with Section 165(3) of the Companies Act, 2013 which is punishable under Section 165(6) of the Act, The NCLT, Kolkata bench has imposed compounding fees of Rs. 50,000/- which is less than minimum fees prescribed under Section 165(6) of the Companies Act, 2013.

The issue for consideration is, whether Tribunal can impose the compounding fees under Section 441 (1) of the Companies Act, 2013, less than minimum prescribed fine for the offence under Section 165 (1) read with Section 165(6) of the Companies Act, 2013.

The NCLAT held that the NCLT, Kolkata Bench has failed to notice the minimum fine prescribed under Sub-Section (6) of Section 165 of the Companies Act, 2013 which was applicable at relevant time.

The Respondent has contravened the provisions of 165(1) of the Companies Act, 2013 which is punishable under Sub-Section (6) of Section 165 of the Companies Act, 2013. Taking into consideration, the facts and circumstances of the case, NCLAT imposed minimum fine at the rate of five thousand rupees for every day for the period 01.04.2015 to 21.02.2016 i.e. 272 days. The NCLAT quantified the penalty amount to Rs. 13,60,000/-. The Respondent has already paid Rs. 50,000/- after adjustment, now he is liable to pay Rs. 13,10,000/-. Therefore, The Respondent is directed to pay such amount within a period of 60 days in National Company Law Tribunal, Kolkata.

Number of Directors falling below minimum

If strength of directors falls below statutory minimum prescribed in the Act or Articles, the decisions taken shall not be valid. If the Articles prescribe for a higher limit of quorum than the higher number will have to be complied with. If the number of directors is as per statutory minimum but less than that as per the articles than also the decision taken shall not be valid for want of quorum.

Board Composition in Listed Entities

Independence of the Board and its' composition with a balanced mix of executive and non-executive directors is prescribed under Regulation 17 of SEBI (LODR) Regulations, 2015, which stipulates that the composition of board of directors of the listed entity shall be as follows:

(i) Board of directors shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty per cent. of the board of directors shall comprise of non-executive directors;

(ii) Board of directors of the top 500 listed entities required to have at least one independent woman director by April 1, 2019 and the Board of directors of the top 1000 listed entities required to have at least one independent woman director by April 1, 2020;

Explanation: The top 500 and 1000 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

(iii) Where the chairperson of the board of directors is a non-executive director, at least one-third of the board of directors shall comprise of independent directors and where the listed entity does not have a regular non-executive chairperson, at least half of the board of directors shall comprise of independent directors:

Provided that where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, at least half of the board of directors of the listed entity shall consist of independent directors.

Explanation.- For the purpose of this clause, the expression "related to any promoter" shall have the following meaning:

(i) if the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;

(ii) if the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.

(iv) Where the listed company has outstanding SR equity shares, at least half of the board of directors shall comprise of independent directors.

(v) No listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy-five years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

*(**Cross Reference**: For more details Student are advised to refer Lesson 10 of Capital Market & Securities Law)*

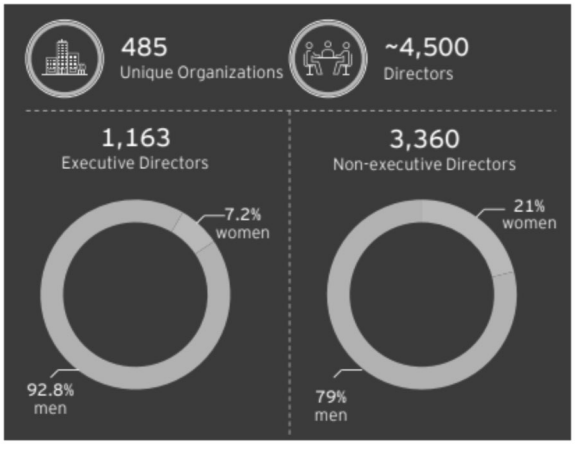
EY released its report on 'D*iversity in the Boardroom: Progress and the way forward*' highlighting its findings on the representation of women on Indian boards and emphasizing the actions organizations must take to increase gender diversity.

During 2013- 2022, India made significant and rapid progress in increasing women representation on boards from 6% in 2013 to 18% in 2022.

Executive versus Non-executive Directors: the great divide

In 2022, women account for 7.2% of executive positions on Indian Boards compared to 6% in 2017.

The growth of women in non-executive positions on Indian Boards paints a more encouraging picture as it has increased from 16% in 2017 to 21.4% in 2022.



95% companies

In 2022, Almost 95% companies out of NIFTY500 have one woman Board member compared to 69% in 2017

Traditionally, women representation on Indian Boards has been limited to leadership positions in Grievance and CSR committees; however, this is changing. Across NIFTY500, the Nomination and Remuneration Committee (NRC) and Audit Committee, customarily reserved for male Board members, had 13% and 12% women Board members respectively in 2017. In 2020, this had increased to 18% and 16%, respectively.

More than 40% of the companies have gone beyond the regulatory mandated limit and have appointed more than one women Board member. There is no doubt that Indian companies are making progress with respect to women representation on Boards; however, statistics highlight that there is still room for improvement as **less than 5% of companies have women as Chairpersons.**

Source: https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/women-fast-forward/2022/09/ey-dei-report.pdf

What is the difference between the term "Non Executive" and "Independent Director" of the Company?

Non-Executive Director of a company simply means a person not holding a position as an executive in the company. Such a director may or may not be an independent director.

An independent director on the other hand means a director, other than a managing director or a whole-time director or a nominee director and is one who fulfills the criteria laid down under Section 149 of the Companies Act 2013, in addition, to the criteria laid down under regulation 16(1)(b) of the SEBI (LODR) Regulations, 2015.

All non- executive directors need not be independent directors, but all independent directors are non-executive director.

Number of Directorships [Section 165]

Limit on Number of Directorships:

As per the provisions of section 165(1) of the Act, the maximum number of directorships shall be as under:

(i) Maximum directorships in aggregate (including alternate directorships) is 20 at the same time;

(ii) Maximum directorship in public companies is 10 companies. This includes directorship in private companies that are either holding or subsidiary company of a public company.

For reckoning the limit of Directorships of twenty companies, the Directorship in a dormant company shall not be included.

The members of a company may, however by passing a special resolution, specify any lesser number of companies in which a director of the company may act as a director.

Section 165 (3) provides that any person holding office as director in companies more than the limits as specified in sub-section (1), immediately before the commencement of this Act shall, within a period of one year from such commencement—

(a) choose not more than the specified limit of those companies, as companies in which he wishes to continue to hold the office of director;

(b) resign his office as director in the other remaining companies; and

(c) intimate the choice made by him under clause (a), to each of the companies in which he was holding the office of director before such commencement and to the Registrar having jurisdiction in respect of each such company.

Exceptions:

Section 165(1) that provides for maximum number of Directorship that a person can hold including alternate Directorship to be twenty companies - shall not be applicable to a section 8 company-Notification dated 05th June, 2015.

Personal liability of the directors to adhere to the limits

In case a person accepts an appointment as a director in violation of Section 165, he shall be liable to a penalty of two thousand rupees for each day after the first during which such violation continues, subject to a maximum of two lakh rupees.

It is the Director's personal liability to ensure compliance with the limits imposed on number of directorships.

Additional Requirements for Listed Companies

As per Regulation 17A of the SEBI (LODR) Regulations, 2015, the Directors of listed entities shall comply with the following conditions with respect to the maximum number of Directorships, including any alternate Directorships that can be held by them at any point of time -

1. A person shall not be a Director in more than eight listed entities with effect from April 1, 2019 and in not more than seven listed entities with effect from April 1, 2020.

   Provided that a person shall not serve as an Independent Director in more than seven listed entities.

2. Notwithstanding the above, any person who is serving as a Whole Time Director / Managing Director in any listed entity shall serve as an Independent Director in not more than three listed entities.

Explanation: For the purpose of this regulation, the count for the number of listed entities on which a person is a Director/ Independent Director shall be only those whose equity shares are listed on a stock exchange.

Question- Mr. A is a Director in the following Companies:

1. SSS Limited
2. PPP Private Limited
3. UUU Limited (A Subsidiary of SSS Limited)
4. HHH Private Limited (A Subsidiary of SSS Limited)
5. LLL Limited (A Dormant Company)
6. FFF Private Limited

In how many Companies, Mr. A can further be appointed as Director?

Answer- He is already a Director in following three Public Companies i.e. SSS Limited, UUU Limited and HHH Private Limited which is a deemed public Company by virtue of Section 165. LLL Limited is excluded from the number of directorship since it is a Dormant Company.

He is Director in two Private Companies namely PPP Private Limited and FFF Private Limited.

He is Director in total five Companies. He can further be appointed as Director in Fifteen Companies out of which not more than Seven shall be Public Companies.

Regulation 26 of SEBI (LODR) Regulations, 2015 requires that a director cannot be a member in more than ten committees or act as chairperson of more than five committees across all listed entities in which he/she is a director which shall be determined as follows:

(a) the limit of the committees on which a director may serve in all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies, 'high value debt listed entities' and companies under Section 8 of the Companies Act, 2013 shall be excluded;

(b) for the purpose of determination of limit, chairpersonship and membership of the audit committee and the Stakeholders' Relationship Committee alone shall be considered.

Registrar of Companies, West Bengal vs. Sabyasachi Bagchi on 24th June, 2020, NCLAT

Facts of the Case:

The Appellant Registrar Companies, West Bengal filed this Appeal under Section 421 of the Companies Act 2013 (in brief the Act) against the order dated 11.07.2018 passed by National Company Law Tribunal, Kolkata Bench, Kolkata.

Respondent Sabyasachi Bagchi was holding Directorship of 17 Companies on 01.04.2014 when section 165 (1) of the Act, came into force. However, he vacated directorship of three companies during the period of 01.04.2014 to 31.03.2015. After receipt of the notice from Appellant the Respondent has resigned from the Directorship of four Companies on 22.02.2016, thus, the Respondent has contravened the provisions of Section 165(1) of the Act, for a period of 01.04.2015 to 21.02.2016 i.e. 326 days.

The reply of show cause notice of Respondent found unsatisfactory, therefore, the Appellant filed a complaint under Section 165 (6) of the Act, against the Respondent before Chief Metropolitan Magistrate, Kolkata.

During the pendency of the Prosecution, Respondent filed an Application under Section 441(1) of the Act, before the National Company Law Tribunal, Kolkata for compounding the offence. The Appellant filed his report on compounding application before the Tribunal. After hearing the parties, Learned Tribunal allowed the Application subject to payment of compounding fees Rs. 25,000/- within 15 days from the date of order.

Being aggrieved with the order the Appellant filed this Appeal on 04.01.2019 along with Application for condonation of delay in filing the Appeal in NCLAT.

The Appellant submitted that the Respondent has accepted that he has contravened the provisions of 165 (1) of the Act, for a period of 01.04.2015 to 21.02.2016 i.e. 326 days. However, in the impugned order the period of default is shown 21 days only and Learned Tribunal has imposed compounding fees of Rs. 25,000/-. The Tribunal has ignored the provisions of sub-Section 6 of Section 165 of the Act, and directed to deposit compounding fees less than a minimum prescribed for the offence. The Tribunal has no jurisdiction to reduce the fine less than the minimum prescribed for the offence.

The issue for consideration is, whether Tribunal can impose the compounding fees under Section 441(1) of the Act, less than minimum prescribed for the offence under Section 165 (1) read with Section 165(6) ?

Judgment

In this case, the Respondent was conscious that after coming into force the provisions under Section 165(1) of the Act, he cannot hold Directorship in more than 20 companies and Directorship in more than 10 Public Companies, at the same time. As per the Section 165 (3) of the Act, till 31.03.2015 Respondent was required to resign from the Directorship of the Companies more than the limits specified in sub- Section 1 of Section 165 of the Act, within the specified period.

The Respondent has vacated the Directorship of three Companies. However, after receipt of the notice from the Appellant the Respondent has resigned from the Directorship of four Companies on 22.02.2016 and there is nothing on record to presume that the Respondent violated the provisions on a bonafide belief. The conduct of Respondent shows that he acted in conscious disregard of its obligation.

