INSOL International

Role of Corporate Boards - Insolvency and Corporate Governance Landscape in India

April 2012

Technical Series Issue No. 23

Role of Corporate Boards - Insolvency and Corporate Governance Landscape in India

Contents

INSOL International
6-7 Queen Street, London, EC4N 1SP
Tel: +44 (0) 20 7248 3333 Fax: +44 (0) 20 7248 3384

Acknowledgement

INSOL is pleased to present the 23rd Technical Paper titled “Role of Corporate Boards - Insolvency and Corporate Governance Landscape in India” under its Technical Paper series. The paper was written by Mr Tejas Karia, Partner; Mr. Deepesh Aneja, Senior Associate; Mr. Nitesh Jain, Senior Associate; and Ms. Aradhana Lakhtakia, Associate, all of Amarchand & Mangaldas & Suresh A. Shroff & Co. Advocates and Solicitors in India.

This paper provides an overview of the best corporate governance practices; duties of interested parties such as shareholders, management, and the board of directors and looks at the adverse effects experienced by Indian companies that fail to implement good corporate governance practices.

The paper also examines the legislation that governs corporate insolvency and discusses the relevant provisions as amended by the Indian Companies Act and compares these with the relevant provisions under the listing agreement of the New York Stock Exchange, Nasdaq and Sarbanes Oxley Act 2002, and the UK Financial Services Bill to the extent it is applicable.

In the final part of the paper, there are proposals for best practices and suggestions for Indian companies to adopt, in view of the limitations of the courts in insolvency related cases.

INSOL International thanks the authors for writing this paper that provides a very useful overview of the position in India that our members may not have been aware of.

April 2012

Role of Corporate Boards - Insolvency and Corporate Governance Landscape in India

By
Tejas Karia, Partner; Mr. Deepesh Aneja, Senior Associate; Mr. Nitesh Jain, Senior Associate; and Ms. Aradhana Lakhtakia, Associate
Amarchand & Mangaldas & Suresh A. Shroff & Co. Advocates and Solicitors*

Introduction

Insolvency in India is divided into corporate and individual insolvency. Corporate insolvency is governed by the Sick Industrial Companies Act, 1985 ("SICA"), and individual insolvency is governed by Presidency Towns Insolvency Act 1909 applicable to presidency towns, and The Provincial Insolvency Act, 1920 applicable to rest of the country.

Corporate insolvency, bankruptcy and dissolution of companies are intertwined concepts under Indian law. In the absence of any comprehensive and unilateral policy on insolvency, there is an interplay with allied Acts dealing with dissolution, bankruptcy and securitization such as the Companies Act, 1956 ("Companies Act"), Recovery of Debts Due to Banks and Financial Institutions Act, 1993 ("RDDBFI Act") and under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("SARFAESI Act"). The fundamental basis of determining if a company is insolvent in India is on the basis of its net worth as opposed to in other jurisdictions, where it is based on debt defaults.

For the purpose of this paper, the evolution of the role of corporate governance norms and regulations as they presently stand in the realm of stock exchange listing agreement, the Companies Act and proposed Companies Bill, 2011 has been dealt with. The paper also evaluates insolvency in India, United States and the United Kingdom.

Since roles of corporate boards would depend upon facts and circumstances of each case, their role cannot be determined by a standard formula. The suggestions in the conclusion are drawn on the basis of their practical applicability.

Insolvency

The SICA works on the concept of "industrial sickness" and serves a dual purpose *viz.* timely detection of sick or potentially sick companies or industrial undertakings[1], and determination and enforcement of remedial measures in respect of such industries.[2]

A "sick industrial company" is an industrial company[3] with accumulated losses equal to or exceeding its net worth at the end of any financial year. Such a company should have been registered for at least five (5) years. The authority responsible for determining "sickness" of an industrial company or whether the same has to be rehabilitated, as the case may be, is ascertained by the Board for Industrial and Financial Reconstruction ("BIFR").[4]

Reference Before the BIFR

In the following circumstances, the Board of Directors ("Board") of an industrial company can make a reference to the BIFR:[5]

1. Within sixty days (60) from the date of finalization of the duly audited accounts of the company for the financial year as at the end of which the company became a sick industrial company; or

2. If the Board has sufficient reasons even before the finalization of accounts to form the opinion that the company has become a sick industrial company, in such a case, within sixty days (60) after the Board has formed such opinion.

* The views expressed in this article are the views of the authors and not of INSOL International, London.

In addition to the above, a reference can also be made to the BIFR by the Central Government or the Reserve Bank of India or a state government or a public financial institution or a state level institution or a scheduled bank, if it has sufficient reasons to believe that any industrial company has become a sick industrial company.[6]

Inquiry into Reference

Upon receipt of reference, the BIFR would commence an inquiry to determine whether an industrial company has become a sick industrial company.[7] After arriving at a determination that the company is a sick industrial company, the BIFR would decide after taking all facts and circumstances into consideration whether it is practicable for the industrial company to make its net worth exceed the accumulated losses within a reasonable time[8]. Upon forming such an opinion, the BIFR would pass an order giving the industrial company such time and subject to such restrictions as it deems fit to make its net worth positive[9].

