Section 233 of the Companies Act, 2013

A conundrum?

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Introduction

In light of the recent changes in the Indian economy, the instances of corporate restructuring have amplified. The authors in this write up have made an attempt to analyse the intricacies of one such restructuring, *viz.* fast-track merger[1] provided under Section 233 of the Companies Act, 2013 ("Act").

Section 233 of the Act entails the concept of fast-track merger procedure which may be opted by a defined set of companies. The said Section has its own benefits which makes it a lucrative approach for the entities to undergo this route.

What is a fast-track merger?

Fast track merger as the name suggests, is an alternate and swifter route to restructure companies, however, not every kind of entity can undergo the said route. The following entities are eligible to undergo this method –

a. Two or more small companies;
b. Holding and its wholly owned subsidiary;
c. Two or more start-up companies and
d. One or more start-up company with one or more small company.[2]

The process is a respite from the lengthy approach laid in Section 230-232 of the Act, *viz,* the NCLT route.

The said Section was only baptized with the Companies Act, 2013 and therefore, did not exist in the erstwhile act, i.e., Companies Act, 1956. The set of provisions were brought into effect from 15th December 2016, which makes it a relatively new concept.

Under the fast-track route, companies may directly approach the Regional Director and the Registrar of Companies to effectuate the scheme proposed by it without the intervention of the adjudicating authority, i.e., National Company Law Tribunal ("NCLT") as required under the Section 230-232 of the Act. The amendment also been a sigh of relief for the NCLTs substantially reducing the Bench's burden during the era of the ever-surmounting cases.

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[1] Merger, in this article shall also entail scheme of arrangement or demerger as the case may be 233(12) of the Act

[2] http://ebook.mca.gov.in/notificationdetail.aspx?acturl=6CoJDC4uKVUR7C9Fl4rZdatyDbeJTqg3Av5wU0A8FXmxbqXEQ1f4a6kCfTDHhUnrbyoFFtGgIMOdOhuNpZuDBg==

A detailed study on the applicability of the provisions of Section 233 essentially covering the onset of the modified definition of small companies and its applicability to non-banking financial companies ("NBFCs") has been attempted by the author in the forthcoming.

Analysis

Applicability of Companies Act, 2013

As per Section 1(4) of the Act, the provisions of the Companies Act shall be applicable to the following companies:

> *(a) companies incorporated under this Act or under any previous company law;*
>
> *(b) insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;*
>
> *(c) banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;*
>
> *(d) companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;*
>
> ***(e) any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act**; and*
>
> *(f) such body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification.*

Definition of a small company

Small company has been defined under Section 2(85) of the Act which has been produced in ad-seriatim below –

> *2(85) "small company" means a company, **other than a public company**,—*
>
> *(i) paid-up share capital of which does not exceed two crores rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and*
>
> *(ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed twenty crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:*
>
> *Provided that nothing in this clause shall apply to—*
>
> *(a) a holding company or a subsidiary company;*
>
> *(b) a company registered under section 8; or*
>
> ***(c) a company or body corporate governed by any special Act[3];***

Therefore, the said definition shall not be applicable to companies or body corporates which are being governed (that should ideally also entail regulated) under any special Act (the question of solely being regulated by the special act or otherwise is yet to be determined).

Interestingly, while Section 1(4) of the Act specifically mentions that the provisions shall be applicable **to every company incorporated under the Act** or the erstwhile Act *(except in so far as the provisions*

[3] Effective *vide* amendment dated 1st February, 2021, G.S.R. 92(E)

are inconsistent with the Act), Section 2(85) categorically bars **companies being governed under any special act.**

Companies incorporated under the provisions of the Act and being governed under special acts, essentially NBFCs be also considered as small companies?

What is a special act?

Special Act may be regarded as an act constituted by the Parliament for a specific purpose. The act so introduced continues to govern/regulate/oversee the activity for which it was brought into force.

These law specifically and invariably governs and controls/ oversees the functioning of entities formed for that very purpose. For example – Airport Authority of India Act, 1994 was brought into force for all the airports across the nation, all civil enclaves, all aeronautical communications and so on so forth.

Similarly, the Life Insurance Corporation Act, 1956 was brought into force for the establishment of Life Insurance Corporation and the act undoubtedly also governs the functioning of the Life Insurance Corporation. The only goblet available for the respite is the specific act and there shall be no preceding act which shall prevail over the provisions of these acts whatsoever. Thus, these special acts can be interpreted to run under a zen mode solely for what is mentioned in its preamble.

