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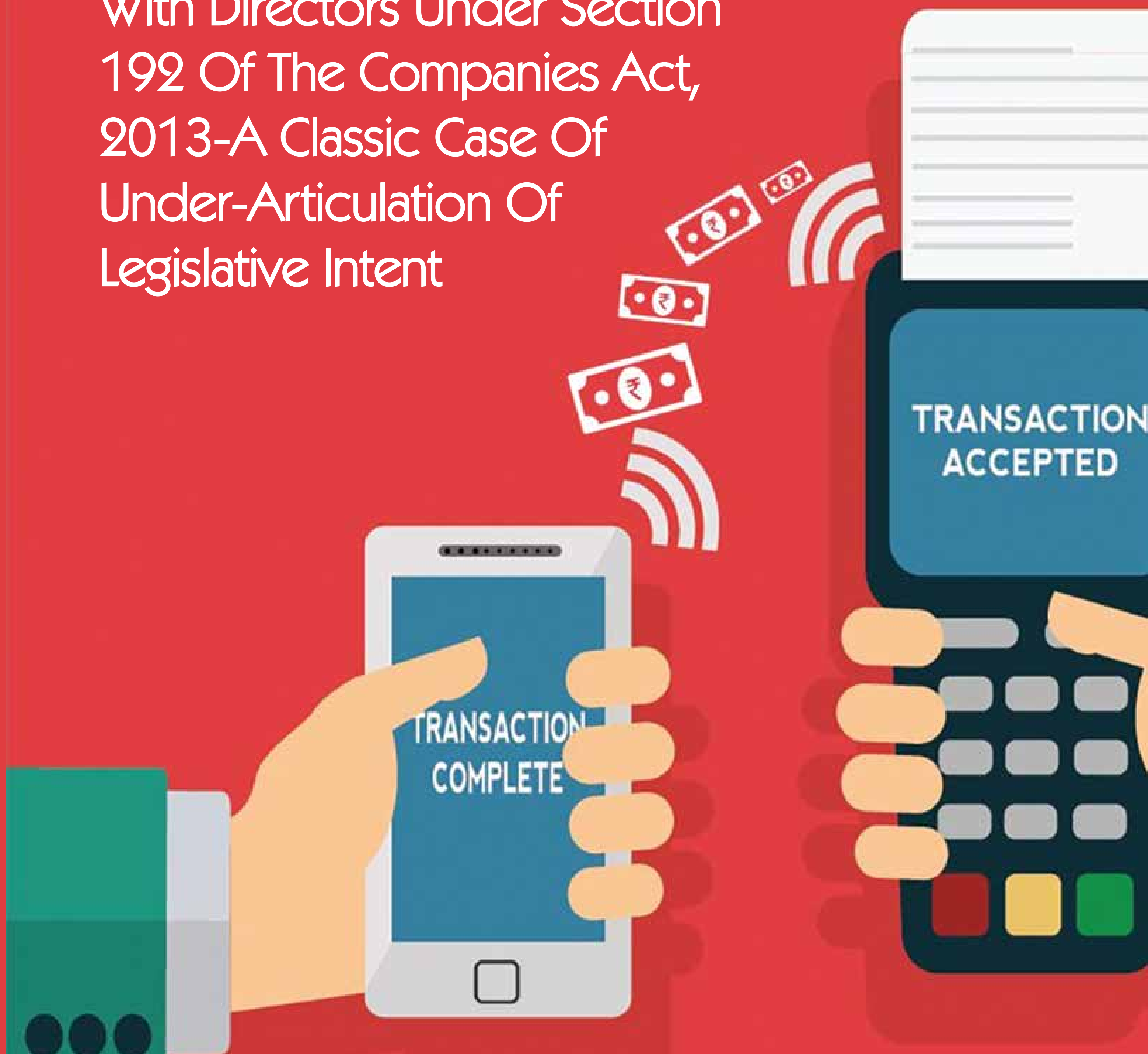
Non-Cash Transactions

With Directors Under Section 192 Of The Companies Act, 2013-A Classic Case Of Under-Articulation Of Legislative Intent



Section 192 of the Act sets out the legal framework for non-cash transactions between a director and a company. It would be advisable that the MCA constitutes an expert committee to comprehensively relook at all drafting inadequacies in the Act

Background

Although the Companies Act, 2013 ("**Act**") underwent an extensive pre-legislative consultation process before the Irani Committee, as well as two Parliamentary Standing Committees, the '***legislative intent***' behind the introduction of many 'new' provisions by the 2013 Act (that were not present in 1956 Act), and the omission of important provisions from the 1956 Act has been grossly under-articulated.

Besides being incoherent, the "***Notes on Clauses***" of various 'new' provisions of the Act are very sketchy (and at times misleading).

