



Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2022 – ISSN 2582-7820
Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

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Ways Introduced to help improve Investors' protection in Securities Market as per Companies Act

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Received 28 June 2022; Accepted 21 July 2022; Published 23 July 2022

The Companies Act, 1956, however, is excellent legislation that had some major flaws in it which led to a number of white-collar crimes such as “Enron” and the “Satyam Scam” which also at the same time affected the economy in a very bad way. Also, not only the economy but also there were the stakeholders who held certain shares in the companies and there was no legislation, no court protecting their rights which were misused by these Corporate Stooges. We can all agree that Investors are nonetheless the backbone supporting the securities market in India, they play the most important role in regulating the prices in the stock market which further decides where these companies in the real world against each other. The Satyam Scam again debates that there was a dire need to reform the Corporate Structure and the Corporate System which needs to be credible and transparent. The following fall of Satyam Computer led to a movement which turned out as the Companies Act, 2013.

Keywords: *companies act 2013, investor protection, securities market, corporate structure, corporate system.*

INTRODUCTION

There are various kinds of stakeholders out of which these are the main ones:

- Investors in equity
- Large institutional Investors

- Foreign Investors
- Investors in Debentures
- Small Investors

Certain Regulations are set up by the Government of India so as to keep a check on the rights of the stakeholders which are:

- SEBI Act, 1992
- Companies Act, 2013
- Securities Contract (Regulation Act) 1956
- The Prevention of Money Laundering Act, 2002

In this article, the learner tries to focus that what changes did the Companies Act, of 2013 bring to the rights of the Stakeholders.

RELEVANT SECTIONS APPLICABLE

Numerous legislations were changed in the act and also removed but the main ones which are to be noticed in the interest of the Stakeholders are mentioned below:

- Section 34 Companies Act, 2013
- Section 36 Companies Act, 2013
- Section 73 Companies Act, 2013
- Section 123 Companies Act, 2013
- Section 125 Companies Act, 2013
- Section 136 Companies Act, 2013
- Section 436 Companies Act, 2013

CHANGES BROUGHT VIA COMPANIES ACT, 2013

The Acceptance of Deposits:

Any deposit from the general public is not permitted under the Companies Act, 2013, and violation of the same is a punishable offence for any company. Section 73¹ of the Act says that any will not accept or review any deposit under the Act from the General Public. The exception to the same rule is provided under Chapter V of the Act and Companies (Acceptance of Deposit) Rule, 2014 which governs how will the companies will be allowed to take direct deposits from the public in a proper provided way so that there can be the minimum chance of the Stakeholder.

Misstatement in the Prospectus:

A prospectus is basically a kind of written statement which is issued by a company to the general public, it contains information pertaining to the Company's portfolio and what kind of investment schemes they offer to the public. Section 34² of the Companies Act, 2013 provides us the solution if any case any company issues a misstatement in any of their prospectuses. Any prospectus which is circulated or distributed amongst the general public, if includes a statement which in the future turns out to be false or untrue or misleading to the public which might induce the general public will invite a criminal liability for the company under section 447³ of the Act for the same.

Fraudulently Inducing Person to Invest Money:

Section 36⁴ of the Companies Act, 2013 provides us with the punishment for the person involved within the company who might intentionally or even recklessly might be inducing or trying to induce a person or any investor to make any kind of investment in the company for the sole purpose of procuring a self-profit for himself/herself, the same will be punishable under section 36. If also the person doing this is concealing the same from the company, he/she will be liable under section 447. This is a very good example of lifting the Corporate Veil in procedure and legislation.

¹ Companies Act, 2013, s 73

² Companies Act, 2013, s 34

³ Companies Act, 2013, s 447

⁴ Companies Act, 2013, s 36

Non-Payment of Dividend:

Every year Public Companies hold an Annual General Meeting in which all the major stakeholders of that same company take part one of the most important parts of these meetings is the Declaration of the Dividend. Now the dividend is nothing but simply the profits that a company earns and which are further to be divided amongst the stakeholders in the ratio to the amount of paid-up shares held by the stakeholders. For example Reliance in 2020s AGM announced that till the end of this Assessment Year it will be a debt free company and also this was the year it had earned the highest profits which in turn led the stakeholders to invest more in the company which further led in the massive increase of the Market Capital of Reliance Industries Ltd.

So the Companies Act, 2013 very well sees to it that every company fulfills its promise to deliver dividends to its shareholders which are protected under section 125⁵ of the Act which provides for the establishment for the sole purpose of the education of the investors and protection fund by the central government. This particular fund is credited with the unpaid amount of application money or simply known as the mature deposits. These accumulations of such huge amounts of funds have the sole purpose to be used for the promotion of the awareness of the investors and the protection of their interests. Section 123⁶ of the Act also says that the amount of dividend whether small or huge should be deposited into the Investors' accounts within 5 days of declaration of the Dividends in the AGM or otherwise.