From the impugned order its manifest and clear that the Tribunal failed to notice the minimum fine prescribed under Sub-Section 6 of Section 165 of the Act, which was applicable at relevant time i.e. before the amendment. In view of the error apparent in the impugned order dated 11.07.2018 passed by the Tribunal, the order is set aside.

BOARD COMMITTEES

A board committee is a small working group identified by the board, consisting of board members, for the purpose of supporting the board's work. Committees are generally formed to perform some expertise work. Members of the committee are expected to have expertise in the specified field. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. Committees enable better management of full board's time and allow in-depth scrutiny and focused attention.

However, the Board of Directors are ultimately responsible for the acts of the committee. Board is responsible for defining the committee role and structure. The structure of a board and the planning of the board's work are key elements to effective governance. Establishing committees is one way of managing the work of the board, thereby strengthening the board's governance role. Boards should regularly review its own structure and performance and whether it has the right committee structure and an appropriate scheme of delegation from the board.

Functions of Board Committee

Committees often serve several different functions:

Governance: In large organizations participation of each and every director is not possible in decisions making of the organization as a whole, a committee is given the power to make decisions, spend money, or take actions. Some or all such powers may be limited or effectively unlimited. Members of the committee take decisions, keeping in view the interest of all stakeholders.

Coordination: Where there is a large board, it is common to have committees with more specialized functions for better coordination - for example, audit committee, finance committee, compensation committee, etc. wherein members meet regularly to discuss developments in their areas, review projects that cut across organizational boundaries, talk about future options, etc.

Research and recommendations: Committees are often formed to do research and make recommendations on a potential or planned project or change. For example, an organization considering a major capital investment might create a temporary working committee of several people to review options and make recommendations to the Board of Directors. Such committees are typically dissolved after giving recommendations.

With the increasing business complexities and time commitment of Board members, constituting committees has become inevitable for organization of any significant size. Committees keep the number of participants manageable; in larger groups, either many people do not get to speak or discussion gets quite lengthy.

Powers of the Board to form a Committee

- The Board of Directors of the Company derive powers from Article of Association of the Company [Table F (Limited by shares) & H (Limited by Guarantee and not having share capital)] under the Companies Act, 2013:
  - (i) The Board may, subject to the provisions of the Companies Act, 2013 delegate any of its powers to committees consisting of such member or members of its body as it thinks fit.
  - (ii) Any committee so formed shall, in the exercise of the powers so delegated, conform to any regulations that may be imposed on it by the Board.
- Under Regulation 4 of the SEBI (LODR) Regulations, 2015, when committees of the board of directors are established, their mandate, composition and working procedures shall be well defined and disclosed by the board of directors.

Mandatory Board Committees

Mandatory Committees of the Board are prescribed under the Companies Act, 2013 (for certain class of companies) and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for listed companies.

AUDIT COMMITTEE

Audit Committee is one of the main pillars of the Corporate Governance mechanism in any company. The main function of an Audit Committee is oversight of financial disclosures, reporting, internal and external audits, internal control, accounting, regulatory compliance and risk management. Its main aim is to strengthen the confidence of stakeholders in the company's financial statements and announcements, its internal control process and the risk management process.

The constitution of Audit Committee is mandated under the Companies Act, 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Constitution of Audit Committee

Section 177(1) of the Companies Act, 2013 read with Rule 6 of the Companies (Meetings of the Board and its Powers) Rules, 2014, provides that the Board of Directors of following companies are required to constitute an Audit Committee of the Board-

(i) Every listed public company;

(ii) All public companies with a paid up share capital of 10 crore rupees or more; or

(iii) All public companies having turnover of 100 crore rupees or more; or

(iv) All public companies, having in aggregate, outstanding loans, debentures and deposits exceeding 50 crore rupees.

The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account for the purposes of this rule.

The following classes of unlisted public companies shall not be covered for the above purpose:-

(a) a joint venture;

(b) a wholly owned subsidiary; and

(c) a dormant company as defined under section 455 of the Act.

Composition of the Audit Committee

The audit committee need to consist of the following:

Category	*Provisions of Section 177 of the Companies Act, 2013*	*Provisions of Regulation 18 of SEBI (LODR) Regulations, 2015*
Number of Directors	Minimum 3 directors as members	Minimum 3 directors as members
Independent Directors	Of the total members, independent directors need to form majority except Section 8 Company	• At least two-thirds of the members of audit committee shall be independent directors and • In case of a listed entity having outstanding SR equity shares, the audit committee shall only comprise of independent directors

Chairperson	The Companies Act, 2013 does not prescribe that the Chairman of the Audit Committee shall be an independent Director	An Independent Director
Educational Qualification	Majority of members of Audit Committee including its chairperson must have ability to read and understand the financial statement	All members of audit committee need to be financially literate and at least one member shall have accounting or related financial management expertise
Presence in AGM/ GM	Not provided in the Act, however, SS-2 provides that either the Chairman of the Committee or any other Member of the Committee authorised by the Chairman of the Committee can attend the general meeting on his behalf	The chairperson of the audit committee shall be present at Annual general meeting to answer shareholder queries
Secretary of the Committee	Not provided	Company Secretary
Presence of other in the meeting of audit committee	The Audit Committee can call for comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and management of the company	The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee: Provided that occasionally the audit committee may meet without the presence of any executives of the listed entity
Meeting of the Audit Committee	As per SS-1, Audit Committee shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board	At least four times in a year and not more than one hundred and twenty days shall elapse between two meetings
Quorum for the meeting	As per SS-1, unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of such Committee is necessary to form the Quorum	Two members or one third of the members of the audit committee, whichever is greater, with at least two independent directors.

Power of Audit Committee	The Audit committee has authority to investigate into any matter in relation to the items specified under Section 177(4) of the Act or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.	The audit committee shall have powers to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.

Functions/Role of the Audit Committee

Section 177(4) stipulates that, every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board.

Terms of reference as prescribed by the Board shall *inter alia,* include, –

(a) The recommendation for appointment, remuneration and terms of appointment of auditors of the company;

> In case of Government Companies, in Clause (1) of sub-section (4) of section 177, for the words "recommendation for appointment, remuneration and terms of appointment" the words "recommendation for remuneration" shall be substituted – Exemption Notification dated 05th June, 2015.

(b) Review and monitor the auditor's independence and performance, and effectiveness of audit process;

(c) Examination of the financial statements and the auditors' report thereon;

(d) Approval or any subsequent modification of transactions of the company with related parties;

The Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as prescribed under rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014.

(e) Scrutiny of inter-corporate loans and investments;

(f) Valuation of undertakings or assets of the company, wherever it is necessary;

(g) Evaluation of internal financial controls and risk management systems;

(h) Monitoring the end use of funds raised through public offers and related matters.

Section 177 is not applicable for Specified IFSC Public Company.

Omnibus approval of Related Party Transactions [Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014].

(1) The Audit Committee must, after obtaining approval of the Board of Directors, specify the criteria for making omnibus approval for related party transactions proposed to be entered into by the company, which need to include the following conditions, namely:

(a) maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year;

(b) the maximum value per transaction which can be allowed;

(c) extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval;

(d) review, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made;

(e) transactions which cannot be subject to the omnibus approval by the Audit Committee.

(2) The Audit Committee need to consider the following factors while specifying the criteria for making omnibus approval, namely: -

(a) repetitiveness of the transactions (in past or in future);

(b) justification for the need of omnibus approval.

(3) The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.

(4) The omnibus approval shall contain or indicate the following: -

(a) name of the related parties;

(b) nature and duration of the transaction;

(c) maximum amount of transaction that can be entered into;

(d) the indicative base price or current contracted price and the formula for variation in the price, if any; and

(e) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

(5) Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year.

(6) Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

(7) Any other conditions as the Audit Committee may deem fit.

Approval of the Audit Committee to a related party transaction can be granted by passing a circular resolution. Elucidate.

Section 188(1) of the Companies Act, 2013 prohibits the Board from dealing with an item of business pertaining to a contract or arrangement with a related party through a circular resolution. However, the law is silent on dealing with any item of business by the Audit Committee through a circular resolution.

Here, the intention of the Legislature is required to be gathered from the language used; which means that attention should be paid to what has been said as also to what has not been said. As a consequence, though it cannot be added that the law imposes any restriction, the principle applicable on meetings of the Board would be applicable to the meetings of the Audit Committee too, while dealing with items of business on related party transactions.

As per the Secretarial Standard on Meetings of the Board of Directors (SS-1), the Audit Committee should discuss related party transactions which are not in the ordinary course of business or which are not on arm's length basis at its meetings and not through circulation.

Related party transactions other than Section 188- As per second proviso to clause (iv) of Section 177(4) in case of transaction, other than transactions referred to in section 188, where Audit Committee does not approve the transaction, the company needs to make its recommendations to the Board.

Transaction involving less than Rs. 1 Crore- As per third proviso to clause (iv) of Section 177(4) in case of related party transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.

Transaction between Holding Company and Wholly Owned Subsidiary- As per fourth proviso to clause (iv) of Section 177(4), for any related party transaction other than transactions referred in section 188, between a holding company and its wholly owned subsidiary company the approval of audit committee is not required.

However, if such transaction is covered under section 188, between a holding company and its wholly owned subsidiary company or between a holding company and its other than wholly owned subsidiary company the approval of audit committee is must.

Rights of Auditors, KMP to be heard by the Audit Committee

The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report. However, they do not have the right to vote.

Disclosure in Board's Report (Section 177(8))

The composition of an Audit Committee must be disclosed by the company in the report of its Board of Directors in the year.

In case the Board does not accept any recommendation of the Audit Committee, the same shall be disclosed in the Board report along with the reasons thereof.

The Role of Audit Committee as prescribed under Part C of Schedule II of SEBI (LODR) Regulation, 2015

The role of Audit Committee under the Regulation 18 is wider than the Companies Act, 2013, which includes:

- Oversight of the listed entity's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;
- Recommendation for appointment, remuneration and terms of appointment of auditors of the listed entity;
- Approval of payment to statutory auditors for any other services rendered by the statutory auditors;
- Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the Board for approval, with particular reference to:
    (a) Matters required to be included in the Director's responsibility statement to be included in the Board's report in terms of clause (c) of sub-section (3) of Section 134 of the Companies Act, 2013;
    (b) Changes, if any, in accounting policies and practices and reasons for the same;
    (c) Major accounting entries involving estimates based on the exercise of judgment by management;
    (d) Significant adjustments made in the financial statements arising out of audit findings;

(e) Compliance with listing and other legal requirements relating to financial statements;

(f) Disclosure of any related party transactions;

(g) Modified opinion(s) in the draft audit report;

- Reviewing, with the management, the quarterly financial statements before submission to the Board for approval;
- Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue or preferential issue or qualified institutions placement, and making appropriate recommendations to the Board to take up steps in this matter;
- Reviewing and monitoring the auditor's independence and performance, and effectiveness of audit process;
- Approval or any subsequent modification of transactions of the listed entity with related parties;
- Scrutiny of inter-corporate loans and investments;
- Valuation of undertakings or assets of the listed entity, wherever it is necessary;
- Evaluation of internal financial controls and risk management systems;
- Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;
- Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;
- Discussion with internal auditors of any significant findings and follow up there on;
- Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board;
- Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern;
- To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors;
- To review the functioning of the whistle blower mechanism;
- Approval of appointment of chief financial officer after assessing the qualifications, experience and background, etc. of the candidate;
- Carrying out any other function as is mentioned in the terms of reference of the audit Committee.
- Reviewing the utilization of loans and/ or advances from/investment by the holding company in the subsidiary exceeding Rs.100 crore or 10% of the asset size of the subsidiary, whichever is lower including existing loans / advances / investments existing as on the date of coming into force of this provision.
- Consider and comment on rationale, cost-benefits and impact of schemes involving merger, demerger, amalgamation etc., on the listed entity and its shareholders.