The "***Notes on Clauses***" has always served as a key source to ascertain the "intention of the lawmaker". Unlike the practice followed in the past, the "Notes on Clauses" of the Act only provides a cursory reproduction of the wording of the provision, instead of a detailed enunciation of the scope and the legislative intent.

It appears that the team in the MCA (Ministry of Corporate Affairs) and the Law Ministry which had drafted the Bill and those who worked on the "Notes on Clauses" were different, and did not speak to each other, resulting in such inadequate legislative guidance behind the introduction of several new provisions, and omission of a few vital provisions of the 1956 Act.

The reports of the two Parliamentary Standing Committees, which had examined the draft Companies' Bills of 2009 and 2011 are also very sketchy, and do not make us any wiser on those vital new introductions and omissions. The parliamentary debates of 2013, both in the Lok Sabha and the Rajya Sabha, focused mainly on the new CSR provision, as if there was no other provision of the Bill, which was worth discussing. The Bill got passed in the Rajya Sabha at around 11 pm on 8 August, 2013, when very few MPs were present in the House.

One such 'new' provision of the Act, where the legislative intent has been grossly under-articulated is Section 192, which provides for a "***restriction on non-cash transactions involving directors***". It is a glaring example of a badly drafted Section of one of the most badly drafted Act, which

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corporate India is required to deal with on a day-to-day basis to conduct its legitimate business activity.

Scheme of Section 192

Section 192 of the Act sets out the legal framework for ***non-cash transactions*** between a director and a company. Section 192(1) inter alia provides that a director of the company, or its holding, subsidiary or associate company [or a person connected with him] cannot acquire **assets** for ***consideration other than cash*** from the company, unless prior approval of the shareholders of the company is obtained for such arrangement. If the director or connected person is a director of the holding company, approval of the shareholders of the holding company should also be obtained.

The word "***assets***" in Section 192(1) would have to be broadly interpreted to include both 'movable' and 'immovable' assets.

Section 192(2) provides that the notice for approval of the resolution by the company, or holding company, in the general meeting shall include the particulars of the arrangement, **along with the value of the assets involved in such an arrangement - calculated by a registered valuer**, in accordance with Section 247 of the Act, read with the Valuation Rules.[1]

Section 192(3) provides that any arrangement entered into by a company or its holding company, in contravention of Section 192, shall be voidable at the instance of the company unless:

a) the restitution of any money or other consideration which is the subject-matter of the arrangement is no longer possible, and the company has been indemnified by any other person for any loss/damage caused; or

b) any rights are acquired *bona fide* for value and without notice of the contravention of Section 192 by any other person.

The fact that Section 192 is a new provision is captured in the ***Notes on Clauses***, which states that Section 192 provides for "regulation of arrangements between a company and its directors in respect of acquisition of assets for consideration other than cash".

However, as mentioned above, the "Notes on Clauses" do not throw further light on the objective behind the introduction of this provision.

Interestingly, the Companies Bill, 2011 made a significant change to Section 192, when compared to the original draft in the Companies Bill, 2009. The Companies Bill, 2009 only covered an arrangement involving a non-cash transaction between the company and – (**i**) a director of the company; or (**ii**) director of the holding company; or (**iii**) any person connected with such director.

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[1] The Companies (Registered Valuers and Valuation) Rules, 2017.

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The Companies Bill, 2011 included directors of **subsidiary** and **associate** companies within the ambit of Section 192, which significantly widens the scope of the restriction.

Comparison with English Law

Under the English Companies Act 2006, a company cannot enter into an arrangement under which a director of the company [or holding company] acquires from the company a "***substantial non-cash asset***" – unless the arrangement has been approved by a resolution of the members.[2]

An asset is a "***substantial non-cash asset***" if its value(**a**) exceeds 10% of the company's asset value and is more than £5,000, or(**b**) exceeds £100,000".[3]

Unlike the English Act, our Act has not incorporated a "***materiality threshold***" based on the value of the asset to be acquired by a director. This may have implications for companies that manufacture consumer goods - where goods manufactured by the company may be allotted to a director either free of charge or at a discounted price for the services rendered towards the company – which is a "***non-cash consideration***".

In the absence of a materiality threshold, every asset acquired by a director [irrespective of its value] may get covered under Section 192.

Will acquisition of assets for an "inadequate cash consideration" be covered under Section 192?

One important issue that arises is whether acquisition of an asset by a director for an "***inadequate cash consideration***" would be covered under Section 192. Section 192 of the Act does not expressly address whether the requirement of obtaining prior shareholder approval will also apply when a director acquires an asset at a price that is less than the fair value of the asset – i.e. for an ***inadequate cash consideration***.