The Right to Demand the Financial Statements of a Company:

This right of the stakeholders helps them keep a check on the company whether they are involved in clean business or not, it brings transparency to the relationship of the company and the shareholder. Section 136⁷ of the Companies Act, 2013 provides the right to a stakeholder and members of a company to obtain copies of Balance sheets and Audited Reports of a Company. In the case of default in complying with the same the company shall be liable for a fine and the officer in charge who is in default will also have to pay a fine. Besides

⁵ Companies Act, 2013, s 125

⁶ Companies Act, 2013, s 123

⁷ Companies Act, 2013, s 136

this, the stakeholder can always move to the courts for help regarding the same under section 436⁸ of the Act.

THE ROLE OF THE BOARD AND SENIOR EXECUTIVES IN PROTECTING THE RIGHTS OF THE STAKEHOLDERS

1. *Regulation of the Board*

As could be seen there was a huge and steep increase in the number of corporate scams in the country, there was a need for transparent boards within the companies which could be held accountable for their actions. The Companies Act, 2013 has laid stricter standards for the board and the management of the company.

- **Duties of the Directors:**

The duties of the directors are now codified under section 166 of the Act which now requires them to always act in good faith, with due and reasonable care towards the interests of the stakeholders. They also need to act with skill and always exercise independent judgement in management tasks and decisions. Now the interesting thing to see is that it was also present in the old Companies Act, 1956 too as part of fiduciary duties but without any check or liability but now in the Companies Act, 2013 there is a levy of hefty fines on the directors who do not act according to the rules provided also now all the decisions pertaining to whether a director acted according to the rules or not will be based on a factual basis and not on the word of the director.

*“As an illustration, every director is required to disclose his "interest" at the first board meeting in which he participates and thereafter, at the first board meeting in every fiscal year or whenever there is any change.”*⁹ For ensuring that transactions are in a company's best interests and to rule out the vested interest of directors, an interested director must disclose his interest in the proposed transaction and refrain from the voting process.¹⁰

A director is interested (*directly or indirectly*) in a contract, if he (*individually or with another director*) holds more than 2% shareholding, or is a promoter, manager, CEO of the other

⁸ Companies Act, 2013, s 436

⁹ Companies Act, 2013, s 184

¹⁰ Companies Act, 2013, ss 184 and 188

transacting company, and in case of any other transacting entity is a partner, owner or member. A contract or even an arrangement in breach of this i.e. without making the necessary disclosures where there is a need is voidable at the company's option. It is, therefore, necessary to accurately record board proceedings, and specifically note dissent raised by a director for attributing liability to the defaulting director only.

Further, under S. 188¹¹, related party transactions ("RPTs") beyond a certain threshold and which are not at an arm's length" require prior shareholders' approval. Details of RPTs have to be maintained in registers and disclosed in the board's report. Such provisions should go a long way in guaranteeing that company's funds are utilized to maximize shareholders' interests. In India, closely held group entities undertake RPTs on a day-to-day basis for economies of scale and optimum utilization of resources. Such companies will have to review things afresh and change their mindsets so as to comply with the strict mandate.

- **Disclosure in Board Report:**

Annual board disclosures are tightened to facilitate transparency by presenting a true picture of a company's state of affairs. S. 134 mandates various additional disclosures to be made in the board report such as (a) details of RPTs undertaken in a fiscal year, (b) particulars on inter-corporate loans and investments, (c) directors' responsibility statement containing affirmations regarding the following accounting standards for preparation of financial statements, the exercise of independent judgment, discharge of duties with due care and skill, having adequate mechanism to prevent fraud, compliance with applicable laws, (d) development and implementation of risk management policy, and (e) details of corporate social responsibility initiatives, if applicable¹².

¹¹ Companies Act, 2013, s 188

¹² Arya Triathy, 'India: Investor Protection Measures Under Companies Act, 2013 – Lessons from the past' (Mondaq, 8 January 2015) (<https://www.mondaq.com/india/corporate-governance/365216/investor-protection-measures-under-companies-act-2013-lessons-from-the-past#:~:text=The%20Act%20introduces%20new%20provisions,%2C%20registered%20valuers%20>)> accessed 25 June 2022

- **Increased Penalty:**

The Act has also enlarged the scope of the penalty imposed on defaulting directors and key managerial personnel ("KMP") for ensuring the responsible functioning of the board as a whole. KMP is a new concept and includes the CEO, MD, manager, CS, whole-time director, CFO, and other officers as designated. For instance, S. 129¹³ penalizes every director as officer-in-default (*in absence of MD, whole-time director, CFO, or specified officer responsible for preparation of financial statements*) for non-compliance with accounting standards and the procedure for preparation of financial statements. Similarly, a director convicted for an offence involving RPTs stands disqualified under S. 164¹⁴. Conviction for an offence involving RPT may be initiated by a company for recovery of loss incurred due to such RPT. However, the possibility of the company initiating proceedings against a director is less probable. The Act aims at establishing adequate checks and balances for ensuring efficient management but the implementation of the stricter penalty provisions is yet to be tested.¹⁵

