MCA releases draft rules on NCLT, schemes of compromises/arrangements and prevention of oppression and mismanagement, for public comments

The Ministry of Corporate Affairs (MCA) has released the draft rules pertaining to the National Company Law Tribunal (NCLT or Tribunal) provisions under the Companies Act, 2013 ('Act') seeking suggestions and comments along with justification from stakeholders by 17 February 2016.

NCLT is being set up under the Act and would replace the Company Law Board (CLB).

283 sections of the Act are operational most of which came into force from 1 April 2014. Provisions related to functioning of NCLT, NCLAT (National Company Law Appellate Tribunal) and certain other authorities are yet to be notified.

The process for constitution of NCLT/NCLAT is in progress in light of the Supreme Court order dated 14 May 2015, and these bodies are likely to be set up shortly.

The Ministry had set-up a committee on 17 July 2015 to examine the draft rules w.r.t procedures to be followed by NCLT/NCLAT. The said committee has since made recommendations on draft rules w.r.t. following matters:

I. Rules on compromises, arrangements, and amalgamations;

II. Rules on prevention of oppression and mismanagement; and

III. Rules on the procedure to be followed by NCLT and NCLAT.

I. Draft rules on compromises, arrangements and amalgamations

We have discussed below the notable difference or new concepts introduced, in the draft rules.

Meeting of the members and creditors

The draft rules require companies to hold meetings of the members and creditors. Thus far, several jurisdictional High Courts have been dispensing with the holding of the meeting of the members and the creditors for unlisted companies. NCLT may dispense with creditors meeting only if ninety per cent creditors consent. However, it appears that this discretion for dispensing the meeting is only for the creditors and not members. This would require clarification from the MCA.

Notice for meeting of the members and creditors

The notice for the meeting is required to be sent at least thirty days before the date fixed for the meeting as against twenty-one clear days' notice under the extant Company Court Rules.
Corporate Debt Restructuring (CDR)

The Companies Act, 1956 (‘old Act’) did not contain any specific provision regarding a High Court approval for a CDR scheme. However, the Act provides an explicit window to apply to the Tribunal with the consent of more than seventy-five per cent of the secured creditors.

The applicant is required to disclose in an affidavit to the NCLT among other matters: (a) auditors report conforming the liquidity test post CDR; (b) Creditors responsibility statement; (c) safeguards for protection of the creditors; and (d) valuation report by a registered valuer in respect of the shares and all the assets of the company.

Buyout of minority shareholding

Shareholders who have, inter-alia, acquired majority stake (holding, at least, ninety of equity share capital) through amalgamation, share exchange, conversion, etc. shall notify the company of their intention to buy-out the minority shareholders. This can provide greater flexibility to the acquirer in realigning the control and management of the company and reduce interference from minority shareholders. The provisions virtually recognise minority squeeze out as a legal option. This has been undertaken by corporate organisations through various corporate restructuring means in the past.

The purchase price is to be ascertained on the basis of the valuation done by a registered valuer. However, the provisions in relation to a registered valuer have not been notified yet.

There is not much clarity if this is a mandatory mechanism for the majority shareholders. Further, the Act also provides an option to the minority shareholders to offer their shares to the majority shareholders.

For a listed company, the price for minority buyout will be the price determined in a manner as specified under SEBI’s regulations, but this needs to be carried out by a registered valuer.

Auditor certificate

The draft rules read with the provisions of the Act also mandates company, whether listed or unlisted, to submit to NCLT, an auditor’s certificate to the effect that the accounting treatment specified in the scheme is in conformity with the prescribed accounting standards. Currently, the provision for filing of an auditor certificate is only mandatory for listed companies under SEBI guidelines. This is expected to reduce the accounting flexibility in case of unlisted companies. Any arrangement may also include reduction of capital and hence the requirement of an auditor’s certificate shall also be extended to capital reduction process.

Form of notice and disclosures

The draft rules prescribe the form of notice along with an exhaustive list of disclosures to be given for meeting of creditors/members including, inter alia, the rationale and benefits to stakeholders of the compromise or arrangement, share exchange ratio, summary of valuation report and fairness opinion of the registered valuer, if any, details of debt/capital restructuring, amounts due to unsecured creditors, nature and extent of interest in the compromise and arrangement of key managerial personnel, directors, promoters, employees, creditors, depositors, etc. and details about any pending investigation or proceedings against the company.

Voting at the meeting is allowed either in person or through a proxy or through postal ballot.
For an unlisted company, the offer price shall be determined by a registered valuer after taking into account various factors i.e. the highest price paid for an acquisition during the last twelve months and fair price of shares after considering various valuation parameters including return on net worth, book value of shares, earning per share, price earning multiple vis-à-vis the industry average, and such other parameters as are customary for valuation of shares of such companies.

