PIONEER
LAW ASSOCIATES

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Parliament has passed the First Amendment to the Companies Act 2006 (2063 B.S.)

The "Companies (First Amendment) Act, 2017 (2074 B.S.)"(the **"Amendment"**), which was recently passed by the Parliament of Nepal, has finally been certified by the President. The Amendment will be effective from the date it has been officially notified in the Official Gazette which is expected to be done soon.

The Amendment has made certain amendments to the Companies Act 2006 (2063 BS) (the "**Companies Act**"). The key changes made by the Amendment are briefly presented below:

1. Relaxation of the provisions relating to issuance of shares at premium price

(a) Section 29 of the Companies Act deals with the provisions applicable for issuance of shares at premium. Section 29(1) had provided following pre-requisite for issuance of shares at premium:

(i) The company should be in profit and should have declared dividend for the last three consecutive years prior to issuance,

(ii) the company's net worth should exceed its total liabilities,

(iii) The issuance should be approved by the general meeting,

(iv) Approval of the Office of Company Registrar (OCR)

The said requirement was applicable to all forms of companies namely; private limited companies, unlisted public limited companies and listed companies.

(b) The Amendment has amended Section 29(1) of the Companies Act. As per the new provision, the provisions in case of the listed companies, premium share issuance shall be subject to the terms and conditions imposed by the applicable securities laws.

(c) The private limited companies and unlisted companies will be able to issue shares at premium after meeting the criteria that such entities do not have negative net-worth (the actual language used in the law is that the assets should be more than liabilities) and the issuance has been authorized by the general meeting.

(d) The Amendment now removes the requirement of the approval of the OCR for issuance of shares at premium.

(c) As the Amendment removes the OCR approval, companies are likely to benefit in the reduced cost and time. In relation to equity investments in private and unlisted companies, the requirement for three years profit and declaration of dividend was substantial bottleneck in

practice and now provides effective tool for investors to invest at appropriate business valuation especially in relation transaction involving primary issuance by the companies.

2. Mandatory requirement for telecommunication service provider companies to be converted into a public company

(a) Section 12 of the Companies Act provided for provision pursuant to which certain business activities like banking, insurance, mutual funds and other notified business activities are required to be incorporated as public limited companies. The Amendment has inserted additional provision in Section 12 of the Companies Act pursuant to which telecommunication service provider companies having paid up capital exceeding Nepalese Rupees 50 Million will have to be registered as public limited companies.

(b) Further, in the case of the existing telecommunication service provider companies (while the Amendment does not define telecommunication service providers, it does appear to include internet service providers by relying on the provision of the telecommunication laws) which have paid-up capital of more than NPR 50 Million are required to be converted into public limited company within a period of 2 years. Section 12 of the Companies Act only covers the form of incorporation and does not deal with the mandatory requirement for issuance of shares to the general public. In view of this such entities will not be required to issue shares to the general public unless mandated under the Telecommunication Act or directives from the telecommunication regulator. .

3. Investment companies exempted from investment ceiling

(a) Section 176 of the Companies Act restricts a company to invest, in excess of (i) sum total of 60% of its paid up capital and free reserve or (ii) 100% of free reserve, whichever is higher, in any other company (the "Investment Ceiling)" . The said Section 176 has also excludes certain companies from application of the Investment Ceiling. For instance, Section 176 of the Companies Act excludes, amongst others, companies having main objective of buying and selling securities" from the application of the Investment Ceiling. In practice, the OCR had implemented Section 176 in the manner that only the activity of trading in shares and not investment activity falls within the coverage of exclusion. This meant that 40% of the equity would be trapped and could not be utilized for making further investments.

(b) The Amendment has inserted "investment company" within the excluded business activity for which Investment Ceiling will not be applicable. Recently, investors have widely used investment companies (including foreign private equity funds) as an investment vehicle and will stand to benefit by this regulatory clarification.

(c) It may be noted that the Company Directive 2015 issued by the OCR (Clause 90), currently still provides that even the excluded business activities (excluded under Section 176 of the Companies Act) can make investment only up to invest up to (i) sum total of 90% of its paid up

capital, and (ii) 100% of free reserve. This provision still compels the investment companies to keep 10% of their share capital idle. The said Clause 90 is inconsistent with the provisions of Section 176 of the Companies Act and will need to be streamlined with Section 176.

4. No mandatory conversion requirement for private companies

(a) Pursuant to Section 13(1)(b) and (c) of the Companies Act, a private company is required to be converted into a public company in following conditions-(a) 25% or more shares of such company are held by one or more public companies, or (b) if such private company acquires 25% or more shares of a public company. This mandatory conversion provision has forced a private company to comply with all the requirements applicable to the public companies. For instance the following conditions are applicable-(a) minimum paid up capital of 10 million Nepalese Rupees or more, (b) minimum number of shares to be raised to 7, (c) minimum number of directors to be 3 with a requirement to appoint at least 1 independent director. Further Section 13(1)(b) and (c) of the Companies Act stand contrary to the provision of Section 14 which has required a public company to be converted into a private company in a situation where the number of shareholders is reduced below 7.