2. *Fraud and Investigation*

The Act has introduced "fraud" for the first time and given it a wide scope.⁹ Apart from the definition, the Act also contemplates the presumption of fraud in certain instances. For example, furnishing false information or suppressing material information upon incorporation, providing misleading or false statements in the prospectus, issuing duplicate share certificates to defraud, fraudulently transferring or transmitting shares, and fraudulently applying for removal of the company's name. For the board, this may have varied connotations. Proof of negligence or wilful misconduct by a director may weigh heavily in adjudging guilt for fraud. It is immaterial if there is any actual wrongful gain or loss, and proof of intent to defraud will suffice. Thus, the directors will now be required to discharge their statutory duties in a reasonable and diligent manner while exercising independent

¹³ Companies Act, 2013, s 129

¹⁴ Companies Act, 2013, s 164

¹⁵ Companies Act, 2013, s 36

judgment to provide a positive inference of non-involvement in any alleged fraudulent conduct.¹⁶

Fraud is a non-compoundable, cognizable offence punishable with imprisonment between 6 months to 10 years and fine ranging from the amounts involved to 3 times such amount. No bail will be granted to an accused unless the public prosecutor is provided with an opportunity to oppose and the court is satisfied that there are grounds for innocence. Further, an auditor has to report instances of fraud to the Central Government ("CG") within 60 days, if, in the course of his duties as an auditor, he has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees.¹⁷

Now to prove that the Companies Act, of 2013 actually helped the stakeholders and investors of the companies here is a report published in the SEBI Annual Report 2016-2017:

*"SCORES is a web based centralized grievance redress system of SEBI. It enables investors to lodge and follow up the complaints and track the status of redressal of the complaints."*¹⁸



Source:- SEBI Annual Report 2016-17

The figure indicates that the number of pending grievances has been steadily declining over the years due to expeditious disposal by SEBI. Moreover, out of the 4,476 pending grievances as of March 31, 2017, 3,492 grievances have been pending for less than six months. Further,

¹⁶ Companies Act, 2013, s 447

¹⁷ Companies Act, 2013, s 143; See also, Companies (Audit and Auditors) Rules, 2014, r 13

¹⁸ Vrunda K Bhuta, 'Investor Protection and education - The Focus is on' (*Tax Guru*, 31 May 2021)

<<https://taxguru.in/company-law/investor-protection-education-focus.html>> accessed 25 June 2022

only 984 grievances were pending for more than six months as of March 31, 2017, as compared to 1,973 grievances pending for more than six months as of March 31, 2016.¹⁹

▪ Status of Investor Grievances received and redressed

Financial Year	Grievances Received		Grievances Redressed		Pending Actionable Grievances*
	Year-wise	Cumulative	Year-wise	Cumulative	
1	2	3	4	5	6
2008-09	57,580	26,74,560	75,989	25,03,560	49,113
2009-10	32,335	27,06,895	42,742	25,46,302	37,880
2010-11	56,670	27,63,565	66,552	26,12,854	28,653
2011-12	46,548	28,10,113	53,841	26,66,695	23,725
2012-13	42,411	28,52,524	54,852	27,21,547	11,410
2013-14	33,550	28,86,074	35,299	27,56,846	9,147
2014-15	38,442	29,24,516	35,090	27,91,936	5,736
2015-16	38,938	29,63,454	35,145	28,27,081	5,452
2016-17	40,000	30,03,454	49,301	28,76,382	4,476

Note: * excludes complaints against which regulatory action has been initiated.
SCORES was launched in June 2011. Details of complaints in the table from 2011-2012 onwards are as per SCORES.

Source:-SEBI Annual Report 2016-17 www.taxguru.in

The number of investor complaints received by SEBI on a cumulative basis increased from 29,63,454 as of March 31, 2016, to 30,03,454 as of March 31, 2017. But, during the same period the number of pending actionable complaints reduced from 5,452 to 4,476.²⁰

CONCLUSION

In the end, I would like to conclude by saying that the enactment of the Companies Act, of 2013 Legislation in our country has proved itself to be a historical development in the Corporate Sector especially if we focus that how much it focuses on the rights of the stakeholders and protecting them. It also shows us that the principles on which the older corporate were operating were not transparent in nature and after the introduction of the 2013 act the principles have thus become more transparent than ever before. The new act now holds the companies responsible for their acts also the people running the companies will also be held liable for their actions. Compared to the old act which did have all the necessary provisions but not the right rules for execution the new act itself comes with a whole different set of rules from the lowest to the highest that will be involved in any corporate structure.

¹⁹ *Ibid*

²⁰ *Ibid*