In case the BIFR decides that it is not practicable for an industrial company to make its net worth exceed the accumulated losses within a reasonable time, then an Operating Agency ("OA") would be appointed to formulate a scheme in relation to a sick industrial company.[10] An OA can be any public financial institution, state level institution, scheduled bank, any other person employed by the BIFR either for inquiry, or preparation of a scheme.[11]

Preparation of a Scheme

Ordinarily, an OA is required to prepare such a scheme within a period of ninety days providing for measures such as financial reconstruction, proper management, amalgamation, rationalization of personnel, preventive, ameliorative and remedial measures, transfer of assets and liabilities, change in board, memorandum and articles of association, continuation of legal proceedings, sale of the industrial undertaking of the sick industrial company, other incidental, consequential and supplemental matters as may be necessary to secure that the reconstruction or amalgamation or other measures mentioned in the scheme are fully and effectively carried out[12]. The moratorium on legal proceedings does not extinguish the recovery but only postpones such recovery.[13]

Moratorium on Legal Proceedings

To ensure effective implementation of a scheme for revival of a sick industrial company, once an inquiry is pending or a rehabilitation scheme is under preparation or an appeal before the Appellate Authority for Industrial and Financial Reconstruction ("AAIFR") is preferred, an automatic moratorium on legal proceedings against the industrial company comes into force. Legal proceedings such as winding - up (dissolution), execution of decrees, appointment of a court receiver, money suits and enforcement of security or guarantees in respect of any loans or advances granted to the company may be initiated only with the prior consent of the BIFR.[14]

Winding Up

Where the BIFR comes to the conclusion that it is not possible to revive an industrial company and it is just and equitable that the company should be wound up, it may record and forward that opinion to the concerned High Court (High Courts are divided state wise in India). The High Court shall, on the basis of the opinion of the BIFR, order winding - up of the sick industrial company in accordance with the provisions of the Companies Act.[15]

As per the provisions of the Companies Act, for winding up of a company, a petition for winding up is required to be presented before the Court. Upon hearing and admitting the petition, the Court may appoint a provisional liquidator. Thereafter, the Court would issue a winding up order which is required to be duly advertised and filed with the Registrar of Companies.

Upon a winding up order being made, the official liquidator takes into custody all the property, effects, books and papers of the company and carries out the process of winding up. The official liquidator is also required to submit a preliminary report within six months from the date of winding up order, regarding

particulars of capital, cash and negotiable securities, liabilities, properties, unpaid calls and an opinion on whether further enquiry is required.[16]

For the purpose of winding up of a sick industrial company, the High Court may appoint any officer of the operating agency as the liquidator of the sick industrial company who would be deemed to be the official liquidator under the Companies Act.[17]

The dissolution of a company is complete only after compliance with all the statutory formalities provided under the Companies Act. It may be noted that the Court merely plays a supervisory role in these proceedings and it is the liquidator who is primarily in charge of hearing and prioritizing claims of creditors, and subsequently disbursing the company's assets.

Insolvency and Securitization Under SARFAESI Act, 2002

With the rising cases of Non Performing Assets ('NPA's) in the economy, there was an increasing concern amongst banking companies facing impediments recovering debts from companies registered before the BIFR. It was against this background that provisions of the SICA have been amended after the introduction of the SARFAESI Act to include:

(a) Where the financial assets of the company have been acquired by any securitization company or reconstruction company, no reference can be made to the BIFR and

(b) Where 75 per cent of the secured creditors (in value) of the sick industrial company or three-fourth in value of the amount outstanding against financial assistance disbursed to the borrower have taken measures to recover their secured debt under the SARFAESI Act, then the proceedings before the BIFR abate.[18]

The SARFAESI Act was passed in the year 2002 to eradicate shortcomings of previous legislation dealing with the recovery of debts and to bring the financial institutions at par with the rest of the world. It stresses on the recovery rather than ascertainment of dues and allows banks and financial institutions to take possession of assets when borrowers fail to repay their loans within 60 days of demanding repayment. Under the SARFAESI Act security interest created in favor of any secured creditor may be enforced, without the intervention of a court or a tribunal, by such creditor in accordance with the provision of this Act.[19] Therefore, now creditors are entitled to recover debts without getting involved in protracted litigation before courts and tribunals while speedily enforcing security interests.

The SARFAESI Act provides three alternative methods for recovery of NPA's. These include taking possession, selling, and leasing the assets underlying the security interests such as movable property (tangible or intangible, including accounts receivable) and immovable property without the intervention of the courts.[20] A NPA is an asset or account of a borrower, which has been classified by a bank or financial institution as sub - standard, doubtful or loss asset.[21]

The SARFAESI Act deals with three further aspects:

1. *Enforcement of security interest by secured creditors viz. banks / financial institutions* - [22] A secured creditor has the right to enforce the security interest without intervention of the court when the borrower who is under the liability to a secured creditor under the security agreement either makes any default in repayment of secured debt or any installment of the secured debt and his debt has been classified as a NPA and a sixty days notice has been given to him to discharge his liability in full.[23]

2. *Transfer of NPA's to Asset Reconstruction Company* - The second concept contemplated under the preamble of the SARFAESI Act is reconstruction of financial assets, defined under the Act as "reconstruction", which means acquisition by any securitization company or reconstruction company of any rights or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance[24].

3. *Providing a legal framework for securitization of assets* - Securitization is a mechanism for acquisition of financial assets by any securitization company or reconstruction company from any originator, whether by raising of funds by such securitization company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise.[25]

The SARFAESI Act is concerned only with enforcement of security interests, whereas it is the RDDBFI Act which extends to ascertainment, adjudication and enforcement of any claim by a banking company.

Insolvency and Debt Recovery Under RDDBFI Act, 1993

The RDDBFI Act, 1993, has been enacted to secure and protect public revenue and for expeditious adjudication and recovery of debts due to banks and financial institutions. The SICA has been enacted for timely detection of sick or potentially sick companies owning industrial undertakings, the speedy determination by a board of experts of the preventive, ameliorative, remedial measures required in respect of such companies and for their effective enforcement. Both are special Acts operating in their own realms. The RDDBFI is a subsequent Act, and it is presumed that the parliament is completely aware of prior Acts while introducing the RDDBFI Act, 1993 gave precedence to it over the SICA.[26] However, the provisions and ruling under the RRDBFI Act are in addition to and not in derogation of the SICA.

