THE COMPANIES BILL, 1997: PROVISIONS ON RAISING FINANCE

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The Working Draft of the Companies Bill, 1997 has been tabled in Parliament and been made public. This Article reviews the changes proposed in the Companies Bill regarding raising of capital. These aim at enabling companies to get access to domestic and international markets, and raise more funds in a shorter timeframe, besides making them aggressively competitive in world markets. Each sub-element covered in the report is discussed below.

SEBI AS SOLE AUTHORITY

The Bill has proposed (vide Clause 47) that the provisions relating to prospectus, allotment, listing and other matters relating to the issue of securities, shall be administered by SEBI in the case of listed public companies and companies proposing to be listed. In other cases, the Government shall be the administering authority. This is being done as there is an overlapping jurisdiction (Department of Company Affairs and SEBI) and conflicts in administration of law in the existing Companies Act. Against this bacl ground, Schedule II of the existing Act has been deleted and shifted to the Rules. The Bill (vide Clause 50) provides for the registration of the prospectus with SEBI (instead of the Registrar of Companies), while a copy will be forwarded to the Registrar of Companies ("RoC").

In the Companies Act, 1956, registration of prospectus is done by the RoC for all types of companies, and the role of SEBI is restricted to vetting of prospectuses to ensure that the guidelines issued by it are duly complied with. As a result of this proposed amendment, the role of the RoC has been reduced to record-keeping. Though the rationale behind this proposal may appear sound, it is not clear how the administration of certain provisions of the Act can be vested with an authority other than the Department of Company Affairs ('DCA'). The RoC must continue to be vested with the administration of the Companies Act, including provisions relating to prospectus (such as the registration of prospectus) and this should not be diluted and taken away on the grounds of liberalised policies. In fact, the role of the RoC in the liberalised environment is much more important than it was ever before.

Indeed, while vetting the prospectus, RoC approaches the issue from a totally different angle based on the history of the company, documents filed by the company with it, past record of the promoters/company, etc. Hence it is in a

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better position to examine the offer document with respect to the past record of the company, promoters background, legal compliance and offer its comments. Further, while the role of SEBI focuses on the issue of securities, the role of RoC does not stop with the issue alone, but extends till the company is wound up. The RoC has also got powers of investigation under various provisions of the Act and hence it is only proper that the administration lies with RoC. It is possible that the shifting of administration of the Act will complicate matters further when a company gets delisted for various reasons.

It is felt the SEBI's role must continue to be that of managing intermediaries of capital markets, laying down guidelines for the issue of securities and protecting investor interests. Recently, SEBI issued a guideline to exempt companies from vetting the offer documents which fulfil its guidelines and in the process to concentrate on those companies which come out with issues which are not in line with the guidelines. This is a clear case of control by exception. This aspect has not been considered by the Bill since SEBI itself wants to restrict its role relating to capital markets. In view of the volume of transactions spread over different parts of the country, a premier watchdog body such as SEBI cannot be expected to fulfil purely administrative functions. It would be wise to strengthen the already existing offices of the RoC and make themselves responsible for proper administration of listed companies also within the framework of SEBI guidelines. An overall view of the administration of companies must be taken into account before dividing the administration of the Act between SEBI and the Central Government. In any case, the minimum that requires to be attended is to suitably amend the Bill to provide for registration of prospectus by SEBI only after clearance from the RoC.

RAISING CAPITAL BY UNLISTED COMPANIES

The Working Group had earlier recommended that public unlisted companies accessing funds (debt, equity, hybrid or any other form of security) from their members or by private placement should come under the purview of the DCA insofar as regulation, policing and enforcement are concerned. As per Clause 73 of the Bill dealing with further issue of capital, the scheme of option given to employees, officers or working directors made by a public company shall be subject to the conditions specified by the Government or SEBI as may be applicable.

It appears that the recommendation of the Group has been specifically accepted only in respect of employee stock options. In other cases such as private placement, the Bill is silent and the Government is not specifically empowered to administer the provisions of the Act relating to the issue of securities by unlisted companies. In the liberalised context, it is essential to frame proper guidelines and stringent disclosure norms relating to fund-raising by even unlisted companies in order to protect the interests of investors and ensure transparent corporate governance. The Bill should be amended so as to specifically provide for such

things, and empower the Government to frame guidelines and regulate the issue of securities by unlisted public companies.

FREEDOM TO SELL, PURCHASE, TRANSFER AND ACQUIRE SHARES

The Bill has deleted Sections 108A to 108I of the Companies Act, 1956 under which prior permission of the Central Government is required for the acquisition and transfer of shares. This is being done in view of the repeal of the MRTP Act and the enactment of the Depositories Act, the new Takeover Code and changes in the Securities Contracts (Regulation) Act, 1956.

HYBRIDS, DERIVATIVES, OPTIONS AND SECURITIES WITH DIFFERENTIAL RIGHTS

The Working Group had earlier recommended the introduction of suitable provisions to enable companies to issue hybrids, derivatives, options and shares and quasi-equity instruments with differential rights. The Group had also recommended framing of suitable guidelines by the DCA (for private and unlisted companies) and SEBI (for listed companies) for issue of securities, with greater stress on disclosure of corporate information.

The reason behind this recommendation is to meet the complex requirement of financing needs. The recommendation is given effect in the Bill in the form of definition of "securities" which includes hybrids, derivatives, options as well as shares and quasi-equity instruments with differential rights. The administration of the Act relating to issue of such securities is vested with SEBI (for listed companies and companies seeking enlistment) and DCA (for other companies). While the recommendation is logical, it is not clear whether the market/investors would be really in a position to understand the implications and risks associated with such securities. It should be noted that the Group, while making this recommendation, had advised the DCA and SEBI to lay stress on disclosure requirements instead of analysing the risk potentials of such instruments which are rarely quantifiable. Under the circumstances, it is not fair to expect the market and the investors to take a sound investment decision.