Majority shareholders and not the company to acquire the shares of minority shareholders.

Cross-border mergers/amalgamations

The Act provides for mergers or amalgamations between Indian companies and foreign companies, whether having its place of business in India or not, with prior approval of the Reserve Bank of India. The same shall be effective upon sanction of the scheme by the Tribunal and the relevant adjudicating and regulatory authorities of the notified countries.

The merger or amalgamation of a company into a foreign company, or vice versa, shall comply in all respects with the Foreign Exchange Management Act, 1999 (FEMA) and any other applicable laws (including the applicable law in the relevant jurisdiction). Amendment to relevant regulations under FEMA would be inevitable in order to make these provisions workable.

Fast track mergers/amalgamations

The Act has also introduced the concept of short form mergers which, at the option of the companies involved and without approval of the NCLT, can be used for:

- The merger of two or more small companies, or
- The merger between holding company and its wholly owned subsidiary company, or
- Such other classes of companies as may be prescribed

The transferor and transferee companies would need to issue a notice to ROC/OL inviting their objections/suggestions. ROC/OL shall communicate their objections within thirty days from the date of the notice.

The scheme would require the approval of at least ninety per cent in value of the members and by a majority representing nine-tenths in the value of creditors. Each of the companies would need to file a declaration of solvency with the ROC. On receipt of no objection or comments from the ROC and OL to the scheme, the CG shall issue a confirmation order.

II. Rules on prevention of oppression and mismanagement

Sections 241 - 244 of the Act provide a mechanism to the members to take action if the affairs of the company are carried out in a manner prejudicial to the interests of the members or the company or the public at large. However, the provisions are yet to be notified.

In case of a company having share capital, an application can be made by either:

- A Hundred members or
- One-tenth of the total number of members, whichever is less or;
- Members holding not less than one-tenth of the total issued capital

In case a company does not have a share capital, the application can be made by a minimum of one-fifth of the total number of members. The Tribunal has been given the power to do away with the requirement of a minimum number of members required to apply. Additional powers have been provided to the Tribunal under the Act to pass orders w.r.t. matters prescribed under Section 242.

Class action

The Act has introduced the concept of class action to be instituted against the company as well as the auditors, consultants, advisors of the company by a minimum number of members or depositors.

The draft rules provide that an application can be made by the members or depositors to restrain the company and its directors from committing an ultra vires act, to declare an alteration to the memorandum or articles void, to claim damages from auditors, expert advisors for any misleading statement made or for fraudulent and unlawful conduct, or for any other remedy the Tribunal deems fit.
In case of a company having share capital, an application can be made by either:

- A hundred members or depositors or
- One-tenth of the total number of members or depositors, whichever is less or;
- Members holding not less than one-tenth of the total issued capital or depositors holding not less than one-tenth of the total outstanding deposits.

In case a company does not have a share capital, the application can be made by a minimum of one-fifth of the total number of members.

III. Rules on procedure to be followed by NCLT and NCLAT

These rules shall be called the National Company Law Tribunal Rules, 2015 (‘NCLT Rules’) and shall come into force from the date of their publication in the Official Gazette. Amongst others, these rules provide for the following notable provisions:

**Constitution**

CG shall by notification, constitute the following:

- NCLT, consisting of President and judicial and technical members;
- NCLAT, consisting of Chairperson and judicial and technical members, not exceeding eleven;

Qualification, selection, terms of appointment of members are provided in Chapter XXVII of the Act

**Territorial jurisdiction of the Tribunal and its benches**

Principal bench shall be at New Delhi and other benches as may be specified by the CG by a notation.

**Service of notices and processes issued by the Tribunal**

Any notice or process to be issued by the Tribunal may be served in an electronic form to the valid e-mail address as provided in the petition or application or in the reply.

The notice if to be served in a physical form can be by way of hand delivery or by registered post or speed post with acknowledgment due or service by the party itself.

**Assessors or valuers**

In any enquiry into a claim, the Tribunal may appoint assessors or valuers possessing any technical or special knowledge with respect to any matter before the Tribunal.

**Empanelment of special authorised representatives by the Tribunal**

The Tribunal may for assistance draw up a panel of legal practitioners or company secretaries in practice or chartered accountants in practice or cost accountants in practice or valuer or such other experts.

**E-filing of applications, petitions or such other documents as provided under these Rules:**

**Purpose**

These rules govern the electronic filing and service of petitions, applications or other documents.

**Effect on existing acts and rules**

These rules shall be in addition to the provisions of the Act and Information Technology Act, 2000. Further, any conflict or contrast with any rules framed under other provisions of the Companies Act, 2013 or other Acts or rules as prescribed for electronic filing, these rules shall prevail.