(b) The Amendment has removed Section 13(1)(b) and (c) thereby allowing a public company to hold hundred percent shares of private company and vice versa without the requirement of mandatory conversion..

5. Special provision for de-registration of the defunct and defaulting companies

(a) The Amendment has made a special provisions relating to de-registration of the defunct or defaulting companies. Pursuant to Section 136 of the Companies Act, de-registration of the defunct companies or defaulting companies are subject to the fulfillment of all the pending compliances and clearance of all the fines and dues by the liable officers. The amount of fine as prescribed under Section 81 of the Companies Act can be huge for the some of the companies which have remained defunct for several years.

(b) The Amendment has provided a grace period of two (2) year from the date of commencement of the Amendment to the defunct or defaulting companies to apply to OCR for the de-registration which have not fulfilled any of the following conditions as of the date of commencement of the Amendment, (a) commence business, (b) submission of details pursuant to Section 80, or (c) payment of fine under Section 81. A decision from the general meeting of such company is required to initiate the process.

(c) The Amendment has further prescribed the applicable government fees for such de-registration is (a) payment of fine under Section 81, or (b) payment of Zero Point Five (0.5) percent of the paid up capital of the company, whichever is less. For such de-registration, the defaulting companies will also need to submit the annual returns and other documents as provided under Section 80.

6. Increase in the maximum number of shareholders of a private company

(a) Pursuant to Section 9 of the Companies Act, a private company can not have more than fifty (50) shareholders. The Amendment has increased this number to One Hundred and One (101). A private company can now have a maximum of 101 shareholders. It is traditional to define the companies as public companies or private companies in terms of the minimum or maximum number of promoters or shareholders. Though the Companies Act and the Amendment still retain this conventional concept, the Amendment has provided flexibility to the private companies in terms of the maximum number of the shareholders. The threshold of maximum number of the shareholders does not apply in case of the employee shareholders.

7. Protection of corporate name/ brand

(a) Section 6 of the Companies Act provides various grounds under which the OCR can refuse to provide name for the registration of the company. Section 6 of the Companies Act, amongst others, included similarity with the name of the registered company as one of the grounds for refusal for registration with a particular name. This protection did not extend to the protection of the registered trademarks though some provisions were inserted in the Company Directive 2015 issued by the OCR.

(b) The Amendment has inserted provision in Section 6 pursuant to which the OCR can now refuse registration of the companies if the proposed name is identical or confusingly similar to the trademark of the registered company.

8. Provision for specific time limitation to bring action

(a) The Companies Act had lacked the provision for time limitation to bring an action against the Company or its officers before the OCR or courts. This implies that any action under the Companies Act can be brought at any time subject to the general provisions provided under the Country Code (*Muluki Ain*). This has provided uncertainty as there remains possibility of challenging past corporate action or decision by an interested party at any point of time and without being subject to time limitation.

(b) The Amendment has been mentioned the time limitation to file a case as two years from the date of knowledge of the cause. This limitation is applicable in case no separate time limitation is prescribed in the Companies Act.

9. Extended prohibition on availing loans to officers and shareholders

(a) Previously, Section 101 of the Companies Act had prohibited the companies to provide loan or financial assistance, security or guarantee to its officers, substantial shareholder or their close relatives or officers, shareholder or their close relative of the holding company of such company.

The provision has not covered the "officers or shareholders of subsidiary company of a company in question" within the prohibition.

(b) Pursuant to the Amendment, the prohibition under Section 101 is now extended to officer, substantial shareholders or officer, shareholder of its subsidiary company or a close relative of such person.

10. Extended coverage of "Substantial Property Transaction"

(a) Pursuant to existing Section 93 of the Companies Act, any substantial property transaction by a public company with its director or his/her close relative or "Substantial Shareholder" is subject to an approval of the general meeting. Similarly, a subsidiary company is restricted to enter into "Substantial Property Transaction" with the director, his/her close relative or substantial shareholder of the holding company without obtaining an approval from the general meeting of the holding company.

(b) "Substantial Property Transaction" as defined in the explanatory clause of Section 93 mean and include-(a) any transaction of sale, purchase or exchange and contract the value of which at the time of doing the transaction exceeds 120,000 Rupees or 5% of the total assets of the Company whichever is lesser, or (b) rental transaction amounting to 120,000 Rupees or more annually.

(c) Section 50 of the Companies Act defines the "substantial shareholding" in the context of the public companies. Pursuant to the said Section, any person owning 5% or more of the paid up capital of any public company with full voting rights is considered to be a "substantial shareholder" of such company. However, in the case of a company having the paid up capital of more than two hundred fifty million rupees, any person owning one percent or more of the total paid-up capital of such company with full voting right is considered to be a "substantial shareholder" of such company.

(d) Prior to the Amendment, the substantial property transaction as provided under Section 93 of the Companies Act was regulated in case of officers or substantial shareholders in their individual capacity. The Amendment has further restricted to carry out "Substantial Property Transaction" with "the firm, company or corporate body" of which such director, close relatives of a director or substantial shareholder holds substantial shares.