The Audit Committee shall mandatorily review the following information:

- Management discussion and analysis of financial condition and results of operations;
- Management letters / letters of internal control weaknesses issued by the statutory auditors;
- Internal audit reports relating to internal control weaknesses; and
- The appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the audit committee.
- Statement of deviations:
  - Quarterly statement of deviation(s) including report of monitoring agency, if applicable, submitted to stock exchange(s) in terms of Regulation 32(1) of the SEBI (LODR) Regulations, 2015.
  - Annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/notice in terms of Regulation 32(7) of the SEBI (LODR) Regulations, 2015.

VIGIL MECHANISM [SECTION 177(9) TO 177(10)]

Section 177(9) of the Act read with Rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides for establishment of Vigil Mechanism for their directors and employees to report their genuine concerns or grievances as under:

(1) Every listed company;

(2) the companies which accept deposits from the public;

(3) the companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

The vigil mechanism set up as above, shall provide for adequate safeguards against victimisation of employees and Directors who use such mechanism and make provision for direct access to the Chairperson of the Audit Committee or the Director nominated to play the role of Audit Committee in appropriate or exceptional cases.

In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.

The companies which are required to constitute an Audit Committee shall oversee the vigil mechanism through the Committee and if any of the members of the Committee have a conflicted of interest in a given case, they should recuse themselves and the others on the Committee would deal with the matter on hand.

In case of other companies (not required to constitute Audit Committee), the Board of Directors shall nominate a Director to play the role of Audit Committee for the purpose of vigil mechanism to whom other Directors and employees may report their concerns.

The details of establishment of the Vigil Mechanism is required to be disclosed by the company on its website, if any, and in the Board's report.

It may be noted that while section 177(9) of the Act mandates to establish a vigil mechanism for directors and employees to report genuine concerns, in case of a listed company, such mechanism is available to all stakeholders.

Regulation 4(2)(d)(iv) of SEBI (LODR) Regulations, 2015 provides that the listed company shall devise an effective vigil mechanism/whistle blower policy enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

Further, the Regulation 22 of the SEBI (LODR) Regulations, 2015 provides that the listed company shall formulate a vigil mechanism/ whistle blower policy for directors and employees to report genuine concerns and such mechanism shall provide for adequate safeguards against victimization of director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

1) What does the term financially literate mean?

According to Explanation to Regulation 18(1) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, "financially literate" shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Given that one of the primary functions of Audit Committee is to review and ensure integrity of the financial statements of the Company, it is pertinent that the members of the Audit Committee are sufficiently capable of understanding the financial statements and its repercussions. Going by the definition it is clear that the members need not necessarily be financial or accounting professional. However it is important that the members understand the process of auditing and possess an in-depth understanding of financial statements.

2) What does the term 'have accounting or related financial management expertise' mean in Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

According to Explanation (2) of Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

3) If a company intends to constitute its Audit Committee with 5 members, then how many such members should be independent?

Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires at least two-thirds of the members of the Audit Committee to be independent directors. Hence given 5 members, 3 members of the Audit Committee should be independent.

SECTION 178: NOMINATION AND REMUNERATION COMMITTEE

Constitution of Nomination and Remuneration Committee

The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, and in handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, and to management's and personnel's remuneration and incentive schemes. The responsibilities of the Nomination and Remuneration Committee are defined in Nomination and remuneration policy or terms of reference of the Nomination and Remuneration document.

The Board of Directors of following companies shall constitute Nomination and Remuneration Committee of the Board:

(a) Every listed Public Company; or

(b) The following class of companies –

(i) all public companies with a paid up share capital of ten crore rupees or more;

(ii) all public companies having turnover of one hundred crore rupees or more;

(iii) all public companies, having in aggregate, outstanding loans , debentures and deposits, exceeding fifty crore rupees.

The paid-up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account for the above purpose.

The following classes of unlisted public company shall not be covered for above purpose:-

(a) a joint venture;

(b) a wholly owned subsidiary; and

(c) a dormant company as defined under section 455 of the Act.

Exceptions:

- After exemption notification dated 05.06.2015 the provisions of Section 178 of the Act are not applicable to the Section 8 Companies.
- After exemption notification dated 04.01.2017 the provisions of Section 178 of the Act are not applicable to the Specified IFSC Public Companies.

Composition of Nomination and Remuneration Committee

Category	*Provisions of Section 178 of the Companies Act, 2013*	*Provisions of Regulation 19 of SEBI (LODR) Regulations, 2015*
Number of Directors	Minimum 3 or more non-executive directors as members. The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.	Minimum 3 non-executive directors as members. The chairperson of the listed entity (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.
Independent Directors	Of the total members, one-half shall be independent directors.	At least two-thirds of the members of the committee shall be independent directors.
Chairperson	Not Provided	An Independent Director.
Presence in AGM/ GM	The chairperson of nomination and remuneration committee or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.	The Chairperson of the nomination and remuneration committee may be present at the annual general meeting, to answer the shareholders' queries; however, it shall be up to the chairperson to decide who shall answer the queries.

Category	*Provisions of Section 178 of the Companies Act, 2013*	*Provisions of Regulation 19 of SEBI (LODR) Regulations, 2015*
Meeting of the Nomination and Remuneration Committee	As per SS-1, Nomination and Remuneration Committees shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board.	At least once in a year.
Quorum for the meeting	As per SS-1, Unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of such Committee is necessary to form the Quorum.	Two members or one-third of the members of the committee, whichever is greater, including at least one independent director in attendance.

Functions of Nomination and Remuneration Committee

As per section 178(2) of the Act, the Committee shall identify the person qualified to become Directors and may be appointed in senior management, in accordance with the criteria laid down and recommend to the Board their appointment and removal and shall specify the manner for effective evaluation of performance of Board, its Committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance.

As per section 178(3) of the Act, the Committee shall formulate the criteria, for determining qualifications, positive attributes and independence of a Director and recommend to the Board the policy relating to remuneration for Directors, KMPs and other employees.

As per section 178(4) of the Act, while formulating its policy, the Nomination and Remuneration Committee shall ensure that:

(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate the directors of the quality required to run the company successfully;

(b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

(c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals:

Such policy shall be placed on the website of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the Board's report.

Exceptions:

In case of Government company - Sub-sections (2), (3) and (4) of Section 178, shall not apply except with regard to appointment of 'senior management' and other employees'. - Notification dated 5th June, 2015.

Functions of the Nomination and Remuneration committee as specified in Part D of the Schedule II of SEBI (LODR) Regulation, 2015:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board of Directors a policy relating to, the remuneration of the directors, key managerial personnel and other employees;
2. For every appointment of an independent director, the Nomination and Remuneration Committee shall evaluate the balance of skills, knowledge and experience on the Board and on the basis of such evaluation, prepare a description of the role and capabilities required of an independent director. The person recommended to the Board for appointment as an independent director shall have the capabilities identified in such description.

   For the purpose of identifying suitable candidates, the Committee may:

   a. use the services of an external agencies, if required;

   b. consider candidates from a wide range of backgrounds, having due regard to diversity; and

   c. consider the time commitments of the candidates.
3. Formulation of criteria for evaluation of performance of Independent Directors and the Board of Directors;
4. Devising a policy on diversity of Board of Directors;
5. Identifying persons who are qualified to become Directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board of Directors their appointment and removal;
6. Whether to extend or continue the term of appointment of the Independent Director, on the basis of the report of performance evaluation of Independent Directors;
7. Recommend to the Board, all remuneration, in whatever form, payable to senior management.

SECTION 178- STAKEHOLDERS RELATIONSHIP COMMITTEE

Constitution of Stakeholders Relationship Committee

Section 178(5) of the Companies Act, 2013 provides for constitution of the stakeholders relationship committee.

The Board of Directors of a company which consists of more than 1000 shareholders, debenture-holders, deposit- holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee.

Composition of Stakeholders Relationship Committee

Category	*Provisions of Section 178(5) of the Companies Act, 2013*	*Provisions of Regulation 20 of SEBI (LODR) Regulations, 2015*
Number of Directors	Stakeholders Relationship Committee shall consist of a chairperson and such other members as may be decided by the Board.	i) Minimum 3 directors as members with at least one being an independent director; ii) In case of a listed entity having outstanding SR equity shares, at least two thirds of the Stakeholders Relationship Committee shall comprise of independent directors.

Category	*Provisions of Section 178(5) of the Companies Act, 2013*	*Provisions of Regulation 20 of SEBI (LODR) Regulations, 2015*
Chairperson	Chairperson shall be a non-executive director	Chairperson shall be a non-executive director
Presence in AGM/GM	The Chairperson of Stakeholder's Relationship Committee or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.	The Chairperson of the Stakeholders Relationship Committee shall be present at the annual general meetings to answer queries of the security holders.
Meeting of the Stakeholder's Relationship Committee	As per SS-1, Committees shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board.	At least once in a year.
Quorum for the meeting	As per SS-1, Unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of such Committee is necessary to form the Quorum.	Not specified.

Functions of Stakeholders Relationship Committee

The main function of the committee is to consider and resolve the grievances of security holders of the company. On similar terms Part D of the Schedule II of the SEBI (LODR) Regulations, 2015 provides the role of the committee which *inter-alia* include the following:

- Resolving the grievances of the security holders of the listed entity including complaints related to transfer/ transmission of shares, non-receipt of annual report, non-receipt of declared dividends, issue of new/ duplicate certificates, general meetings etc.
- Review of measures taken for effective exercise of voting rights by shareholders.
- Review of adherence to the service standards adopted by the listed entity in respect of various services being rendered by the Registrar & Share Transfer Agent.
- Review of the various measures and initiatives taken by the listed entity for reducing the quantum of unclaimed dividends and ensuring timely receipt of dividend warrants/annual reports/statutory notices by the shareholders of the company.

Penalty for Contravention of Section 177 and 178

Section 178(8) provides that in case of any contravention of the provisions of section 177 and section 178, the company shall be liable to a penalty of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of one lakh rupee.

However, inability to resolve or consider any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of this section.

Schedule IV under Section 149(7) of the Act contains the Code for Independent Directors. Under Sl. No. II (5) and (6) of the Code, Independent Directors are mandated to safeguard the interest of all stakeholders, especially the Minority Shareholders and balance the conflicting interests of the stakeholders.

RISK MANAGEMENT COMMITTEE

Constitution of Risk Management Committee

A Risk Management Committee fosters an integrated, enterprise-wide approach to identify and manage risk and provides an impetus toward improving the quality of risk reporting and monitoring, both for management and the Board.

The Companies Act, 2013 does not specifically contain any provisions with respect to constitution of a Risk Management Committee. However, It is to be noted that section 134(3)(n) of the Companies Act, 2013, provides that Board Report must contain a statement indicating the development and implementation of a Risk Management Policy for the company, including the identification of risks that may pose a threat to the existence of company.

Further section 177(4)(vii) of the Companies Act, 2013 state that the Audit Committee has an obligation to evaluate the company's internal financial controls and risk management systems.

Part II of Schedule IV of the Companies Act, 2013 requires, an Independent director of a company to bring an independent judgment to the board deliberations regarding the risk management systems of the company.

Composition of Risk Management Committee

Regulation 21 of the SEBI (LODR) Regulations, 2015 requires that the company through its Board of Directors shall constitute a Risk Management Committee.

Applicability

The provisions of this regulation shall be applicable to top 1000 listed entities, determined on the basis of market capitalization as at the end of the immediate preceding financial year and a 'high value debt listed entity'.

Composition of Risk Management Committee

- The Risk Management Committee shall have minimum 3 members with majority of them being members of the board of directors, including at least one independent director.
- In case of a listed entity having outstanding SR equity shares, at least two-thirds of the Risk Management Committee shall comprise of independent directors.
- The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.

Meetings/Quorum

- The risk management committee shall meet at least twice in a year.
- The quorum for a meeting of the Risk Management Committee shall be either two members or one-third of the members of the committee, whichever is higher, including at least one member of the board of directors in attendance.
- The meetings of the risk management committee shall be conducted in such a manner that on a continuous basis not more than 180 days shall elapse between any two consecutive meetings.