Hence, Special Acts or Laws are essentially acts which comes into existence for the purpose of giving birth to a new or special entity and further governs and regulates the activities performed by the entities formed under these acts.

NBFCs

NBFCs are companies incorporated under the Companies Act (1956/2013) carrying out a specific set of functions which are distinct from companies involved in activities having the likes of production, manufacturing, consultancy and paraphernalia activities.

These are specifically engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Given the intricacies of NBFCs, the Government have put in place several statute which, along with the Companies Act, 2013 shall regulate such NBFCs. Therefore, preliminarily these are multi-regulated entities.

The Master Directions/Rules/Regulations laid down by the RBI generally provides a stricter set of norms in addition the provisions of the Companies Act, 2013. Following are the criteria for an entity to be classified as an NBFC:

a. It must be a financial institution **which is a company.**
b. It has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner.

c. such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.
d. it must further have a net owned fund of Rupees Two Hundred Lakhs or Rupees Two Crores (**aggregate of the paid-up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, after deducting therefrom accumulated balance of loss, deferred revenue expenditure and other intangible assets** minus the amount of investments of such company in shares of its subsidiaries, companies in the same group and all other NBFCs and the book value of debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group, to the extent it exceeds 10% of the owned fund).

As emphasized in the point above, such entities should necessarily be a company registered under the Companies Act, clearly establishing the fact that the RBI Act, albeit being a special act (discussed later) – is not the only act governing the functions of these NBFCs

Is RBI Act, 1934 a special law enacted for NBFCs?

RBI Act, 1934 was constituted for the sole purpose of incorporating the Reserve Bank of India ("RBI") on 1st April, 1935. The RBI Act, 1934 was enacted to bring and regulate RBI and therefore considered to be a special law.

The Preamble of the RBI Act, 1934 states that following –

> *"to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth."*

The purpose of the RBI Act, 1934 was to oversee the operations of the Reserve Bank of India, the silhouette of the Act gradually became more defined and developed with the regulation/governance of entities like NBFCs into its umbrella.

NBFCs are not considered to be banks but a hybrid between a bank and a company. In India, banks are governed by the Banking Regulation Act, 1949, NBFC's are precluded from such Act in its entirety, therefore, such NBFCs are being regulated by RBI Act.

Further, no NBFC can carry out the activities of that of an NBFC unless it has been registered as a company under the Companies Act 1956/2013.

Given that the Banking Regulation Act, 1949 did not cover the activities performed by an NBFC, the government, to regulate the functioning of the NBFCs brought into force an amendment with effect from 1st February, 1964, which gave way to the inception of Chapter III B to the RBI Act, 1934 to regulate the **activities** of NBFCs.

With the passage of time, the norms with respect to NBFCs only proved to be more stringent. NBFCs, thus need to comply with the regulations set out by various authorities which inter-alia included – SEBI, MCA, IRDA, RBI.

Are NBFCs essentially governed by a special Law?

a. In the foregoing, it is established that the RBI Act, 1934 is a special Act constituted to form the Reserve Bank of India, which, undoubtedly is a special purpose, however, that does not necessarily establish that it is indeed a **special law to govern NBFCs as well**. The RBI Act, 1934 begun regulating the NBFCs **after three decades of coming into the existence** which, therefore, should not ideally be considered as a special act when it comes to NBFCs. In a plain and simple context, an act is a special act constitutes solely for a special purpose. In the instant case, the special purpose of the RBI Act, 1934 was to constitute RBI (since inception), regulation of NBFCs may at the most be considered to be a supplementary power associated with it.

b. Upon perusing other provisions of the Companies Act, 2013, for instance,

- Section 73(1) of the Companies Act, 2013 read with Rule 1(3)(ii) of the Companies (Acceptance and Deposits) Rules, 2014, an NBFC is explicitly barred from the Rules. The extract of the provision is as follows –

  "(1) On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter:

  Provided that nothing in this sub-section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 (2 of 1934) *and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf."*

  "1(3) These rules shall apply to a company other than –

  i. a banking company;

  ii. ***a non-banking financial company as defined in the Reserve Bank of India Act, 1934 (2 of 1934) registered with the Reserve Bank of India;***

  iii. a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987 (53 of 1987); and

  iv. a company specified by the Central Government under the proviso to sub-section (1) of section 73 of the Act."