11. Extended prohibition to provide financial assistance

The restriction for providing loan or financial assistance as provided under Section 62 of the Companies Act has further been widened by the Amendment. Prior to the Amendment, the restriction was applicable to the companies and holding companies. Pursuant to the Amendment, a company is further restricted to provide financial assistance to anyone for the purpose of buying its shares or the shares of its subsidiary company.

12. Mandatory participation in the general meeting

Pursuant to Section 68 of the Companies Act, a director is required to be present in the general meeting to the extent possible. No alternative means of presence was allowed by Section 68. The Amendment has provided the mandatory participation of the director in all the general meetings. However, a director can participate in the general meeting by means of video conferencing or similar technology. However, ensuring presence by means of video conferencing or similar technology is allowed in force majeure situations only.

13. Additional requirement for private companies in relation to annual general meeting

(a) Section 76 of the Companies Act requires each public company to conduct the annual general meeting within six (6) months from the end of a fiscal year. Section 76 has granted right to the shareholders of a public company to seek recourse in case a public company does not convene annual general meeting within the statutory timeline. A shareholder, as prescribed under Section 76, can seek recourse from (a) OCR to issue directive to the public company in question requiring holding annual general meeting, and (b) court if the company does not comply with the directive of the OCR in regard to concluding the general meeting.

(b) The existing Companies Act does not provide similar provisions to the private companies. Furthermore, it is not mandatory for the private companies to conduct annual general meetings unless the same is provided in the articles of association of the company.

(c) The Amendment has now provided the requirement of convening of Annual General Meeting and other compliances thereto in case of private company as well. The statutory timeline, as mentioned under Section 76, for concluding the annual general meeting is also now applicable to private company as well. This will provide right and recourse to the shareholders of a private company to ask such company to conduct annual general meeting by taking assistance from the OCR and court.

14. Specified Timeline for holding extra ordinary general meeting ("EGM") upon requisition

(a) Pursuant to Section 82(3) of the Companies Act, the Board of Directors of a company is required to call EGM in case of the shareholders holding at least ten percent shares of the paid–up capital of a company or at least twenty five per cent shareholders of the total number of shareholders make an application, setting out the reasons for the same. But, prior to the Amendment, the timeline to call and convene the EGM upon request by shareholders was not specified.

(b) The Amendment has now prescribed the time and as such the BOD is required to hold the EGM within thirty (30) days from the date of receipt of such request/application from the shareholders.

15. Maximum number of directors

(a) The flexibility allowed to a private company regarding the appointment of directors in desired number has been removed by the Amendment. Pursuant to Clause 21 of the Amendment, a private company can now only have a maximum of eleven (11) numbers of directors. As the private companies generally have small board of directors, this provision should not have any adverse impact to the company.

16. Requirement of mandatory female director

Pursuant to the Amendment, a public company is required to have a mandatory female director if there is one or more female shareholder in the company. This requirement, however, is not applicable to-(a) private companies, or (b) even public companies without female shareholders.

17. Statutory recognition to online system

(a) The Amendment has provided a statutory basis for the recognition and implementation of the online filing of the documents with Office of the Company Registrar (the "**OCR**"). Though the OCR has already implemented the online filling and submission, it had no legal basis. Further, the Amendment has also recognized the use of electronic signature in the documents to be submitted to the OCR.

(b) It is not clear as to whether the manual submission of the documents would also be required following the online submission of the documents. Currently, the documents are submitted both online and manually. The registration certificate and charter documents are also required to be collected from the OCR physically. Hence, the practice will need to be aligned in line with the provisions of the Amendment to implement the online system in real sense.

18. Reduction of the statutory timeline for registration of companies

(a) The Companies Act, under its Section 5(1), required the completion of registration of a company within a period of fifteen (15) days from the date of application. The notification of refusal of registration was required to be given within 15 days as provided under Section 6(2).

(b) The Amendment has reduced the statutory timeline for giving decision by the OCR as to the proposed registration of the companies. Pursuant to Section 4 of the Amendment, the OCR is required to register a company within 7 days. In case of refusal, the decision of refusal will need to be notified to the applicant within next 3 days.

19. Provision of services from the branch offices of the Office of the Company Registrar

(a) Generally the entire system of company registration, reporting, payment and similar services of OCR is centralized in the Kathmandu valley only. There is no any branch office of OCR to

render services. The only example in the past was the establishment of a unit of OCR in Lalitpur District.

(b) Therefore, the demand for the establishment of branch offices of OCR has been raised time and again, at least in major business cities. The Amendment has thus provided for the establishment of branch offices of the OCR. In line with the provision, the OCR can now establish the branch offices and provide the services related to company registration and administration through such branch offices. This is likely to simplify the business registration as well as compliances related process.

20. Compliance with the anti-money laundering requirement

The Amendment has prescribed the compliance requirement with the anti-money laundering laws. The company is required to make commitment pursuant to the applicable laws on anti money laundering and terrorist financing.