Functions/Role of Risk Management Committee

The board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit, such function shall specifically cover cyber security.

The role and responsibilities of the Risk Management Committee shall mandatorily include the performance of functions specified in Part D of Schedule II of SEBI (LODR) Regulations, 2015.

The role of the committee shall, inter alia, include the following:

- To formulate a detailed risk management policy;
- To ensure that appropriate methodology, processes and systems are in place to monitor and evaluate risks associated with the business of the Company;
- To monitor and oversee implementation of the risk management policy, including evaluating the adequacy of risk management systems;
- To periodically review the risk management policy, at least once in two years, including by considering the changing industry dynamics and evolving complexity;
- To keep the board of directors informed about the nature and content of its discussions, recommendations and actions to be taken.

(**Cross Reference:** *For more details Students are advised to refer Lesson 10 of Capital Market & Securities Laws*.)

Powers of Risk Management Committee

The Risk Management Committee shall have powers to seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.

CORPORATE SOCIAL RESPONSIBILITY COMMITTEE [SECTION 135]

Applicability of CSR Committee

- Every company having net worth of Rs.500 crore or more, or turnover of Rs.1000 crore or more or a net profit of Rs.5 Crore or more during the immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board.
- Where the CSR obligation of the company does not exceed Rs.50 Lakhs, the requirement for constitution of the Corporate Social Responsibility Committee shall not be applicable and the functions of such Committee provided under section 135 shall, in such cases, be discharged by the Board of Directors of such company.
- A company having any amount in its Unspent Corporate Social Responsibility Account as per Section 135(6) shall constitute a CSR Committee and comply with the provisions contained in sub-sections (2) to (6) of the said section. [*Second Proviso to Rule 3(1) of the Companies (CSR Policy) Rules, 2014*]

Composition of CSR Committee

- The CSR Committee shall consist of 3 or more Directors, out of which at least 1 Director shall be an Independent Director.
- Where a company is not required to appoint an Independent Director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee two or more Directors.

Hence, a company which is not required to appoint an Independent Director, it shall have its CSR committee without such Director.

- A private company having only 2 directors on its Board shall constitute its CSR Committee with two such directors.
- With respect to a foreign company, the CSR Committee shall comprise of at least 2 persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Companies Act, 2013 and another person shall be nominated by the foreign company.

Meetings/Quorum

- As per SS-1, the committee shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board.
- A member of the Committee appointed by the Board or elected by the Committee as Chairman of the Committee, in accordance with the Act or any other law or the Articles, shall conduct the Meetings of the Committee. If no Chairman has been so elected or if the elected Chairman is unable to attend the Meeting, the Committee shall elect one of its members present to chair and conduct the Meeting of the Committee, unless otherwise provided in the Articles.
- Quorum of CSR Committee- Unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of CSR Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of such Committee is necessary to form the Quorum.

Functions of CSR Committee

- To formulate and recommend to the Board, a CSR Policy which shall indicate the activities to be undertaken by the company in areas or subjects as specified in Schedule VII of the Companies Act, 2013.
- To recommend the amount of expenditure to be incurred on the CSR activities.
- To monitor the Corporate Social Responsibility Policy of the company from time to time.
- Further the CSR rules provide that the CSR Committee shall formulate and recommend to the Board, an annual action plan in pursuance of its CSR policy, which shall include the following, namely:-

  (a) the list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the Companies Act, 2013;

  (b) the manner of execution of such projects or programmes as specified in sub-rule (1) of rule 4 of CSR Rules;

  (c) the modalities of utilisation of funds and implementation schedules for the projects or programmes;

  (d) monitoring and reporting mechanism for the projects or programmes; and

  (e) details of need and impact assessment, if any, for the projects undertaken by the company.

However, Board may alter such plan at any time during the financial year, as per the recommendation of its CSR Committee, based on the reasonable justification to that effect.

Disclosures related to CSR Committee

- The Board of Directors of every company required to form a CSR Committee shall after taking into account the recommendations made by such Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as prescribed;
- The Board of Directors of the Company are mandatorily required to disclose the composition of the CSR Committee, and CSR Policy and Projects approved by the Board on their website, if any, for public access.

OTHER BOARD COMMITTEES

In addition to the Committees of the Board mandated by the Companies Act, 2013, viz., Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee and the CSR Committee, Board of Directors may also constitute other Committees to oversee a specific objective or project. The nomenclature, composition and role of such Committees will vary, depending upon the specific objectives of the company.

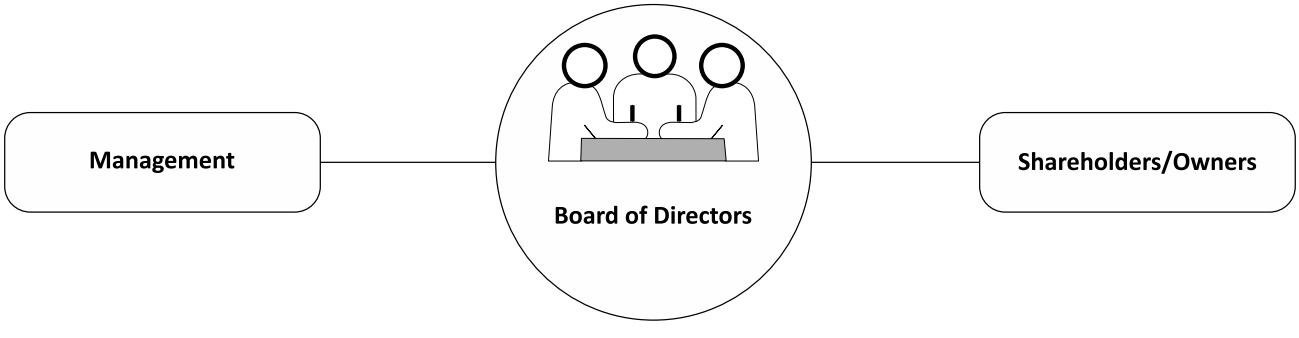
A few examples of such Committees prevalent in the corporate sector in India and abroad are given below:

1. Corporate Governance Committee;
2. Science, Technology & Sustainability Committee;
3. Regulatory, Compliance & Government Affairs Committee;
4. Investment Committee;
5. Ethics Committee etc.

POWERS OF BOARD [SECTION 179]

Shareholders derive their powers from the AoA – therefore, the company has all the powers except those that are *ultra vires:*

- The Board has the general power to do everything that the company is empowered to do;
- Except for matters where the Companies Act, 2013 requires concurrence of general meeting;
- Or matters where shareholders have regulated the conduct of the directors;
- Or the articles confine the powers.



Powers to be exercised in Board Meeting

Section 179 of the Companies Act, 2013 empowers the Board to exercise all powers, and to do all such acts and things, as the company is authorised to exercise and do, except those powers which can only be exercised or done by the company in a general meeting. The powers of the board are however, subject to the provisions contained in that behalf in the Act, the memorandum and articles of association of the company or including regulations made by the company in general meeting.

However, no regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

In the case of *M/s K.K. Ahuja vs. V.K. Vora & Anr.* Under Negotiable Instrument Act, 1881, Supreme Court observed that a company though a legal entity can act only through its Board of Directors. The settled position is that a Managing Director is prima facie in charge of and responsible for the company's business and affairs and can be prosecuted for offences by the company. But insofar as other directors are concerned, they can be prosecuted only if they were in charge of and responsible for the conduct of the company's business.

The following [Section 179(3) read with Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014] powers of the Board of Directors shall be exercised **only by means of resolutions passed at meetings of the Board**, namely :-

(a) to make calls on shareholders in respect of money unpaid on their shares;

(b) to authorise buy-back of securities under section 68;

(c) to issue securities, including debentures, whether in or outside India;

(d) to borrow monies;

(e) to invest the funds of the company;

(f) to grant loans or give guarantee or provide security in respect of loans;

(g) to approve financial statement and the Board's report;

(h) to diversify the business of the company;

(i) to approve amalgamation, merger or reconstruction;

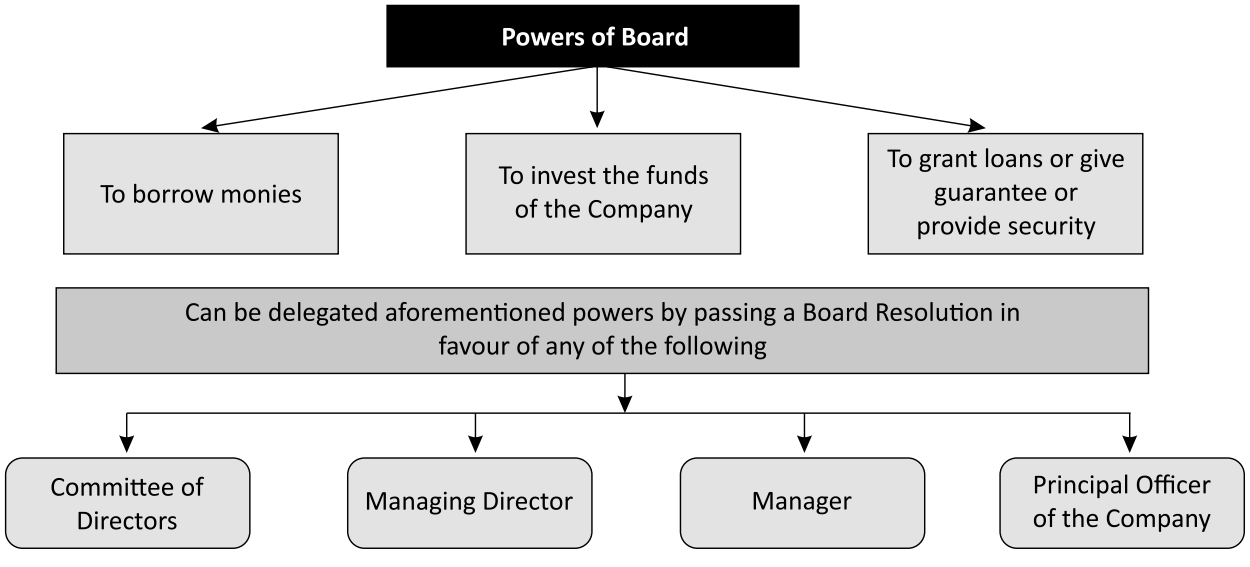
(j) to take over a company or acquire a controlling or substantial stake in another company;

(k) to make political contributions;

(l) to appoint or remove key managerial personnel (KMP);

(m) to appoint internal auditors and secretarial auditor.

Delegation of Powers of Board



First proviso to section 179(3) specifies that the following powers, on such conditions as it may specify can be delegated by the board to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office :-

- to borrow money;
- to invest the funds of the company;
- to grant loans or give guarantee or provide security in respect of loans.

The delegation of above powers can only be done by way of passing Resolution at the meeting of the board of directors and delegation cannot be made by way of passing Circular Resolution.

The acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of section 179 of the Companies Act, 2013.

Section 179(3)(d) of the Companies Act, 2013 shall not apply to borrowings by a banking company from other banking companies or from the Reserve Bank of India, the State Bank of India or any other banks established by or under any Act.

In respect of dealings between a company and its bankers, the exercise by the company of the power specified in Section 179(3)(d) of the Companies Act, 2013 shall mean the arrangement made by the company with its bankers for the borrowing of money by way of overdraft or cash credit or otherwise and not the actual day-to-day operation on overdraft, cash credit or other accounts by means of which the arrangement so made is actually availed of.

However, nothing in section 179 shall be deemed to affect the right of the company in general meeting to impose restrictions and conditions on the exercise by the Board of any of the powers specified in this section.

Exceptions

In case of Section 8 companies resolutions related to clauses (d), (e) and (f) of sub-section (3) of Section 179 of the Act i.e. borrow monies, to invest funds of the company and to grant loans or give guarantee or provide security in respect of loans by section 8 companies may be decided by the Board by circulation instead of at a meeting (*Exemption Notification dated- 5.6.2015*).