**Electronic filing wholly compulsory and mandatory unless ordered by Tribunal**

The electronic filing and serving of Tribunal documents shall be mandatory except as provided otherwise, with effect from the date to be notified by the CG in the official gazette. Till such time, the filing of applications or petitions will continue to be done manually.
Dedicated portal online

“Dedicated Portal Online” is a portal through which all the parties or central or state government agencies and local government bodies may electronically send and receive documents to or from the Tribunal and make required payments.

Filars to file a document with the Registry by electronically transmitting the document to the portal using a digital signature, which then electronically transmits the document to the Registry. A filer filing or serving a document must have a valid account with the portal.

Procedure relating to issuance of orders and disposal of cases:

Amicus Curiae

The Tribunal may seek views of professionals/professional bodies to provide their views on any points or legal issues.

Transitional provisions:

Matters earlier dealt by the CLB

If an original civil action or case arising out of the Companies Act or Reserve Bank of India Act, 1934 is filed or pending before the CLB on the date on which the Tribunal is constituted, then all the cases on such date pending with the CLB or such benches shall stand transferred to the respective benches of the Tribunal.

The Tribunal shall consider any action taken under the said rules be deemed to have been taken or done under the corresponding provision of these rules and provisions of the Act except where the order is reserved by the CLB or its bench. In such a scenario, the Tribunal shall re-open and rehear the case as if the hearing had not taken place.

Further, a fresh application/petition may also be filed if both the parties consent unanimously with the approval of the Tribunal and withdrawing the proceedings before the CLB.

Matters earlier dealt by the District Court or High Court

All proceedings under the Companies Act, 1956 including proceedings in relation to arbitration, compromise, arrangements and reconstruction and winding up of companies, pending before any District Court or High Court, immediately before such date as may be notified by the CG, shall stand transferred to the Tribunal from such date and from the stage before their transfer.

The NCLT Rules lack clarity in dealing with any non-conformity of the portion of the process completed under the old Act and Company Court Rules, with the provisions of the Act and NCLT Rules.

Matter earlier dealt by Board for Industrial and Financial Reconstruction (BIFR)

Any appeal preferred to the Appellate Authority for Industrial and Financial Reconstruction or any reference made or inquiry pending before the BIFR or any proceeding of whatever nature pending before the Appellate Authority for Industrial and Financial Reconstruction or the BIFR immediately before the commencement of this Act, shall stand abated. Such a company may make a reference to the Tribunal within 180 days from the commencement of this Act in accordance with the provisions of this Act at no further fees.

Petition or Application under Section 45QA(2) of the RBI Act, 1934

Provisions of these rules shall apply to an application or petition made to CLB under Section 45QA(2) of the RBI Act, 1934 or any other provisions. Similarly, these rules shall extend to the petitions or applications filed under various provisions of the existing acts before the CLB.

Detailed rules, forms and procedures have been prescribed in relation to certain specific matters including but not limited to the following:

- Petition to follow a different accounting year for consolidation of accounts
- Petition for the conversion of a public company into a private company
• Application to cancel variation of rights of shares

• Petition for issuance of redeemable preference shares in lieu of amount due in respect of unredeemed preference shares including dividend

• Appeal against the refusal for registration of transfer or transmission of securities or for rectification of Register of members

• Application for consolidation and division of all or any share capital resulting in change in the voting percentage of shareholders’

• Application or petition for reduction of share capital

• Application where a company fails to redeem the debentures or repay the deposits or any part thereof or any interest thereon

• Application for calling or obtaining a direction to call an annual general meeting.

• Application for obtaining approval for preparing revised financial statement or revised report in respect of any of the three preceding financial years

**Our comments**

The much awaited draft rules on NCLT have been released by MCA for stakeholders’ comments and suggestions. The draft rules signify MCA's continuing effort and steps towards notifying all the provisions of the Companies Act, 2013 and phasing out the provisions of the Companies Act, 1956 and rules thereunder.

Corporate India would welcome the need for the electronic filing of applications, service of petitions and other documents with the Tribunal and is a step towards digitalization of the processes.

The requirement for an auditor’s certificate for schemes of compromises, arrangements or amalgamations for all listed and unlisted companies again signifies an effort to make the provisions consistent with the listing regulations issued by SEBI.

The new rules stress on extensive disclosures and reporting requirements for companies undergoing schemes of compromise, arrangement or amalgamation. Also, the need for holding of creditors meeting is likely to further lengthen the process and timelines for a scheme approval.

The transition phase is a pivotal point, and it would be intriguing to see in practice how effectively MCA carries out the transition from CLB to NCLT.
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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