The RDDBFI Act was considered because there was an urgent need to work out a suitable mechanism to realize dues to banks and financial institutions without any delay.[27]

The Debt Recovery Tribunals ("DRT") were constituted to receive claim applications from the Banks and Financial Institutions against their defaulting borrowers[28], for debts due more than Rs. 10,00,000/- (Rupees Ten Lakh).[29]

The DRT is empowered to make interim orders debarring the borrower company from alienating or dealing with any property and assets.[30] The DRT also has the power to direct the company to furnish security, order the attachment of the property, appoint a receiver of any property and remove any person from the possession or custody of the property and issue certificates of recovery ("Recovery Certificate") in respect of the debts.[31]

On the basis of the Recovery Certificate, proceedings are initiated by the Recovery Officer appointed to facilitate the recovery of money under the Recovery Certificate[32]. The amount due to the banks and the financial institutions is seen as public money where the interest of the public is involved. In *Kundan Rice case*, it was a held *"… where there is conflict between the interest of the private individuals and the public at large, a differentials treatment is acceptable and the summary procedure of adjudication instead of the elaborate trial as which is in the Civil Procedure Code before the Tribunal is permissible …"*[33]

Rising Cases of Insolvency Before the BIFR

While the SICA was enacted in the public interest, *inter alia,* to enable a sick company to be revived[34], there has been a trend of companies filing references to the BIFR with the intent of avoiding creditors and thereby forestalling recovery proceedings by the financial institutions and allowing the companies to siphon off its assets.[35]

Further, due to protracted proceedings, the moratorium on legal proceedings continues in respect of the company which has been reported sick.[36] This results in an increase in the quantum of NPA's at an alarming rate.[37] The implementation by the BIFR of the various steps and measures under the scheme sanctioned, in a sequential rather than the concurrent manner is an additional contributory factor leading to long and avoidable delays in the disposal of cases and proceedings.[38]

Insolvency proceedings in India can vary from three to four years and can extend to 10 years in certain cases. The BIFR takes substantial time to determine whether a company is sick and thereafter to formulate a revival strategy. In situations where the BIFR decides to wind up the sick company, the procedure before the High Court can take a substantial time.

Under the SICA, a company normally approaches the BIFR upon erosion of its entire net worth[39], thereby the very effort to seek revival of a sick industrial undertaking commences at a belated stage. This is coupled with the lack of adequate infrastructure and machinery for effective monitoring of revival schemes sanctioned by the BIFR.

Insolvency - India and United States

In contrast to insolvency law being divided into the SICA and other allied Acts, the US has one comprehensive Code, the US Bankruptcy Code[40] (US Code), Chapter 11 which governs reorganization as well as liquidation.

Bankruptcy in the United States is a matter placed under the Federal jurisdiction by the United States Constitution (in Article 1, Section 8, Clause 4), which allows Congress to enact "uniform laws on the subject of bankruptcies throughout the United States." The Congress has enacted statute law governing bankruptcy, primarily in the form of the Bankruptcy Code, stated at Title 11 of the United States Code.[41]

Debtors usually file under Chapter 11 of the US Code when the potential future earnings of the company are worth more than the individual assets of the company. This allows the business to reorganize, implement a payment plan for debts and continue to operate. Business assets may not be affected by Chapter 11 bankruptcy, unless it is required that they be sold in the reorganization plan. Since the business is likely to be still operating, the assets that are needed to operate will be untouched. However, if there is a large amount of cash in hand, then this may be required under the reorganization plan to repay some creditors. The main benefit of filing Chapter 11 bankruptcy is that the business is normally allowed to operate under the debtor's ownership. The purpose of Chapter 11 is the reorganization of the company to repay the debts owed and allow the company to eventually become profitable again.[42]

In India, in order to continue operations when the reorganization is pending with the BIFR, the prior approval of the BIFR will have to be sought by the company and the business can be carried out only according to the directions of the BIFR. Regarding the sale of assets during the interim period pending reorganization, the company can seek special approval of the BIFR for sale of the assets which may be granted at the discretion of the BIFR. The BIFR has the power to restrict the sale of the assets if it is of the view that the sale would not be in the publics interest.[43]

Apart from the Bankruptcy laws, the United States also has the Bankruptcy Abuse Prevention and Consumer Protection Act (Pub. L. No. 109-8, 119 Stat. 23) (April 20, 2005)[6] which states that, persons who have the ability to pay will be required to pay back at least a portion of their debts. Those who fall behind their state's median income will not be required to pay back their debts.

A strong need is being felt in India to put in a comprehensive Code relating to corporate insolvency. The efficient functioning of rehabilitation and liquidation processes in relation to corporates in India is largely hindered by the lack of:

(a) a comprehensive bankruptcy Code that meets international standards;

(b) an effective trigger for the rehabilitation of sick companies;

(c) time frames for restructuring and liquidation proceedings;

(d) adequate infrastructure for effective handling of insolvent companies; and

(e) lack of insolvency experts.[44]

While the Indian government is making attempts to revamp the corporate bankruptcy laws and procedures in India, a stronger need is being felt for the active participation of corporations in adopting "best practices" to avoid insolvency related situations in India. A holistic solution to the problems of the insolvency regime in India is only possible by adoption of corporate governance practices by companies in India.

Role of Corporate Boards

Tracing Evolution of Corporate Governance in India

The initial drive for better corporate governance came after the onset of international competition consequent to the liberalization of the economy.[45] The reforms started almost with the creation of the Securities and Exchange Board of India (SEBI) in 1992.

Subsequently, in the year 1997 and 1999 key regulations such as SEBI Takeover Code 1997 and the SEBI Disclosure & Investor Protection Guidelines 1999, dealing primarily with acquisition of control. The mid -1990s saw the first reforms in corporate governance, the watershed event is generally perceived to be SEBI's promulgation of Clause 49 of the stock exchange listing agreement in 2000.[46]

The thrust in corporate governance came with Clause 49 in 1998, when the Confederation of Indian Industries (CII) proposed a Voluntary Code of corporate governance for Indian firms followed by the SEBI forming the Kumar Mangalam Birla Committee (KMBC), whose draft set of recommendations came out on 1 October 1999 and became effective five months later as Clause 49 of the listing agreement.