In case of Specified IFSC Public Company/Specified IFSC Private Company - In sub-section (3) of Section 179, after the second proviso, the following proviso shall be inserted, namely:-

"Provided also that in case of a Specified IFSC public company/ Specified IFSC Private Company, the Board can exercise powers by means of resolutions passed at the meetings of the Board or through resolutions passed by circulation"- *Notification Dated 4th January 2017*.

Restriction on Powers of Board [Section 180]

The Board can exercise following powers only with the consent of the company by **passing a special resolution**, namely –

(a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.

Explanation to section 180(i)(a) defines the meaning of the expression "undertaking".

(i) "**Undertaking**" shall mean an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent. of the total income of the company during the previous financial year;

(ii) the expression "**substantially the whole of the undertaking**" in any financial year shall mean twenty per cent. or more of the value of the undertaking as per the audited balance sheet of the preceding financial year.

In case of *Madras Gymkhana Club Employee Union vs. Management of the Gymkhana*, the Hon'ble Supreme Court held that the business of the Company or undertaking of the company must be distinguished from the other properties belonging to the company. The meaning of undertaking was further defined to mean "any business or any work or project which one engages in or attempts as an enterprise similar to business or trade".

(b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;

(c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium apart from temporary loans obtained from the company's bankers in the ordinary course of business;

The acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

Explanation – For the purposes of this clause, the expression "temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature.

(d) to remit, or give time for the repayment of, any debt due from a director.

The company cannot pass a blanket resolution in relation to borrowing money exceeding paid up share capital, free reserves and securities premium. It has to specify in the resolution the total amount up to which the money may be borrowed by the Board of Directors.

Nothing contained in clause (a) of sub-section (1) of Section 180 shall affect –

(a) the title of a buyer or other person who buys or takes on lease any property, investment or undertaking as is referred to in that clause, in good faith; or

(b) the sale or lease of any property of the company where the ordinary business of the company consists of, or comprises, such selling or leasing.

Condition may be imposed for resolution under Section 180

Any special resolution passed by the company consenting to the transaction as is referred to in clause (a) of sub- section (1) of Section 180 may stipulate such conditions as may be specified in such resolution, including conditions regarding the use, disposal or investment of the sale proceeds which may result from the transactions.

However, this sub-section shall not be deemed to authorise the company to effect any reduction in its capital except in accordance with the provisions contained in this Act.

It is prescribed that no debt incurred by the company in excess of the limit imposed by clause (c) of sub-section (1) of Section 180 is valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed by that clause had been exceeded, the Company shall be liable for the repayment of the same.

As per MCA Exemption Notification dated 05th June, 2015, Section 180 is exempted to Private Limited Companies.

Section 180 shall apply in case of a Specified IFSC public company, unless the articles of the company provides otherwise - *Notification Dated 4th January 2017.*

Illustration:

The following figures were extracted from the books of X Ltd (audited).

- Paid up share capital Rs.100 Lakh
- Reserve & Surplus General Reserve Rs.50 Lakh
- Security Premium Account Rs.25 Lakh
- Re-valuation Reserve Rs.25 Lakh
- Long Term Borrowings Rs.125 Lakh
- Short Term Borrowings (Cash Credit Loan) Rs.50 Lakh
- Temporary Loan for construction of Building Rs.25 Lakh

The Board of Directors further want to borrow a sum of Rs. 50 Lakh as Long Term Loan without obtaining the consent of the members in general meeting by special resolution. Advice the Board about the validity of this proposal. What will be your answer if it is a Private Limited company ?

As per section 180(1)(c), the board of directors of a company with the consent of the company by a special resolution shall borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium, apart from temporary loans obtained from the company's bankers in the ordinary course of business.

Temporary loans means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature.

In view of the above provision the eligible amount which can be borrowed by the Board is given below:

Paid up share capital	Rs. 100 Lakh
Reserve & Surplus General Reserve	Rs. 50 Lakh
Security Premium Account	Rs. 25 Lakh
Total	Rs. 175 Lakh

Re-valuation Reserve is not treated as free reserve as per Section 2(43).

The total borrowing of the company for the purpose of this sub section is –

Long Term Borrowings	Rs. 125 Lakh
Temporary Loan for construction of Building	Rs. 25 Lakh
Total	Rs. 150 Lakh

Short Term Borrowings (Cash Credit Loan) of Rs. 50 Lakhs is considered as temporary loan and loan for construction of building in not consider as temporary loan as per the explanation for temporary loan mentioned above.

Therefore, the company can borrow a further sum upto Rs. 25 Lakh without seeking the approval from the members. So, the board cannot borrow a sum of Rs. 50 Lakhs as Long Term Loan without obtaining the consent of the members in general meeting by special resolution.

In case of private company the provision of section 180 does not apply vide exemption notification dated 05th June, 2015, hence the board can borrow without approval from members in general meeting by passing special resolution.

Contributions to Charitable Funds [Section 181]

The Board of Directors of a company may contribute to bona fide charitable and other funds.

However, prior permission of company in its General Meeting is required if such contribution in case any amount the aggregate of which, in any financial year, exceeds 5% of its average net profits for the 3 immediately preceding financial years.

In the case of *Graphite India Ltd. and Anr. vs. Dalpat Rai Mehta and Anr*., the Calcutta High Court observed that the word "contribution" has been defined inter-alia, as giving money or other aid for specified object.

In other words, a contribution is an aid or payment without any consideration.

Prohibitions and Restrictions Regarding Political Contributions [Section 182]

Section 182 of the Companies Act, 2013 prohibits certain companies to make political contribution as well as restricts some companies to make political contribution subject to the compliances of section 182. These are the Companies which are prohibited to make political contribution:

- A Government Company;
- A company which has been in existence for less than three financial years.

Other than above mentioned companies all companies can directly or indirectly make political contribution to any Political party subject to the following compliances:

- Every company shall pass a Board resolution at a meeting of the Board of Directors to authorise such political contribution, and such resolution shall, subject to the other provisions of this section, be deemed to be the justification in law for making such contribution authorised by it.
- Every company shall disclose in its profit and loss account the total amount contributed by it under this section during the financial year to which the account relates.
- The contribution shall be made by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.
- A company may make contribution through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

"Political Party" means a political party registered under section 29A of the Representation of the People Act, 1951.

Without prejudice to the generality of the political party contribution, these are some transactions which shall be treated as Political party contribution:

(a) a donation or subscription or payment caused to be given by a company on its behalf or on its account to a person who, to its knowledge, is carrying on any activity which, at the time at which such donation or subscription or payment was given or made, can reasonably be regarded as likely to affect public support for a political party shall also be deemed to be contribution of the amount of such donation, subscription or payment to such person for a political purpose;

(b) the amount of expenditure incurred, directly or indirectly, by a company on an advertisement in any publication, being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like, shall also be deemed:

  (i) where such publication is by or on behalf of a political party, to be a contribution of such amount to such political party, and

  (ii) where such publication is not by or on behalf of, but for the advantage of a political party, to be a contribution for a political purpose.

In case of a contribution made by a company is in contravention of the provisions of Section 182, the Company and every officer in default shall be penalized in following manner:

Company	Fine which may extend to five times of the amount so contributed.
Every officer who is in default	Imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed.

Power of Board and other Persons to make Contributions to National Defence Fund, etc. [Section 183]

The Board of Directors of any company or any person or authority exercising the powers of the Board of Directors of a company, or of the company in general meeting, may, notwithstanding anything contained in sections 180, 181 and section 182 or any other provision of this Act or in the memorandum, articles or any other instrument relating to the company, contribute such amount as it thinks fit to the National Defence Fund or any other Fund approved by the Central Government for the purpose of national defence.

The company is required to disclose in its profit and loss account the total amount or amounts contributed by it during the financial year to which the amount relates.

INTER CORPORATE LOANS, INVESTMENTS GUARANTEES AND SECURITY

The power to invest the funds of the company is the prerogative of the Board of Directors. This power is derived by the Board under Section 179 of the Act. However, the Companies Act, 2013 contains provisions for restrictions on investments that a company can make and loans it can provide. Moreover, giving corporate guarantee or security is also as good as giving a loan, because the person to whom guarantee or security is given can decide to enforce the guarantee or security in certain conditions and in such a situation, the company will have to pay the amount. Thus, apart from loan and investments, restrictions are also placed on the guarantees which the company can give or security can provide for a loan.

Provisions in respect of giving of loans, making investments, giving guarantee or providing security or acquiring securities of any other body corporate have been considerably modified by the Companies Act, 2013. As of

now, an overall limit of 60% of paid-up share capital plus free reserves and securities premium account or 100% of free reserves and securities premium account, whichever is more, has been fixed.

The Calcutta High Court in the case of *Saradindu Sekhar Banerjee vs. Lalit Mohan* has held that "Every loan is a debt but every debt is not a loan".

Let us understand some terminologies used in Section 186 of the Companies Act, 2013:

(1) Free Reserves

As per section 2(43) of the Companies Act, 2013 ('the Act') "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that –

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

(2) Paid-up share capital

As per Section 2(64) of the Act, "paid-up share capital" or "share capital paid-up" means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called;

The definition of paid-up share capital is exhaustive. Paid up share capital includes both equity and preference share capital.

(3) "Body Corporate" or "Corporation"

As per Section 2(11) of the Act, "body corporate" or "corporation" includes a company incorporated outside India, but does not include –

(i) a co-operative society registered under any law relating to co-operative societies; and

(i) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf.

(4) Difference between 'Advance' and 'Loans'

Section 2 of the Companies Act, 2013, does not define "loan". A loan is defined by the Oxford English Dictionary as a thing lent; something the use of which is allowed for a time, on the understanding that it shall be returned or an equivalent given, a sum of money lent on these conditions and usually with interest.

There is a difference between advance and loan. Loan is lending of money with absolute promise to repay whereas advances is to be adjusted against supply of goods and services. Genuine trade advances given to suppliers against orders for supply of goods will not be considered as loans and hence will be out of purview of Section 186. Similarly, advances given to employees against current month's salary will also not be in the nature of loans.

(5) Investments

The word 'Investments' in common parlance would include any property or right in which money or capital is invested. However, for the purpose of this study, the term 'Investments' is used in a limited sense to mean the investment of money in shares, stock, debentures, or other securities.

The power to invest the funds of the company is the prerogative of the Board of Directors. This power is derived by the Board under Section 179 of the Act. However, the Companies Act, 2013 contains provisions for restrictions on investments that a company can make and loans it can provide. Moreover, giving corporate guarantee or security is also as good as giving a loan, because the person to whom guarantee or security is given can decide to enforce the guarantee or security in certain conditions and in such a situation, the company will have to pay the amount.

Thus, apart from loan and investments, restrictions are also placed on the guarantees which the company can give or security it can provide for a loan. Provisions in respect of giving of loans, making investments, giving guarantee or providing security or acquiring securities of any other body corporate have been considerably modified by the Companies Act, 2013 by inserting Section 186.

LOAN AND INVESTMENT BY COMPANIES (SECTION 186)

Company to make investments through not more than two layers of investment companies - Section 186(1)

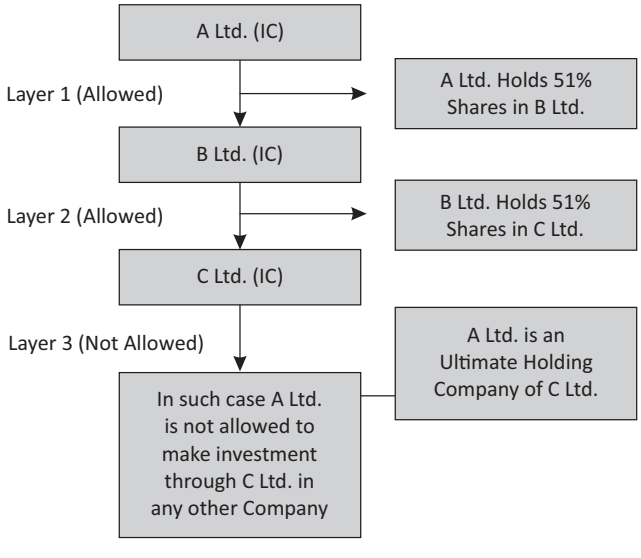
Section 186(1) restricts the power of a company from making an investment through not more than 2 layers of investment companies, unless otherwise prescribed, subject to exceptions provided in the proviso as follows:

(i) Acquisition of any other company incorporated in a country outside India, which has investment subsidiaries beyond two layers as per the laws of such country;

(ii) A subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

'Layer' according to explanation (d) of Section 2(87) of the Companies Act, 2013 in relation to a holding Company means its subsidiary or subsidiaries.