This assumes relevance as there may be situations where a company sells an asset to a director at a price that is significantly lower than the fair value of the asset. For instance, corporate history is replete with examples where a residential apartment is sold to a director at a price that is significantly lower than its fair market value. Such heavily discounted price may be offered on account of the director's contribution to the company, and the services rendered by him.

While the context and legislative intent behind the enactment of Section 192 has not been documented, it may be inferred that this provision was enacted to regulate transactions where assets are sold to a director at a 'throwaway price'.

[2] Section 190(1) of the English Companies Act, 2006.

[3] Section 191 of the English Companies Act, 2006.

If contract/arrangements where assets are sold to a director for an ***inadequate cash consideration*** are excluded from Section 192, then this would effectively make this provision redundant - as even a token cash consideration [say ₹100] would be sufficient to carve out a transaction from the regulatory ambit of Section 192.

Keeping in mind the legislative context behind the enactment of Section 192, and the "*mischief that was sought to be remedied*", Courts are likely to adopt an interpretation that would further the object of the provision, and would not be inclined to take a view that would make Section 192 totally redundant on the statute book.

A view may hence be taken that regulating transactions where the cash consideration is ***inadequate*** is implied within the scheme of Section 192, and is an essential ingredient of this provision.

It is also pertinent to note that Section 166 of the Act has, for the first time, codified the fiduciary duties of directors - in accordance with the well-recognized common law principles. The Section 192 restriction should also be evaluated in the context of Section 166, which provides that the director's interest should not conflict with the company's interest[4], and a director should not achieve (or attempt to achieve) any "*undue gain or advantage*".[5]

Further, as Section 192(2) of the Act requires that the value of the asset should be calculated by a registered valuer, Section 192 should also be read in conjunction with Section 247, and if an asset is proposed to be sold to a director at a price that is less than the fair market value, the contract/arrangement should require prior shareholder approval.

"It is also pertinent to note that Section 166 of the Act has, for the first time, codified the fiduciary duties of directors

RPT Implications

A director is a "related party" with reference to the company, as per Section 2(76) of the Act.

The acquisition of assets by a director for a ***non-cash consideration*** would be a related party transaction covered under Section 188(1)(b) of the Act, which deals with "*selling, or otherwise disposing of, or buying,* ***property*** *of any kind*". In addition to obtaining shareholder approval under Section 192, such a transaction should comply with Section 188, and would also require Audit Committee approval under Section 177(4).

Along with Section 188, listed companies should also comply with the RPT provisions of the SEBI (LODR) Regulations, 2015 ("**LODR**"). As per Regulation 2(1)(zc) of the LODR, a "*related party transaction*" means "*a transfer of resources, services or obligations between a listed entity and a related party,* ***regardless of whether a price is charged.***" A contract/arrangement for 'transfer' of an asset to a director for a ***non-cash consideration*** would accordingly be covered under the definition of "related party transaction".

In accordance with Regulation 23(2), the contract/arrangement would require prior Audit Committee approval. Prior shareholder approval will be required, if the materiality threshold is breached, and no related party of the company can vote to approve the proposed shareholder resolution.[6]

Concluding Thoughts

Section 192 is one of the many provisions which gives effect to the duties of directors enshrined under Section 166 of the Act – by ensuring that shareholder approval is obtained before an asset is sold to a director for a consideration that is less than the fair value of the asset.

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4 Section 166(4) of the Companies Act, 2013.

5 Section 166(5) of the Companies Act, 2013.

6 Regulation 23(4) of the SEBI (LODR) Regulations, 2015.

Despite its important objective, and its implications from a corporate governance perspective, Section 192 seems to be one provision that has been long forgotten by both India Inc and the regulators. The curious case of Section 192 also highlights the significance of one of the recommendations made by the Sodhi Committee [2013][7], which had suggested that every regulator should incorporate specific "***legislative notes***" for each provision, to set out the legislative intent for which the provision has been formulated.

While the requirements of Section 192 are even more stringent than the requirements under English law - the absence of clarity regarding its legislative intent, coupled with the ambiguous drafting, has resulted in a situation where there is a lack of clarity about the implications of Section 192.

Given the potential ramifications of Section 192, and its close correlation with the RPT regulatory regime, the MCA would be well-advised to provide greater clarity on the scope of Section 192, and must also settle the debate relating to whether 'inadequacy of cash consideration' is implicit within the scheme of Section 192.

The Act is like the Constitution of India for the corporate sector. It would be advisable that the MCA constitutes an expert committee to comprehensively relook at all such drafting inadequacies in the Act. It would improve India's international ranking in the ease of doing business index.

[7] Report of the High-Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, 1992, under the Chairmanship of Justice (Retd) N.K. Sodhi, December 7, 2013.

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