Firms failing to meet the requirements of Clause 49 could be delisted.[47] The CII voluntary code in many respects appears to be designed to attract foreign investors to Indian firms. Following Clause 49, Naresh Chandra Committee (2002), Y.H. Malegam Committee (2003) and Narayana Murthy Committee (2003) were constituted to look into prevailing corporate governance practices.

In late 2002, the SEBI constituted the Narayana Murthy Committee to assess the adequacy of current corporate governance practices and to suggest improvements. Based on the recommendations of this committee, the SEBI issued a modified Clause 49 on 29th October 2004 (the 'revised Clause 49') which came into operation on 1st January 2006. The major recommendations impacting the landscape of corporate governance in India are discussed below:

Naresh Chandra Committee Report (2002)

The Enron debacle in July 2002, involving the hand - in - glove relationship between the auditor and the corporate client and the consequent enactment of the Sarbanes Oxley Act, 2002 ("SOX Act, 2002") in the United States was an important factor leading to the appointment of the Naresh Chandra Committee.

In its report, the committee evaluated and commented on poor structure and composition of the board of directors of Indian companies, scant fiduciary responsibility, poor disclosures and transparency, inadequate accounting and auditing standards, need for experts to go through the minutest details of transactions among companies, banks and financial institutions, capital markets, etc. On the auditor - company relationship, the committee recommended that the proprietary of auditors rendering non - audit services is a complex area which needs to be carefully dealt with. The recommendations of this committee were mostly in line with the Rules framed by the Securities & Exchange Commission ("SEC") in accordance with the provisions of the SOX Act, 2002.[48]

2004 Amendment to SCRA, 1956

During 2004 the Indian Government amended the Securities Contracts (Regulation) Act, 1956 to enact Section 23 E to impose larger financial penalties for violations of the listing agreement, up to Rs. 25 Crore (US$ 6,250,000 approximately) for a violation.[49] This was a significant increase in penalties from the initial penalty of de - listing for violations of Clause 49.

Narayana Murthy Committee (2003)

In the year 2002 the SEBI analyzed the statistics of compliance with Clause 49 by listed companies and felt that there was a need to look beyond the mere systems and procedures. The mandatory recommendations of the Committee relate to; (a) the role and functions of the Audit committee; (b) the risk management and minimization procedures; (c) the uses and the application of funds received from the initial public offers; (d) code of conduct for the board, (e) nominee directors and independent directors.[50]

J.J. Irani Committee Recommendations

In 2005, J.J. Irani Committee proposed certain amendments to the Companies Act. These suggestions marked a shift towards greater customization and self-regulation (e.g., requiring shareholder approvals for executive compensation). Moreover, there would be greater protections for smaller shareholders, especially in merger transactions.

Finally, the process of enforcement is to be streamlined, the bankruptcy system upgraded, and the actual legal provisions rationalized and simplified. The changes will apply to all firms in India (not just those listed on the exchanges as with Clause 49). These changes are not inconsistent per - se with Clause 49 given that Clause 49 only applies to a subset of firms (listed firms).

In December 2009, the Ministry of Corporate Affairs (MCA) published a new set of "Corporate Governance Voluntary Guidelines 2009", designed to encourage companies to adopt better practices in the running of boards and board committees, the appointment and rotation of external auditors, and creating a whistle blowing mechanism.[51]

Regulatory Landscape in India

Clause 49 - Listing Agreement

Clause 49 includes detailed guidance for listed companies in India under 7 heads *viz.* board of directors, audit committee, subsidiary companies, disclosures, CEO / CFO certification, report of corporate governance and compliance. In respect of the above topics, Clause 49 provides as stated below:

(a) *Board of Directors*

(i) At least a third of boards should comprise independent directors in cases where the board chair is an independent director.

(ii) At least 50 percent of the board should comprise independent directors where the board chair is an executive director.

(iii) At least a third of the board should comprise of independent directors where the board chair is a non - executive director.

(iv) Tightening the definition of *"independence directors"* in Clause 49(I)(A) to include - a non executive director of the company who:

a. does not have a material pecuniary relationship with the company, its promoters, senior management, holding company, subsidiary or associated companies;

b. is not related to promoters or management at the board level or one level below the board;

c. has not been a executive of the company in the preceding three financial years;

d. is not a partner or executive of the internal / external auditors of the company and has not been such for the last three financial years;

e. is not a supplier, service provider or customer of the company; and

f. is not a substantial shareholder of the company (i.e. more than 2%).

(v) Mandating the number of board meetings per year to at least four times a year with a maximum time gap of four months between any two meetings.

(vi) Developing an internal code of conduct for all board members and senior management of the company. The same shall be posted on the website of the company.

(vii) Imposing limits on the number of directorships a director could simultaneously hold.

It has been the practice of most of the companies in India to fill the board with representatives of the promoters of the company as independent directors. This has undergone a change and now the boards comprise of the following groups of directors: Promoters' directors, executive directors, non - executive directors, a portion of which are independent.

(b) *Audit committee*

Enhancing the power of the audit committee by requiring financial literacy, experience and independence of its members, and by expanding the scope of activities on which the audit committee had oversight.

(c) *Disclosures by the company*

Enhanced disclosure obligations on many things including accounting treatment and related party transactions.

(d) *CEO / CFO certification of financial results*

Certifications by the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) of financials and overall responsibility for internal controls.

(e) *Corporate Governance*: Reporting on corporate governance as part of the annual report.

(f) *Subsidiary Companies*: Governance and disclosures regarding subsidiary companies.

(g) Certification of compliance of a company with the provisions of Clause 49.