BUY-BACK OF SHARES

The Bill has introduced provisions relating to buy-back of shares vide Clause 68. These include passing of a special resolution, filing a declaration of solvency and complying with certain norms such as a ban on issuing any new shares (including rights issues but excluding bonus issues) for 12 months, maintenance of a debt-equity ratio of less than 2:1 and such other restrictions relating to voting rights, dividend rights, bonus issues and rights issues eligibility. This buy-back can be for preventing a take-over or for treasury operations.

While this is a welcome move, it should be ensured through suitable guidelines that this provision is resorted to only to meet certain specific purposes and not misused by the corporate sector to get rid of some shareholders. Guidelines

should protect the interests of the minority shareholders as well as employee shareholders. A clear-cut guideline in this regard should be framed immediately after enactment of the Companies Bill.

FULL BUY-OUT

The Bill, vide Clause 272, provides that in the event of any person, group or body corporate acquiring 95 per cent of the shares of a public listed company (either through takeover or otherwise) and the company getting de-listed, the residual shareholders should sell their shares to the 95 per cent owner at a price determined in accordance with Government rules. This amendment seeks to legislate in India the key feature of shareholder democracy. This move takes care of the interests of the residual holder who may face the problem of selling at a lower price due to non-listing. This is similar to the provisions of Section 395 of the present Act and must be implemented with strict compliance norms. Proper certification by the company's auditors should be insisted upon for determining the share prices to be offered to the residual shareholders. It would also be worthwhile considering the extension of this proposal on a voluntary basis to investors whose holding exceeds the threshold limit of 80 per cent ownership, as, for all practical purposes, the minority shareholders have very little leverage.

INDIA DEPOSITORY RECEIPTS (IDR)

The Working Group had earlier recommended the issuing of Indian Depository Receipts (IDR) similar to Global Depository Receipts (GDR) or American Depository Receipts (ADR). This would imply that foreign companies could issue IDRs where the underlying security is the equity or any other security of a foreign company. Clause 43 of the Bill empowers the Government to prescribe rules for issue of IDRs. This provision could take care of the possibility of India getting economically integrated with South East Asia and the SAARC countries. It should, however, be ensured that the funds are used only for Indian operations and dubious diversion of funds abroad is avoided.

GLOBAL DEPOSITORY RECEIPTS AND AMERICAN DEPOSITORY RECEIPTS

The Group has recommended that issuers of GDRs and ADRs must file with the RoC the (i) prospectus or offering circular after such issue (ii) basic data on the issue such as price of the depository receipt and amount subscribed and (iii) material details after conversion to shares. This is to monitor the flow of foreign investment in India through the GDR and ADR route, which will have an impact of Indian capital market. In the Bill, no specific provision has been made for ADRs, but Clause 52 stipulates that the information memorandum containing the aforesaid particulars must be filed with the RoC after the closure of offer. This provision recognises the role of GDRs and ADRs in the capital market.

SHELF PROSPECTUS

The Bill, vide Clause 51, provides for the filing of the shelf prospectus, which will have a validity period of 365 days with suitable updates on material facts, litigations and changes in financial position between the previous offer and the next. This facility is extended to public sector financial institutions and banks and companies specialising in infrastructural finance. The Government is empowered to extend this facility to other corporate bodies.

This provision will enable financial institutions going to public more than once in a year, since it is not necessary to prepare a full-fledged prospectus every time. This is a good suggestion and the Government should provide for the compulsory updation of data once in a quarter, with severe punishment for failure to comply with guidelines.

BOOK-BUILDING

The Group had earlier recommended that the definition of "prospectus" should exclude the information memorandum issued at the time of book-building (prior to prospectus). It had also recommended the filing of such memorandum with the RoC on formal closure of book-building. Clause 52 of the Bill incorporates these recommendations.

Book-building is essentially a pre-issue exercise to get better idea of the demand and final offer price of an initial public offering (IPO). The provision needs to be implemented with judicious care and caution in the prevailing capital market environment.

EMPLOYEE STOCK OPTIONS

The Group has recommended that the employee stock options (warrants or other securities with pre-specified date of conversion) should be explicitly incorporated in the new Act. Accordingly, Clause 73 of the Bill provides for such issue of securities to employees, officers and working directors, provided the option together with the existing capital shall not amount to an increase of more than 5 per cent of the existing capital.

It is felt that there is no need to legislate regarding employee stock options. As part of human resources development, managements themselves would volunteer to offer employee stock options in line with the guidelines.

THE 'TREE' COMPANIES AND THEIR KIN

The Group has recommended that the "units" issued by plantation, forestry, horticulture, fisheries and similar companies be treated as "security" for the purposes of the provisions of prospectus under the Act. These are now outside the purview of SEBI, DCA or the RBI. The track record of the large number of companies in these sectors is not at all encouraging, and the gullible investor gets trapped without any worthwhile legal remedies in case of the failure of such companies to fulfil these promises.

It is necessary to prescribe suitable guideline to include these "units". The Bill, vide Clause 2(57), defines "securities" as those which include units or any other instrument which entitles the owner to be allotted any kind of property or payment of money in lieu thereof at a future date. Thus, these types of companies are now treated as "security" and covered under the Act. This is a welcome move and must be enforced in letter and spirit. The recommendations of the Working Group on raising of capital takes into account contemporary developments in the capital market and have been incorporated in the Bill. While this is laudable, it should be ensured that the liberalisation and simplification measures are backed by strict compliance norms and transparent disclosure requirements. Hence, SEBI and the Government must notify appropriate guidelines soon to protect the interests of investors and all concerned.