- Similarly, provisions of Section 186 states that –

  "(1) Without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:

  Provided that the provisions of this sub-section shall not affect—

  (i) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;

  (ii) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

  (2) No company shall directly or indirectly —

  (a) give any loan to any person or other body corporate;

  (b) give any guarantee or provide security in connection with a loan to any other body corporate or person; and

  (c) acquire by way of subscription, purchase or otherwise, the securities of any other body corporate,

exceeding sixty per cent. of its paid-up share capital, free reserves and securities premium account or one hundred per cent. of its free reserves and securities premium account, whichever is more.

…

(11) Nothing contained in this section, except sub-section (1), shall apply—

(a) to any loan made, any guarantee given or any security provided or any investment made by a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of and engaged in the business of financing industrial enterprises, or of providing infrastructural facilities;

(b) to any investment—

(i) made by an investment company;

(ii) made in shares allotted in pursuance of clause (a) of sub-section (1) of section 62 or in shares allotted in pursuance of rights issues made by a body corporate;

(iii) made, in respect of investment or lending activities, by a non-banking financial company registered under Chapter III-B of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities."

- Rule 3 of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015 provides that the following class of companies shall file their financial statement and other documents under section 137 of the Act, with the Registrar in e-form AOC-4 XBRL and the consolidated financial statements, if any, with form AOC-4 CFS.

  "The following class of companies are:

  (i) all companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or

  (ii) all companies having paid up capital of rupees five crore or above;

  (iii) all companies having turnover of rupees hundred crore or above; or

  (iv) all companies which were hitherto covered under the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011:

  Provided that the companies in banking, insurance, power sector, non-banking financial companies and housing finance companies need not file financial statements under this rule.

  Rule 4 of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015 provides that a company required to furnish cost audit report and other documents to the Central Government under sub-section (6) of section 148 of the Act and rules made there under, shall file such report and other documents using the XBRL taxonomy given in Annexure-III for the financial years commencing on or after 1st April, 2014 in e-Form CRA-4 specified under the Companies (Cost Records and Audit) Rules, 2014."

Therefore, if the applicability of the definition of small companies were not to apply to an NBFC, the provisions laid would be knitted in a language akin to the Sections as reproduced above.

c. As explained in the foregoing, a special act is created solely for a specific purpose. Under this pretext when one sees the RBI Act, it may be noted that the Act was brought into force for a

separate purpose, i.e., for setting up the Reserve Bank of India. NBFC's are the by-products of the Act, hence, as per the author's view the said Act should not be considered as a special act as regards as NBFC's are concerned.

d. Moreover, upon glancing through the framework of the provisions of the Companies Act, 2013, specifically Section 1(4)(c) of the Act it is pertinent to note that Banks are categorically not covered under the applicability provisions-

(c*) banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949*

The charter of the Act may stitched something akin to the above for NBFCs as well. Going by the golden rule of interpretation, given that NBFCs are neither barred from Section 1(4) of the Act, nor has been ruled out from Section 2(85) of the Act, it is the humble view of the author that NBFCs should be considered as small company subject to the other criteria as may be applicable.

e. In addition to the above, it is interesting to note that as per the annual compliance laid in Section 92 of the Act, every company is annually required file its return in form MGT 7.
Vide notification dated 5th March 2021, Ministry of Corporate Affairs prescribed a new form MGT 7A for one person and small companies. A small NBFC also falls under the ambit of Form MGT 7A. Hence, it would be absurd to take two stances, wherein at one stage it is held that an NBFC is governed by a Special Act, hence it cannot be treated as a small company while on the other hand, the compliances for such NBFCs remains to be in line with that of a small company.

Our view

As per the analysis mentioned above, the authors are of the humble view that the NBFCs should be considered as small company since the provision of Section 2(85) of the Act is rather vague and has not been explicitly barred from the said set of definition as compared to other provisions of the Companies Act, 2013 (as referred above).

Further, when it comes to the applicability of Section 233 of the Act, an interesting thing to note is that an NBFC may be allowed to undergo a fast track merger if it is a wholly owned subsidiary of another company or vice versa, similarly, an NBFC should also be undertaken under the realm of a small company and shall therefore be able to undergo fast track merger under Section 233 provided it meets the threshold specified under Section 2(85) of the Act.