Companies Act, 1956

The Companies incorporated in India are required to comply with provisions of the Companies Act, 1956 (as amended). The Act prescribes certain corporate governance requirements, which include the following:

(a) *Disclosure of interest by director*: Directors of a company are required to disclose the nature of interest (direct or indirect) in relation to any contract or arrangement, entered into or proposed to be entered into, by or on behalf of the company.[52]

(b) *Interested director not to participate or vote in board meetings:* No director of a company is permitted to take part in discussions of, or vote on, any contract or arrangement entered into or to be entered into by or on behalf of the company, if he / she is in any manner interested (directly or indirectly) in the contract or arrangement. Further, his presence will not be counted for the purpose of forming a quorum at the time of any such discussion or vote. [53]

(c) *Compliance with accounting standards:* Every company is required to prepare its balance sheet and profit and loss account as per accounting standards prescribed by Chartered Accountant institute of India.[54]

(d) *Providing shareholders sufficient notice for passing of resolutions and reasons for the same:* Notice of at least 21 days is required to be provided for calling a general meeting of the company. Further, an explanatory statement is required to be annexed to the notice setting out material facts regarding items of business to be transacted.[55]

(e) *Accounts:* A board is required to (i) prepare financial statements as per applicable accounting standards along with explanations for any material departures (ii) financial statements to be subjected to independent verification and examination (iii) accounting standards to be selected and uniformly applied to give consistent view of the accounts.[56]

Companies Bill, 2011

The Companies Bill, 2011 ("Bill")[57] seeks to replace the half - a - century - old Companies Act and to encourage responsible corporate behavior by mandating stricter corporate governance norms.

Management and appointment of directors -The Bill gives the necessary powers of management and supervision to directors.[58] Further, the Bill prescribes for a minimum requirement of appointing at least one director for a company while it is mandatory to appoint two directors in case of a public company, CSL and cell company.[59] In this regard, the number of directors may be fixed as per the articles of the company.[60]

Duties of directors - With respect to duties of directors, the Bill mandates directors to act in good faith, with 'due diligence and skill' that a reasonably prudent person would exercise in the same circumstances and introducing 'standard of care' as a measure for a director's decision making in respect of the company and its constituents.[61] In this regard, while taking decisions, a director has to take into account the nature of the company and its activities, nature of the decisions and conduct and position of the director and nature of responsibilities undertaken by the director.

Directors report - Further, directors have been mandated to prepare a directors' report for each financial year of the company stating and discussing the principal activities during the year. While doing so, directors have been mandated to disclose their interest in the company during the course of the financial year to ensure transparency.[62] Further, the directors' report has to disclose a statement in respect of all directors at the time stating that all necessary information has been disclosed to the auditor and the director has taken all steps to ensure acquiring the requisite information.[63] Any false statement or recklessness on the part of a director would attract a summary conviction and fine of Rs 250,000/- (Rupees Two Lakh Fifty Thousand).[64]

Reliance on records - When exercising powers or performing duties, directors have been entitled to rely on reports, registers, records, books and financial statements prepared by employees, professional advisers and expert advice.[65] Clearly, this is in consonance with larger and wider responsibility placed on directors[66].

Disclosures by directors - Directors of a company having interest in a transaction entered into or to be entered into by the company which to a 'material' extent conflicts or may[67] conflict with interest of the company has to be disclosed upon the director becoming aware of such fact[68]. The sole exception to this compliance is when the transaction is carried out in the ordinary course of business. Even though a failure to disclose does not affect the validity of the transaction[69], such failure would attract a summary conviction and a fine of Rs 100,000/- (Rupees One Hundred Thousand). The Bill empowers the company to declare any interested transaction as void.

Committee of directors - Directors have been permitted to designate one or more committees of directors consisting of one or more directors. Further, these committees have been mandated to appoint sub-committees and delegating powers exercisable by the committee. The power to appoint a committee however has been subject to certain exceptions i.e. duties which cannot be delegated to a committee which includes the power of making a declaration in respect of insolvency.

Auditors - The Bill provides that every company other than a small company has to appoint auditors for each financial year of the company. The company has to appoint auditors at an annual general meeting, which auditor shall hold office till the next annual general meeting.[70] In this respect, the Bill provides for the qualification for appointment of auditor *viz.* individuals, partnerships, body corporate and excludes an officer or employee of the company to act as an auditor. Any failure on the part of the auditor to notify its disqualification can be made liable for a summary conviction and to a fine not exceeding Rs 200,000/- (Rupees Two Hundred Thousand).

US Experience

The corporate governance philosophy in the United States is best summarized in one simple quote by U.S. Supreme Court Justice Louis Brandeis i.e. "sunlight is the best disinfectant" while referring to the

benefits of openness and transparency. Across the Atlantic in the United States corporate governance systems were introduced much earlier with promulgation of securities laws in 1930 and 1934 respectively.

Subsequently, Foreign Corrupt Practices Act, 1977 made specific provisions regarding establishment, maintenance and review of system of internal control. In 1979, US Securities Exchange Commission prescribed mandatory reporting on internal financial controls. After the Enron debacle of 2001, came other scandals such as WorldCom, Qwest, Global Crossing and the auditing lacunae that eventually led to the collapse of Andersen. These developments triggered another phase of reforms in the area of corporate governance, accounting practices and disclosures, which were more comprehensive than ever before.

The Sarbanes - Oxley Act, 2002 (SOX)

SOX Act, 2002, was signed into law by President Bush on 30 July 2002 with a view to eliminate accounting fraud and management wrongdoings and to restore confidence in the U.S. financial markets. This law is the most sweeping package of corporate governance legislation since federal securities laws were enacted in the 1930s.[71]

It measures everything from board composition to regulation of auditors. It emphasizes on the audit function and financial disclosures while strengthening the power, importance and independence of the audit committee. It provides for the constitution of Public Company Accounting Oversight Board to oversee the audit of public companies that are subject to securities laws, establish audit report standards and rules, and inspect, investigate and enforce compliance by auditors. It emphasizes on audit independence and prohibits an auditor from performing specified non-audit services along with the audit. It also requires pre-approval by the audit committee for those non-audit services that are not expressly forbidden. It confers responsibility upon the audit committee for the appointment, compensation and oversight of any audit firm employed to perform audit services. It requires an audit committee member to be a member of the board and to be independent. Audit firms will be appointed by and will report directly to the audit committee and subjected to rotation of partner and firm. The most relevant sections are 302 and 404 that govern rules of disclosure and financial reporting respectively.