"Investment Company" means a company whose principal business is the acquisition of shares, debentures or other securities and a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than fifty per cent. of its total assets, or if its income derived from investment business constitutes not less than fifty per cent. as a proportion of its gross income.



PROCEDURES INVOLVED IN MAKING LOAN GIVING GUARANTEE AND PROVIDING SECURITY

Section 186(2) stipulates that, no company shall directly or indirectly –

(a) give any loan to any person or other body corporate;

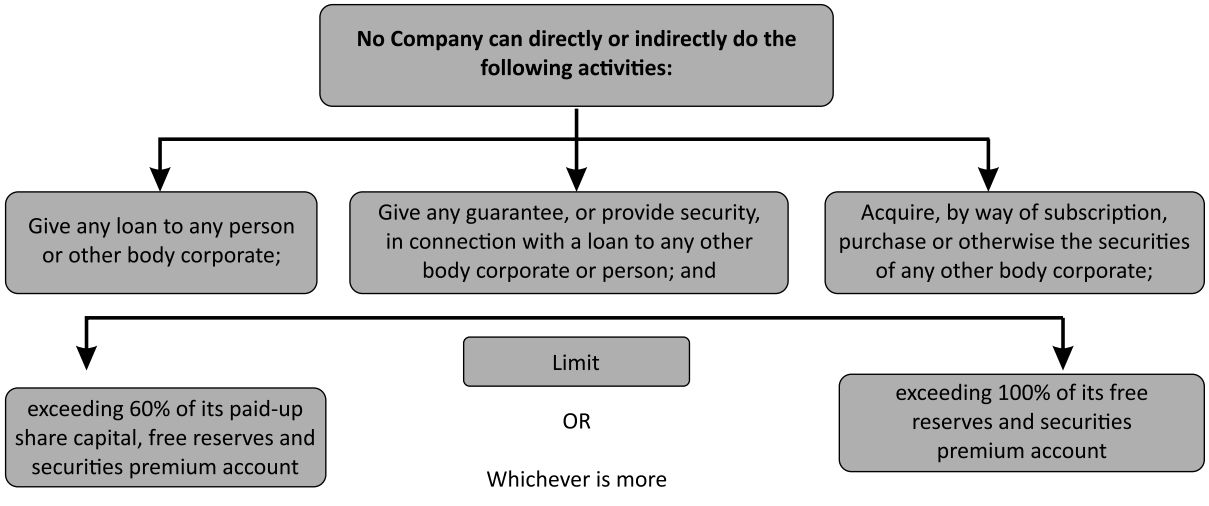
(b) give any guarantee, or provide security, in connection with a loan to any other body corporate or person; and

(c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate;

exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more.

***Explanation*. –** For the purposes of this sub-section, the word "person" does not include any individual who is in the employment of the company.

Limits for Loans, Guarantees, Security and Investment - Section 186(2)



Loan/Investment to be made with the approval of all the Directors at the Board Meeting [Section 186(5)]

No loan or investment shall be made or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

Approval from Members [Section 186 (3)]

Though Section 186(2) makes restriction as above, Section 186(3) of the Act, empowers the company by stating that where the aggregate of the loans and investment so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under sub-section (2) of Section 186 of the Act i.e. 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account whichever is more , investment or loan can be made or guarantee can be given or security can be provided only with the previous authorisation by a special resolution passed in a general meeting. [Section 186(3)]

Where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription,

purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of section 186(3) of the Act shall not apply i.e. prior special resolution is not required.

Rule 13 of the Companies (Meetings of Board and its Powers) Rules, 2014 prescribes that a resolution passed at a general meeting in terms of sub-section (3) of section 186 to give any loan or guarantee or investment or providing any security or the acquisition under sub-section (2) of section 186 shall specify the total amount up to which the Board of Directors are authorized to give such loan or guarantee, to provide such security or make such acquisition.

Further, the company shall disclose to the members in the financial statement the full particulars in accordance with the provisions of sub-section(4) of section 186.

As per Section 186(6) read with Rule 11 of the Companies (Meetings of Board and its Powers) Rules, 2014, no company, which is registered under section 12 of the Securities and Exchange Board of India Act, 1992 (SEBI Act) and covered under such class or classes of companies which is notified by the Central Government in consultation with the Securities and Exchange Board, shall take inter-corporate loan or deposits in excess of the limits specified under the regulations applicable to such company, pursuant to which it has obtained certificate of registration from the Securities and Exchange Board of India and such company shall furnish in its financial statement the details of such loan or deposits.

Section 12 of the SEBI Act, 1992 deals with the registration of stock brokers, sub-brokers, share transfer agents and various other market intermediaries.

Disclosure in Financial Statements [Section 186(4)]

The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security. Such disclosure has to be in the Board's Report also.

Prior Approval of Financial Institution [Section 186(5)]

The company has to obtain prior approval of the public financial institution concerned where any term loan is subsisting. Section 186(5) of the Act provides that no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

However, the prior approval of Public Financial Institution shall not be required where the aggregate of loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given does not exceed the limit as specified in sub-section (2) of Section 186 of the Act and there is no default in repayment of loan installments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution [Proviso Section 186(5)].

Illustration:

Metal Industries Ltd. passed a special resolution in the last general meeting to empower the Board of Directors to grant of loan to Subash Finance Ltd. in excess of the 60% of paid-up share capital, free reserves and securities premium account. However, the company auditor took a contrary view to the resolution passed stating that the resolution did not mention the loan amount that can be provided for. Besides, from the minutes of the Board Meeting in which such item was discussed had a dissenting vote by one of the directors of the company. Comment on the issued raised by the auditor.

In terms of sec 186 (2) of the Companies Act, 2013, no Company shall, directly or indirectly:

(a) give any loan to any person or other body corporate;

(b) give any guarantee, or provide security, in connection with a loan to any other body corporate or person; and (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate;

exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more.

Where a loan and investment made, the amount for which guarantee or security provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board exceeds the limits as specified above, no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorized by a special resolution passed at a general meeting.

There is no requirement to mention the amount in such resolution however, all relevant details may be given in the resolution and explanatory statement as good corporate governance practice.

According to section 186(5), no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

Rate of Interest [Section 186(7)]

Loan given under this section shall carry the rate of interest not lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

In case of section 8 companies, section 186 (7) of the Act, following proviso shall be applicable:-

Provided that nothing contained in this sub-section shall apply to a company in which twenty-six per cent. or more of the paid-up share capital is held by the Central Government or one or more State Governments or both, in respect of loans provided by such company for funding Industrial Research and Development projects in furtherance of its objects as stated in its memorandum of association." (Notification dated 13-06-2017)

Default subsists with respect to repayment of deposits [Section 186(8)]

No company, which is in default in repayment of any deposits accepted before or after the commencement of the Companies Act, 2013 or in payment of interest thereon, shall give any loan or give any guarantee, or provide any security or make an acquisition till such default is subsisting.

This prohibition will operate in respect of any default made under Section 73 to 76 of the Act and the Rules made thereunder and not only on the default of repayment of deposit or payment of interest thereon.

Register of Loans Made, Guarantees Given, Securities Provided and Investments Made [Section 186(9)]

Sub-section (9) of section 186 of the Act, provides that every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars and shall be maintained in manner prescribed under Rule 12 of the Companies (Meetings of Boards and its Powers) Rules, 2014.

Rule 12 states that every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in **Form MBP 2** and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid. Further, the rule specifies that:

- The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition;
- The register shall be kept at the registered office of the company and shall be open to inspection at such office;
- The register shall be preserved permanently and shall be kept in the custody of the Company Secretary of the company or any other person authorised by the Board for the purpose;
- The entries in the register (either manual or electronic) shall be authenticated by the Company Secretary of the company or by any other person authorised by the Board for the purpose. The register can be maintained either manually or in electronic mode;
- The extracts from the register maintained may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

NON APPLICABILITY OF SECTION 186

Exemptions

Sub-section (11) of section 186 of the Act, provides that nothing contained in section 186, except sub-section (1) of Section 186, shall apply –

(a) to any loan made, any guarantee given or any security provided or any investment made by a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of and engaged in the business of financing industrial enterprises, or of providing infrastructural facilities;

- *"Investment Company" means a company whose principal business is the acquisition of shares, debentures and other securities and a company will deemed to be principal engaged in above mentioned business, if its assets in the form of investment in shares, debentures and other securities constitute not less than 50% it total assets, or if its income derived from investment business constitutes and not less than 50% proportion of its gross income.*
- *the expression "infrastructure facilities" means the facilities specified in Schedule VI.*

(b) to any investment –

(i) made by an investment company;

(ii) made in shares allotted in pursuance of clause (a) of sub-section (1) of section 62 or in shares allotted in pursuance of rights issues made by a body corporate;

(iii) made, in respect of investment or lending activities, by a non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities.

Exemption from Applicability of Section 186 to Government Company

In view of the Central Government's notification dated 5th June 2015 under Section 462 of the Companies Act, 2013, Section 186 shall not apply to:

(a) a Government company engaged in defence production;

(b) a Government company, other than a listed company, in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.

Note: Except the government companies falling under the above mentioned conditions, all other companies are required to comply with the provisions of Section 186. In cases where there is no share capital, computation shall be based upon the free reserves of the company, if any.

Exemption from Applicability of Section 186 to Specified IFSC Companies

- In case of Specified IFSC Public Company/ Specified IFSC Private Company - In Sub-section (5) of section 186 after the proviso, the following proviso has been inserted –

  "Provided further that in case of a Specified IFSC public company/ Specified IFSC Private Company, the Board can exercise powers under this sub-section by means of resolutions passed at meetings of the Board of Directors or through resolutions passed by circulation." - *Notification Date 4th January, 2017.*

- In case of Specified IFSC Public Company/ Specified IFSC Private Company - In Sub-sections (2) and (3) of section 186 shall not apply if a company passes a resolution either at meeting of the Board of Directors or by circulation. - *Notification Date 4th January, 2017.*

- In case of Specified IFSC Public Company/Private Company - Sub-section (1) of section 186 shall not apply. -*Notification Date 4th January, 2017.*

Penalty for Contravention of Section 186

For Company:

If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees; and

For Officers:

Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees [Section 186(13)].

INVESTMENTS TO BE HELD IN COMPANY'S OWN NAME

According to Sub-section (1) of Section 187 of the Act, all investments made or held by a company in any property, security or other asset shall be made and held by it in its own name.

The requirement that the investment made by the company must be held in its own name is confined to only those investments which are made by it on its own behalf and not on behalf of someone else.

As per proviso to section 187(1) of the Act, the company may hold any shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

Where the shares of a company were registered in the joint names of the company and one of its directors, it was held that the director was a nominee of the company for that purpose and could only act jointly as he had no rights of his own. [*Exchange Travel (Holdings) Ltd. Re, (1991) BCLC 728 (Ch D)*].

Exemptions from applicability of Section 187(1)

In terms of the provisions of Section 187(2), Section 187(1) of the Act, does not prevent a company:

(a) from depositing with the bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon; or

(b) from depositing with or transferring to, or holding in the name of, the State Bank of India or a scheduled bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof.

However, if within a period of 6 months from the date on which the shares or securities are transferred by the company to, or are first held by the company in the name of, the State Bank of India or a scheduled bank as aforesaid, no transfer of such shares or securities takes place, the company shall, as soon as practicable, after the expiry of that period, have the shares or securities re-transferred to it from the State Bank of India or the scheduled bank or, as the case may be, again hold the shares or securities in its own name; or

(c) from depositing with, or transferring to, any person any shares or securities, by way of security for the re-payment of any loan advanced to the company or the performance of any obligation undertaken by it.