1. Section 302: Mandates that a CEO and CFO shall personally certify corporate financial statements and filings. They shall also affirm that they are responsible for establishing and enforcing disclosure controls and procedures at all levels of their corporations. In addition they must disclose to the audit committee all significant deficiencies, material weaknesses and acts of fraud.

2. Section 404: Requires an annual evaluation of internal controls and procedures for financial reporting. Every corporation must document its existing controls that have a bearing on financial reporting, test them for efficacy and report on gaps and deficiencies. Further, the company's independent auditors must issue an annual report that attests to management's assertion regarding these controls.

NYSE and NASDAQ Listing Rules

After the SOX Act, both the New York Stock Exchange ("NYSE") and the NASDAQ National Market ("NASDAQ") also promptly revised their respective corporate governance rules.[72]

The company must have an Audit, Compensation and Nominating / Corporate Governance Committee. Each committee must have a written charter addressing the required matters. These charters must be posted on the company's website. Each committee must conduct an annual performance evaluation. The disclosure requirements mandate that the Charters must be available on the company's website. The Company's Form 10-K must state that the charters are available on its website and in print to any shareholder who requests them.[73]

NASDAQ Rules also mandate the establishment of such committees and it further lays down that committees must be comprised solely of independent directors, provided that one non independent member may serve on each of such committees under exceptional and limited circumstances for up to two years, so long as he or she is not a current officer, employee or family member of an officer or

employee and, in the case of the audit committee, meets the independence criteria set forth in Section 10A(m)(3) of the Exchange Act.[74]

Dodd - Frank Wall Street Reform and Consumer Protection Act, 2010

Dodd - Frank Wall Street Reform and Consumer Protection Act ("Dodd - Frank") was signed into law by President Obama on July 21, 2010. Dodd - Frank is primarily focused on the regulation of banks and the financial services industry, but some of its provisions apply more generally to US listed companies. These provisions have introduced profound change to the corporate governance of US listed companies generally and the regulation of executive compensation in particular.[75]

Advisory shareholder votes - One of the most significant changes brought about by Dodd - Frank is the obligation of listed companies to provide shareholders with a non - binding "Say - on - Pay" vote on the overall compensation of the most senior executive officers at least once every three years. A further significant change is that Dodd - Frank now requires any 'golden parachute' payment triggered in connection with an acquisition, merger or sale to be subject similarly to a non - binding shareholder vote.[76]

Claw back policies - A further very significant change introduced by Dodd - Frank is that the US securities exchanges are required to implement rules whereby incentive-based compensation made to executive officers of listed companies can be recouped by the company in the event of a required accounting restatement that results from material non-compliance with financial reporting requirements under the securities laws. As an expansion of SOX, the Dodd - Frank provisions are expected to apply to current and former executive officers receiving incentive-based compensation during the three - year period preceding the date on which the company is required to prepare the restatement as compared to the one - year period in SOX. In addition, the Dodd - Frank claw backs apply irrespective of whether this non - compliance occurred as a result of misconduct.[77]

Proxy access - Under Dodd - Frank, the SEC has enacted rules allowing shareholders to propose their own nominee director(s) in a listed company's proxy statement for an annual or special meeting at which directors will be elected. Generally, under those rules, a shareholder or group of shareholders is eligible to submit its nominee(s) for inclusion in the company's proxy materials if they satisfy certain thresholds like holding at least three per cent of the total voting power of the company's securities that are entitled to be voted on the election of directors at the meeting.

UK Experience

It was certain high profile failures of Companies in England in 1980's that led to the establishment of the Cadbury Committee under the chairmanship of Sir Adrian Cadbury in May 1991. In 1992, the Cadbury Report was published and is referred to as the "Code of Best Practices". The Code consisted of 19 recommendations, several of which were mandatory. Subsequently, in 1998, a committee on Corporate Governance was constituted under the chairmanship of Sir Ronald Hampel, which while reinstated recommendations of the Cadbury Committee made stricter norms for non-executive directors on boards.

The Financial Reporting Council (FRC) is UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. It promotes high standards of corporate governance through the UK Corporate Governance Code. Amongst other roles, the FRC sets standards for corporate reporting, actuarial practice and enforces accounting and auditing standards while overseeing regulatory activities of the professional accountancy bodies and operating independent disciplinary arrangements for public interest cases involving accountants and actuaries.[78]

FRC's functions are exercised principally by its operating bodies i.e. the Accounting Standards Board, the Auditing Practices Board, the Board for Actuarial Standards, the Professional Oversight Board, the Financial Reporting Review Panel and the Accountancy Investigation and Discipline Board. The Committee on Corporate Governance, whose members are drawn from the Board, assists it in its work on corporate governance.

The roles of its principal decision - making groups are as follows:

The Board

(a) Determines strategy and priorities.

(b) Sets budget, secures the necessary funding and monitors expenditure.

(c) Makes appointments to the Board, the operating bodies and senior management.

(d) Oversees the delivery by each operating body of its functions through regular reports from the operating body chairs.

(e) Oversees the performance of the Executive through regular reports from the CEO.

(f) Approves any significant structural changes to the FRC.

(g) Monitors the Combined Code on Corporate Governance and approves any changes to the Code and related guidance

(h) Ensures that the FRC and its operating bodies achieve high levels of accountability and transparency.

(i) Undertakes an annual assessment of the risks to its success and oversees the necessary risk mitigation plan.

(j) Undertakes annual evaluation of its own performance, and that of its committees, against its objectives, including a review of the schedule of matters reserved to the Board.

The Chair and Deputy Chair are appointed by the Secretary of State for Business, Enterprise and Regulatory Reform. The CEO is a member of the Board and has responsibility for the Executive, which provides support to the operating bodies.

The Operating Bodies

(a) Make the regulatory decisions for which they are responsible in a way which has regard to the Regulatory Strategy and Plan & Budget.

(b) Keep under review any emerging risks or other matters which could affect those aspects of confidence in corporate reporting and governance which fall within their remits.

(c) Make appointments to working groups and committees, in consultation, where appropriate, with the Chair of the FRC.

(d) Undertake annual evaluations of their own performance and that of their sub - committees[79].

UK Financial Services Act, 2010

This Act received Royal Assent on 8 April 2010. It contains a broad range of measures affecting the way in which the Treasury, the Bank of England and the FSA work together. It alters the statutory framework of the UK by amending the Financial Services and Markets Act 2000 (FSMA). The Act alters powers and duties by giving:

(a) A new regulatory objective to contribute to UK financial stability;

(b) A duty to establish a new consumer financial education body (public awareness objective is expected to be removed subsequently);

(c) An extension of the powers to write general rules and to alter firms' regulatory permissions so that they can be used to meet each of the regulatory objectives;

(d) Enhanced powers to control short selling;

(e) A power to make consumer redress scheme rules (which is to be commenced at a date not yet known);

(f) A number of new disciplinary powers (the Act also affects the use of existing Enforcement powers);

(g) A new power to gather information that is relevant to financial stability;

(h) A duty to make rules in relation to remuneration; and

(i) A duty to make rules in relation to Recovery and Resolution Plans.[80]

Conclusion

Corporate governance regulations do not by themselves provide for any specific or express guidance on functioning of the company or its board during insolvency. However, as the company approaches the stage of insolvency, it is for the board to re - evaluate its goals and perspective to ensure fairness and transparency in its functioning and decision making. The board has to ensure setting the 'right tone at the top'. In such a situation, a board can have two alternatives i.e. (i) either to seek restructuring of the company in the interest of its members, shareholders and other constituents; or (ii) to seek the best possible value for the creditors in case the insolvency process has to be taken to its logical conclusion.

The first objective of the board therefore, would be to set a final goal for the company as well as for constituents of the company i.e. whether to revive or to dissolve the company. While setting the goals, the board should bear the following factors in mind prior to any decision making:

(a) Balancing the interests of various constituents of the company with interests of creditors.

(b) Ensure decision making is supported by adequate due diligence and adopt the standard of care and fair play.

(c) Change their roles with shifting of responsibility from members to the creditors.

(d) Take informed decisions before the BIFR or High Court (Winding - up).

(e) Rely upon expert financial advice and information from external consultants to forge their way forward.

(f) Ensure that the BIFR or High Court responsible for insolvency or dissolution process has been provided accurate information obtained from experts in order to take informed decision.

(g) Work with Operating Agency, BIFR or Winding - up Court to obtain best possible value in case of dissolution.

The directors, audit committee or boards responsibility for decisions taken during the pre - insolvency period should be effective corporate behavior while fostering reasonable risk taking. At any cost, the minimum standards to be adopted by boards, audit committee's or directors should address conduct based on knowledge of or reckless disregard for adverse consequences.

[1] Section 3(f) of SICA, 1985 defines 'industrial undertaking' as any undertaking pertaining to a scheduled industry carried on in one or more factories by any company but does not include (i) an ancillary industrial undertaking as defined in clause (aa) of Section 3 of Industrial (Development and Regulation) Act, 1951 and ;(ii) a small scale industrial undertaking as defined in clause (j) of section 3.