(d) from holding investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

Thus, it is not necessary for the company to hold the shares or stocks or debentures in its own name if they are deposited with the bank as aforesaid. A resolution of the Board of directors in this behalf is sufficient. The bank is entitled to have the shares or debentures registered in its own name with the specific purpose of collecting dividend or interest from the company whose shares or debentures are deposited with the bank. The company holding the investment in the name of the bank is only required to enter into a separate agreement with the bank that the latter will collect dividend and interest and credit the company with the amounts so collected. It may be noted that the deposit of shares, stocks and debentures with the bank need not be by way of a pledge but may be made for the specific object of enabling the banker to act as agent of the company to collect dividend and interest.

REGISTER OF INVESTMENTS NOT HELD IN COMPANY'S OWN NAME

According to sub-section (3) of section 187 of the Act, where in pursuance of clause (d) of sub-section (2) of section 187, any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall maintain a register which shall contain such particulars as prescribed under Rule 14 of the Companies (Meetings of Board and its Powers) Rules, 2014 and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

Rule 14 of the Companies (Meetings of Board and its Powers) Rules, 2014 states the following:

(1) Every company shall, from the date of its registration, maintain a register in **Form MBP-3** and enter therein, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.

(2) The company shall also record whether such investments are held in a third party's name for the time being or otherwise.

(3) The register shall be maintained at the registered office of the company.

(4) The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

(5) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

Let us Remember

The company has to maintain register of loans, investments in Form MBP-2 and register of Investment beneficially held by the company but not held in the name of the company in Form MBP-3.

Punishment

According to section 187(4) of the Act, if a company is in default in complying with the provisions of this section, the company shall be liable to a penalty of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

RELATED PARTY TRANSACTIONS

Related party transactions mean contracts or arrangements between a company and its related parties with respect to transactions covered in Section 188 of the Companies Act, 2013 (Act). The expression 'contract or arrangement' has different connotations under the Act. While 'contract' envisages a written / formal binding document, 'arrangement' may be with or without a written document.

Under the Companies Act, 2013, the scope and coverage of related party transactions has been made more complex and intricate. Besides strict procedural compliances have been foisted.

Related Party

According to Section 2(76) of Companies Act 2013, **"related party",** with reference to a company, means—

(i) a director or his relative;

(ii) a key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager or his relative is a member or director;

(v) a public company in which a director or manager is a director and holds along with his relatives, more than two per cent (2%) of its paid-up share capital;

(vi) any body corporate whose Board of Directors, Managing Director or Manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

(viii) any body corporate which is –

- a holding, subsidiary or an associate company of such company ;
- a subsidiary of a holding company to which it is also a subsidiary; or

- an investing company or the venturer of the company.

Explanation. — For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

(According to Notification no. GSR 464(E), dated 05th June, 2015 in case of Private Companies Section 2(76) Sub- clause viii shall not apply with respect to section 188.)

(ix) such other person as may be prescribed.

According to Rule 3 of the Companies (Specification of Definitions Details) Rules, 2014 for the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director other than independent director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

List of relatives in terms of Section 2(77) of the Companies Act, 2013

Relative with reference to any person, means anyone who is related to another if-

(a) they are members of Hindu Undivided Family;

(b) they are husband and wife; or

(c) one person is related to other in accordance with Rule 4 of the Companies (Specification of Definitions Details) Rules, 2014.

A person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely-

(i) Father: the term "Father" includes step-father;

(ii) Mother: the term "Mother" includes the step-mother;

(iii) Son: the term "Son" includes the step-son;

(iv) Son's wife;

(v) Daughter;

(vi) Daughter's husband;

(vii) Brother: the term "Brother" includes the step-brother;

(viii) Sister: the term "Sister" includes the step-sister.

Nature of Related Party Transactions

The scope of dealing with Related Party Transactions has been widened under the Companies Act, 2013. Section 188 of the Act provides that except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as prescribed under Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014, no company shall enter into any contract or arrangement with a related party with respect to :

(i) sale, purchase or supply of any goods or materials;

(ii) selling or otherwise disposing of, or buying, property of any kind;

(iii) leasing of property of any kind;

(iv) availing or rendering of any services;

(v) appointment of any agent for purchase or sale of goods, materials, services or property;

(vi) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and

(vii) underwriting the subscription of any securities or derivatives thereof, of the company.

However, such approval by the Board of Directors will not be required for transactions entered in the ordinary course of business and on an arm's length basis. In other words, approval of the Board of Directors will only be required for related party transactions which are either not in the ordinary course of business or not on an arm's length basis.

The approval of the Board of Directors cannot be obtained by way of passing of resolution by circulation. The law specifically requires that resolution can be passed in a duly convened meeting of the Board of Directors and only thereafter contract or arrangement can be entered into.

'Ordinary course of business'- Black's Law Dictionary defines 'ordinary course of business' as the 'normal routine in managing the trade or business'.

In common parlance, 'ordinary course of business' would include transactions which are entered into in the normal course of the business pursuant to or for promoting or in furtherance of the company's business objectives, as per the charter documents of the company.

For example, in case of a manufacturing company, purchase and sale of goods, taking premises on lease/ rent, construction of factory, employing workers, etc. will be considered as ordinary course of business. To carry on a business, several activities are carried on by the company; all such activities will be considered to be in the ordinary course of business.

However, if a manufacturing company for the purpose of diversification, decides to acquire another company which is engaged in a completely unrelated business, this activity will not be considered to be in the ordinary course of business.

In the case of *M/s. Bharti Televentures Ltd. vs. Addl./Jt. Commissioner of Income Tax*, it was held that the Memorandum and Articles of Association is not conclusive for deciding whether an activity is in the ordinary course of business of the company. Frequency of the activity is sought to be highlighted. It should be a continuous activity carried out in a normal organized manner.

'Arm Length Transaction'- Explanation to sub-section (1) of Section 188 of the Act defines the term 'arm length transaction' means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

The phrase 'on an arm's length basis' is in fact 'at arm's length' or 'an arm's length relationship' which means avoiding intimacy or close contact. The phrase 'at arm's length' in relation to dealings between two parties is used to refer to dealings when neither party is controlled by the other.

In the case of *Iljin Automotive Private Limited vs. Asst. Commissioner of Income Tax*, the Court opined that "the determination of 'arm's length price' seeks answer to the question – What would have been the price if the transactions were between two unrelated parties, similarly placed as the related parties in so far as nature of product, and terms and conditions of the transactions are concerned?"

The Bangalore Bench of the Income Tax Appellate Tribunal in the case of *Filtrex Technologies Pvt. Ltd. vs. Asst. Commissioner of Income Tax,* held that acceptance of arm's length price declared by one party cannot preclude the Revenue from examining arm's length price in the hands of the other party to the same transaction.

Issue: Who determines that the transaction with related party is in the ordinary course of business? Is it the Board or the Audit Committee?

***View*:** The Companies Act, 2013 does not clearly lay down tests for determining whether a transaction is in the ordinary course of business.

The Memorandum of Association of the company should be referred to for ascertaining whether the activity is covered in the objects clause therein. This is not a conclusive test but will assist in determining whether a transaction is in the ordinary course of business or not. The Audit Committee may decide whether a particular transaction is in the ordinary course of business and such decision will be based on the policy on transactions with related parties, if any. The company's policy on transactions with related parties should specify the parameters to guide the Audit Committee on whether a transaction is in the ordinary course of business or not.

Apart from such a policy, a company may formulate guidelines approved by the Audit Committee and the Board of Directors on transactions with related parties. In such cases, the company can enter into transactions based on the approved guidelines and every transaction need not be placed before the Audit Committee for determining whether the same is in the ordinary course of business or not. In case the company does not have an Audit Committee, the decision as to whether a transaction is in the ordinary course of business or not will be taken by the Board.

Office or Place of Profit

As per Explanation to Sub-Section (i) of Section 188 the expression "office or place of profit" means any office or place where such office or place is held by:

(i) a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(ii) an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise.

For example, in case of a transaction with respect to remuneration of a director, it will be considered to be on an arm's length basis if the director gets remuneration in accordance with the provisions of Section 197 read with Schedule V of the Act.

In *Firestone Tyre & Rubber Co. vs. Synthetics & Chemicals Ltd.,* the Hon'ble Bombay High Court held that 'the object underlying Section 314 of the 1956 Act (corresponding to Section 188 of the Companies Act, 2013) is to prevent a director or his relative from holding any office or place of profit carrying a total monthly remuneration beyond the prescribed limits under the company and thereby put in his pocket, directly or indirectly, additional profit over and above the remuneration to which he is entitled as such director, without obtaining the requisite permission.'

Illustrations:

a) Mr. A is the managing director in AB Ltd., which is engaged in manufacturing medicines. Mr. A is a qualified software expert. AB Ltd. after following a due process of tendering engages the services of Mr. A in his capacity of a software expert and for which an amount of Rs 50 lakh is proposed to be paid. The next lowest quotation for the proposal is Rs 2 crore.

Ans. This is a transaction with a related party. This transaction will fall under the proviso to Section 197(4) of the Act. If the terms and conditions are comparable with those offered by other parties, the transaction will not be treated as an office or place of profit as covered under Section 188. (Price offered by Mr. A is certainly far lower than the next lowest quote but the other terms also need to be examined). However, approval of the Audit Committee will be necessary. Approval of the Nomination & Remuneration Committee as provided under Section 197of the Act will also be required.

b) Mr. X was appointed as the managing director in MNP Ltd. on 1st January 2020. MNP Ltd. is engaged in manufacturing automobiles. Mr. X holds a few patents in his name since July 2010 and he is requested by MNP Ltd. for a licence of 5 years of one of the patents for which an amount of Rs 50 lakh is proposed to be paid.

Ans. Although this transaction is with a related party, this transaction will be protected under the proviso to Section 197(4) of the Act. Section 188(1) of the Act will be attracted if the transaction is not on an arm's length basis. This transaction is in the same line of business as that of the company and obtaining a license of the patent will be in its ordinary course of business. However, approval of the Audit Committee will be necessary. Approval of the Nomination & Remuneration Committee as provided under Section 197 of the Act will also be required.

Information to the Board for Related Party Transactions

Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that a company shall enter into any contract or arrangement with a related party subject to the following conditions, namely:-

(1) The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-

(a) the name of the related party and nature of relationship;

(b) the nature, duration of the contract and particulars of the contract or arrangement;

(c) the material terms of the contract or arrangement including the value, if any;

(d) any advance paid or received for the contract or arrangement, if any;

(e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;

(f) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and

(g) any other information relevant or important for the Board to take a decision on the proposed transaction.

(2) Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

Prior Approval of the Company by a Resolution

First Proviso to the Section 188 (1) of the Act provides that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as prescribed, shall be entered into except with the prior approval of the company by a resolution.

Rule 15 of the Companies (Meetings of board and its Powers) Rules, 2014 provides that except with the prior approval of the company by a resolution, a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into,-

(a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mentioned below-

Particular	***Threshold***
(i) Sale, purchase or supply of any goods or materials, directly or through appointment of agent	Transaction value ≥ 10% of annual turnover
(ii) Selling or otherwise disposing of, or buying, property of any kind, directly or through appointment of agent	Transaction value ≥ 10% of net worth
(iii) Leasing of property of any kind	Transaction value ≥ 10% of annual turnover
(iv) Availing or rendering of any services, directly or through appointment of agent	Transaction value ≥ 10% of annual turnover
(v) Appointment to any office or place of profit in the company, its subsidiary company or associate company	Monthly remuneration > Rs. 2.50 lakh
(vi) Remuneration for underwriting the subscription of any securities or derivatives thereof	Transaction value > 1% of net worth

The limits specified in sub-clause (i) to (iv) above shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

The turnover or net worth referred in the above sub-rules shall be computed on the basis of the audited financial statements of the preceding financial year.

Exceptions: The requirement of passing the resolution shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

In case of wholly owned subsidiary, if the resolution is passed by the holding company, it shall be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.