[2] Preamble, SICA, 1985
[3] Section 3(e) defines 'industrial company' as a company which owns one or more industrial undertakings
[4] Section 4, SICA, 1985
[5] Section 15(1), SICA, 1985
[6] Section 15(2), SICA,1985
[7] Section 16, SICA, 1985
[8] Section 17(1), SICA, 1985
[9] Section 17(2), SICA, 1985
[10] Section 17(3) and Section 18, SICA, 1985
[11] Section 3(1)(i), SICA, 1985
[12] Section 18, SICA, 1985
[13] Shri Chamundi Moped v Church of South India Trust: (1991)75Company Cases 440 (SC)
[14] Section 22, SICA, 1985
[15] Section 19, SICA, 1985
[16] Section 455, Companies Act
[17] Section 20(3), SICA, 1985
[18] Section 15(1), SICA, 1985
[19] Section 13, SARFAESI Act, 2002
[20] Section 13(4), SARFAESI Act, 2002
[21] Section 2(1)(o), SARFAESI Act, 2002
[22] Section 13, SARFAESI Act, 2002
[23] Section 13(2), SARFAESI Act, 2002
[24] Section 2(1)(b), SARFAESI Act, 2002
[25] Section 2(1)(z), SARFAESI Act, 2002
[26] RG Chaturvedy: law and practice of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests: 3rd Edition 13-19.34.8
[27] Statement of Objects, RDDBFI Act, 1993
[28] Section 19, RDDBFI Act, 1993
[29] Section 1(4), RDDBFI Act, 1993
[30] Section 19 (12), RDDBFI Act, 1993
[31] Section 19(13), 19(18), 19(19), RDDBFI Act, 1993
[32] Section 25 and 28, RDDBFI Act, 1993
[33] Kundan Rice and General Mills and other v. Union of India and Others, [1998] 92Comp Cas895 (P&H), (1997)115PLR279
[34] Tata Finance Ltd. v. Chemox Chemical Industries Ltd., AIR 1999 Bom 196
[35] Engineering Construction Services v. M&A Machinery Corpn. Ltd, [1996] 85 Comp. Cas. 53
[36] Deputy Commercial Tax Officer v. Coromandel Pharmaceuticals , [1997] 89 Comp. Cas.1 (SC)
[37] The Provisions of SICA & Companies Act – By Purnima Mishra
[38] Recent Developments in Insolvency Reform of India, J. DP Wadhwa, 2001 (http://www.oecd.org/dataoecd/8/21/1874164.pdf)
[39] Section 4, SICA, 1985
[40] Title 11 of the United States Code and amended in 1978.
[41] http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics.aspx
[42] http://www.uscourts.gov/FederalCourts/Bankruptcy.aspx
[43] Bankruptcy Laws – A Comparative analysis: United States and India, authored by Nishith Desai Associates
[44] The Asia-Pacific Restructuring and Insolvency Guide 2006 - India, Authored by Mr. Cyril Suresh Shroff and Mr. Ashwani Puri
[45] Verma S.K., Gupta Suman, Corporate Governance and Corporate Law Reform in India, March 2004, available online at: http://www.ide.go.jp/English/Publish/Download/Als/pdf/25.pdf, (last visited on 19 May 2011)
[46] Khanna Vikramaditya, Law Enforcement and Stock Market Development: Evidence from India, CDDRL Working papers, January 2009, available online at: http://iis-db.stanford.edu/pubs/22401/No_97_Khanna_Law_enforcement_stock_market.pdf, (last visited on 19 May 2011)
[47] Now there is the possibility of financial penalties from Section 23 E of the Securities Contracts Regulation Act 1956 (as amended in 2004).
[48] Verma S.K., Gupta Suman, Corporate Governance and Corporate Law Reform in India, March 2004, available online at: http://www.ide.go.jp/English/Publish/Download/Als/pdf/25.pdf, (last visited on 19 May 2011)
[49] Inserted by Securities Laws (Amendment) Act, 2004, S.11 (which takes effect from Oct. 12, 2004).
[50] Verma S.K., Gupta Suman, Corporate Governance and Corporate Law Reform in India, March 2004, available online at: http://www.ide.go.jp/English/Publish/Download/Als/pdf/25.pdf, (last visited on 19 May 2011)
[51] "ACGA White Paper on Corporate Governance in India" January 19, 2010, Asian Corporate Governance Association (ACGA) Hong Kong, available online at: http://www.acga-asia.org/public/files/ACGA_India_White_Paper_Final_Jan19_2010.pdf, (last visited on 23 May 2011)
[52] Section 299 of Companies Act, 1956
[53] Section 301 of Companies Act, 1956
[54] Section 211 of Companies Act, 1956
[55] Section 171 and 173 of Companies Act, 1956
[56] Section 209 and 223 of Companies Act, 1956
[57] As on agenda in Winter Session, 2011of Parliament (9th session of Fifteenth Lok Sabha and the 224th session of Rajya Sabha) commencing on 22nd November, 2011 and concluding on 22nd December, 2011.
[58] Clause 134(2) of Companies Bill, 2011
[59] Clause 135 (1) and (2) of Companies Bill, 2011
[60] Clause 135(3) of Companies Bill, 2011
[61] Clause 150 (1) and (2) of Companies Bill, 2011
[62] Clause 202 of Companies Bill, 2011
[63] Clause 203 of Companies Bill, 2011
[64] Clause 203(5) of Companies Bill, 2011
[65] Clause 152 of Companies Bill, 2011
[66] Clause 150 of Companies Bill, 2011
[67] Clause 137 of Companies Bill, 2011
[68] Clause 153 of Companies Bill, 2011
[69] Clause 153(4) of Companies Bill
[70] Clause 210 of Companies Bill, 2011
[71] Erinn B. Broshko Kai Li, Corporate Governance Requirements in Canada and the United States: A Legal and Empirical Comparison of the Principles-based and Rules-based Approaches, June, 2006, available online at: http://finance.sauder.ubc.ca/~kaili/BroshkoLi.pdf (last visited on 18 May 2011)

[72] Erinn B. Broshko Kai Li, Corporate Governance Requirements in Canada and the United States: A Legal and Empirical Comparison of the Principles-based and Rules-based Approaches, June, 2006, available online at: http://finance.sauder.ubc.ca/~kaili/BroshkoLi.pdf (last visited on 18 May 2011)
[73] Securities Exchange Act, 1934 Rule 10A-3 and NYSE Rules 303A(4),(5),(6),(7),(9)
[74] NASDAQ Rules 4350 (c) and (d)
[75] The Dodd-Frank Wall Street Reform And Consumer Protection Act: How Does It Differ From The Current UK Corporate Governance Regime And How Might It Influence Further Reform Of UK Corporate Governance, Global Insolvency provided by American Bankruptcy Institute and INSOL International, available online at: http://globalinsolvency.com/articles/dodd-frank-wall-street-reform-and-consumer-protection-act-how, (last visited on 24 May 2011)
[76] The Dodd-Frank Wall Street Reform And Consumer Protection Act: How Does It Differ From The Current UK Corporate Governance Regime And How Might It Influence Further Reform Of UK Corporate Governance, Global Insolvency provided by American Bankruptcy Institute and INSOL International, available online at: http://globalinsolvency.com/articles/dodd-frank-wall-street-reform-and-consumer-protection-act-how, (last visited on 24 May 2011)
[77] The Dodd-Frank Wall Street Reform And Consumer Protection Act: How Does It Differ From The Current UK Corporate Governance Regime And How Might It Influence Further Reform Of UK Corporate Governance, Global Insolvency provided by American Bankruptcy Institute and INSOL International, available online at: http://globalinsolvency.com/articles/dodd-frank-wall-street-reform-and-consumer-protection-act-how, (last visited on 24 May 2011)
[78] About the Financial Reporting Council, United Kingdom available at http://www.frc.org.uk/about/ last accessed 23rd June, 2011.
[79] Organizational Structure of the Financial Reporting Council available at http://www.frc.org.uk/about/organisation.cfm last accessed 23rd June, 2011.
[80] Financial Services Authority Consultation Paper, "Implementing Aspect of the Financial Services Act, 2010", April 2010, available at www.fsa.gov.**uk**/pubs/cp/cp10_11.pdf last accessed 23rd June, 2011.