Information to be provided: The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the following particulars, namely:-

(a) name of the related party;

(b) name of the director or key managerial personnel who is related, if any;

(c) nature of relationship;

(d) nature, material terms, monetary value and particulars of the contract or arrangements;

(e) any other information relevant or important for the members to take a decision on the proposed resolution.

Issue: Will the requirement of passing a shareholder's resolution not be applicable for transactions entered into between a Holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed for approval before the shareholders at the general meeting of the Holding company?

View: Yes, the fifth proviso to Section 188(1) provides that the requirement of passing the resolution under the first proviso of section (1) of Section 188 shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

It is pertinent to observe that explanation (2) to Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that in case of a wholly owned subsidiary, the resolution that is passed by the holding company would be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.

This will mean that in case the fifth proviso to Section 188(1) is not available to a company as the accounts are not so consolidated, then as per explanation (2) to Rule 15 a resolution passed by the holding company will be sufficient.

Related Party not to Vote on Resolution

Second Proviso to Section 188 (1) of the Act provides that no member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.

This shall not apply to a company in which ninety per cent. or more members, in number, are relatives of promoters or are related parties.

The Ministry of Corporate Affairs, vide their Circular No. 30/2014 dated 17th July, 2014 has clarified that " the related party, if he is a member of the Company, shall not take part in the voting on Resolution – second proviso of Section 188 (1). It is clarified that 'related party 'referred to in the second proviso has to be construed with reference only to the contract or arrangement for which the said resolution is being passed.

Thus, the term 'related party' in the above context refers only to such related party as may be a related party in the context of the contract or arrangement for which the said resolution is being passed.

- **Exemption to Private Companies**: In case of private companies second proviso to Section 188(1) of the Act, shall not apply (*Notification No. GSR 464(E) dated 5th June, 2015*).
- **Exemption to Government Companies**: In case of Government companies First and Second Proviso to the section 188 (1) of the Act shall not apply to -

  (a) A Government company in respect of contracts or arrangements entered into by it with any other Government company or with Central Government or any State Government or any combination thereof;

  (b) A Government company, other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before entering into such contract or arrangement.

  [*Notification No. GSR 463(E) dated 5-6-2015) further amended by (Notification No: G.S.R. 151(E) dated 02nd March, 2020*].

- **Exemptions to Specified IFSC Public Company :** Second proviso to sub section (1) of section 188 shall not apply, In case of Specified IFSC Public Company.

By virtue of MCA Notifications dated, 13th June, 2017, the exemption from applicability of the Second Proviso to Section 188 (1) of the Companies Act is available only to those private and Government companies who have not committed a default in filing of their financial statements under Section 137 or Section 92 of the Companies Act, 2013.

Disclosure in Board's Report

Section 188(2) of the Act, provides that every related party contracts or arrangements shall have to be disclosed in the Board's report and referred to shareholders along with the justification for entering into such type of transactions in the prescribed form i.e., **Form no. AOC-2** [pursuant to Section 134(3)(h) and Section 188(2)].

Form AOC-2 shall be signed by the persons who have signed the Board's Report.

Consequences of entering into Related Party Contracts or Arrangements by the Director or the Employee without the consent of the Board or Approval by Resolution:

- Section 188(3) of the Act, provides that where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting under Section 188(1) and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board or, as the case may be, of the shareholders and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.
- Section 188(4) of the Act, states that it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.
- A person shall not be entitled to be appointed as a Director by virtue of Section 164(1)(g) of the Companies Act, 2013 upon such director being convicted of an offence dealing with related party transactions under Section 188 of the Act at any time during the last preceding five years.

Issue: *Will a transaction of payment of salary to an employee who is a relative of a Director, (where such payment is in the ordinary course of business and on arm's length) require disclosure as a related party transaction in the Board's Report?*

View: The same need not be disclosed as a related party transaction in Form AOC-2 in the Board's Report unless the same is material in the context of the company's business.

Issue: *Is it required that items falling in the ambit of the fourth proviso to Section 188(1) of the Act i.e. transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis, be mentioned in Form AOC-2?*

***View*:** Form AOC–2 uses the term 'material' and therefore if the transactions are material, the same will need disclosure. A transaction which is in the ordinary course of business and on arm's length basis but which is considered to be material will require disclosure in Form AOC–2. It is to be noted that approvals of the Board and the shareholders are not required if the transaction is in the ordinary course of business and on arm's length basis, but disclosure is required from the perspective of transparency.

Penalties for Non Compliance

Section 188(5) of the Act, prescribes penalty for any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section :

In case of listed company	Liable to penalty of Rs. 25 Lakhs
In case of any other company	Liable to penalty of Rs. 5 Lakhs

Cross Reference: For detailed discussion on Relate Party Transactions Provisions under SEBI(LODR)Regulations, 2015, please refer Lesson 10 of Capital Market & Securities Laws.

CASE STUDY

25/04/2022	***Securities and Exchange Board of India (Appellant) vs. R.T. Agro Private Limited & Ors. (Respondents)***	***Supreme Court***

Facts of the Case

The company R. T. Exports Limited proposed to enter into a transaction with one Neelkanth Realtors Private Limited for purchase of 40,000 sq. ft. of residential space. This proposal was treated as a related party transaction and was required to be approved by the shareholders of the Company. Accordingly, a special resolution was approved by R. T. Exports Limited on 15.07.2014. In terms of Section 188 of the Companies Act, 2013, the related parties abstained from voting on this special resolution. Thereafter, an Extra-Ordinary General Meeting was convened on 16.12.2016 for rescinding the resolution dated 15.07.2014 in which, the related parties also voted.

However, the appellant-SEBI took up the matter on a complaint and issued notice alleging violation of Regulation 23 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015. The Adjudicating Officer, ultimately, proceeded to penalise the present respondents with a cumulative sum of Rs. 35 lakhs for the alleged violation of the said Regulation 23.

Judgment

The Supreme Court observed that the Securities Appellate Tribunal has not approved this order passed by the Adjudicating Officer and has allowed the appeal filed by the present respondents while, inter alia, holding that the bar of voting as per Section 188 of the Companies Act, 2013 on related parties operated only at the time of entering into a contract or arrangement, i.e., when the resolution dated 15.07.2014 was passed; and therein the said related parties indeed abstained from voting. The Appellate Tribunal found no fault in the said parties voting in the recalling/rescinding of the said resolution.

It was held that the view, as taken by the Appellate Tribunal, in the given set of facts and circumstances of the present case, appears to be a plausible view of the matter. In fact, nothing of ill-intent on the part of the respondents has been established in the present case. The hyper-technical stance of the appellant could have only been, and has rightly been, disapproved on the given set of facts and circumstances. The appeal fails and is, therefore, dismissed.

LESSON ROUND-UP

- Every company shall have a Board of Directors consisting of individuals as directors and shall have—
  (a) a minimum number of three directors in the case of a public company,
  (b) two directors in the case of a private company, and
  (c) one director in the case of a One Person Company.
- Every company shall have at least one director who stays in India for a total period of not less than one hundred and eighty-two days during the financial year.
- No person, shall hold office as a director, including any alternate directorship, in more than twenty companies at the same time.
- For reckoning the limit of directorships of twenty companies, the directorship in a dormant company shall not be included.
- The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.
- The vigil mechanism shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.
- The Nomination and Remuneration Committee shall formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.
- No investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.
- Approvals for making investments and loans would have to be taken in accordance with the specific provisions of the Companies Act. A blanket approval of the shareholders for the purpose would not suffice.
- No member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party. This shall not apply to a company in which ninety per cent. or more members, in number, are relatives of promoters or are related parties.
- The Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed.

GLOSSARY

Ordinary course of business: 'Part of doing regular business; the regular or customary condition or course of things; as things usually happen'.

Arm Length Transaction: A transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

Director: A director appointed to the Board of a company.

Financial Institution: Includes a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934.

TEST YOURSELF

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).*

1. Raso Ltd. Is an unlisted public company having a paid-up capital of Rs. 50 Crore as on 31st March, 2022 and a turnover of Rs.200 Crore. The total number of directors are 15.

   (a) State the minimum number of independent directors that the company should appoint.

   (b) How many independent directors are to be appointed if Raso Ltd. is a listed company?

2. Lamco Engineers Ltd. has a paid-up capital of Rs.50 lakhs, Free Reserves of Rs.3 lakhs and Securities Premium of Rs.2 lakh. It has granted a loan of Rs.20 lakhs to Manza Traders Ltd. The Board of Directors is proposing the following transactions without securing approval of the members :

   (I) Sanctioning a loan of Rs.2 lakh to ASC Cement Ltd.; and

   (II) Sanctioning a loan of Rs.3 lakh to an employee of the company.

3. Mohit is a well-known banker and holds directorship in 22 companies as on 30th September, 2021. The companies include 10 public companies, 11 private companies (including XYZ Pvt. Ltd., a dormant company) and 1 company registered under section 8 of the Companies Act, 2013.

   Recently, on 20th December, 2021, ABC Ltd. in which Mohit is not a director acquired 100% shares in XYZ Pvt. Ltd. In this context, answer the following :

   (i) Whether the directorships held by Mohit as on 30th September, 2021 are valid ?

   (ii) Can Mohit continue to hold directorship in all 22 companies after acquisition made by ABC Ltd. ?

   (iii) Company Secretary of ABC Ltd. has proposed to restrict number of directorship of the directors in ABC Ltd. Whether the proposal given by the Company Secretary is tenable in light of the provisions of the Companies Act, 2013 ?

4. Sensa Ltd. intends to acquire shares in another company. How much amount can be invested by Sensa Ltd. without passing special resolution considering the facts mentioned below?

Particulars	***Amount (Crore)***
Paid-up Share Capital	Rs. 100
Free Reserves	Rs. 80
Securities Premium Account	Rs. 70
Investment in another company	Rs.50

5. If A Ltd. makes an investment in B Ltd. and further B Ltd. makes an investment in X, which is a Limited Liability Partnership. Whereas X, LLP holds shares of Y Ltd. Is there any violation of Section 186 of the Companies Act, 2013 ?

6. Dynamic Ltd. (paid-up share capital Rs. 25 Crore) proposes to enter into a contract with Sunil for the procurement of raw materials for an amount of Rs. 5 Crore during the financial year. Sunil is the step brother (father's second wife's son) of Anil, who is a director of Dynamic Ltd. Discuss the compliance requirements in respect of the above procurement contract.

7. The Board of Directors of ABC Ltd. has agreed in principle to grant loan of Rs. 6 crores to XYZ Ltd.: ABC Ltd. has provided the following information:

   Authorised Share Capital: Rs.15 crores Paid up Share Capital: Rs.10 crores

   Free Reserves: Rs.4 crores

   Securities Premium Account: Rs.1 crore

   ABC Ltd. has already given loan of Rs.3 crores to another company namely PQR Ltd. and has made investment of Rs.2 crores in the shares of other companies. What advice would you give to the Board of Directors of ABC Ltd. about the proposed loan to XYZ Ltd. in the light of provisions of the Companies Act, 2013 and the rules made thereunder?

8. Does the acceptance of deposits by a public limited company from its director attract compliance of any of the provisions of section 188?

9. Explaining the meaning of the term 'related party' in relation to a company under the provisions of the Companies Act, 2013, decide whether the following shall be treated as 'related party':

   - Kamal, a director of Deep Ltd. holds 170 shares in the company's paid-up share capital.
   - Fair Ltd. is an associate company of Mohan Ltd. Also explain whether a company can enter into a contract with a related party' for leasing of the company's property and also for sale of any goods produced by the company.

10. The AOA of XYZ Ltd. Provide that the maximum number of Directors in the Company shall be 10. Presently the maximum number of directors is 8. The Board of Directors of the said Company desires to increase the number to 16. Advise whether it can do so.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- The Companies Act, 2013
- Secretarial Standard-1
- Guidance Note on SS-1
- The SEBI(LODR) Regulations, 2015

OTHER REFERENCES (Including Websites/ Video Links)

- *http://ebook.mca.gov.in/Default.aspx?page=main*