Key Recommendations For Company Act, Industrial Enterprise Act and Foreign Investment and Technology Transfer Act

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INTRODUCTION

Nepal's investment regime formally began with the liberalization process. The enactment of foreign investment and technology transfer act 1992, and the Industrial Enterprise act, 1992 in this regard can be seen as the starting point of the official recognition of investment made by domestic and foreign, natural and legal persons. After twenty-seven years, the FITTA has been replaced by a more sophisticated legislation, that seeks to bring into effect the vision and ambition of foreign investment policy and after nearly 24 years the Industrial Enterprise act was replaced by the Industrial Enterprise act 2016, which was later replaced by the current Industrial Enterprise Act, 2020 to accommodate for the changes brought by the new federal structure. Together these two legislation along with the company act 2007, are the primary satutes governing Nepal's investment climate, both domestic and foreign.

Much has already been said about the need for private investment in a country like Nepal. The current pretext of fulfillment of investment gap through domestic private sector investment and foreign investment has also been widely recognized by government agencies. In a globalized world, the interactions between firms from richer countries seeking to establish themselves in resource rich countries has also been clearly established. More importantly, the benefits that host countries can reap either in the form of economic development or knowledge transfer has also been established clearly in literature.

Nepal's own aspiration of robust economic growth and attainment of SDGs align with the benefits that private investment brings. The need for increasing the pace of industrialization in Nepal has never been clearly felt than in recent times. More importantly, there is also a stronger realization post-covid among developing and developed nations that the pace of global private investment will take ample amount of time to return to pre-covid levels. Developing and least developed countries have been quick to adapt to the changing times, most countries have made significant changes to their foreign investment regimes and domestic investment regimes, making entry and exit easier to attract investments from abroad. Nepal has never been quick to adapt to the changing global context. While the country holds immense potential as a hydropower developing country, as a religious, cultural, and adventurous tourism destination, as a breeding ground for Information Technology experts, or even as a regional hub for world-class education services, current trends do not provide evidence to guarantee efficient utilization of resources. Fortunately, there has been some realization on part of the government concerning the need for private

investments in the country, although no concrete actions have been taken. To this extent, current literature suggests the need for an encouraging environment, moreover, investment specific legislation is known to be drivers for greater private sector participation. While Nepal has a standalone foreign investment law, and domestic investment laws in the form of Industrial Enterprise act and Company act, both the gross capital formation, and the inflow of foreign investment in Nepal suggests that the quality of legislation itself is questionable. Guided by this, the current policy brief attempts to highlight some of the shortcomings of the foreign investment and technology transfer act, company act and Industrial Enterprise act. The act is analyzed to provide concrete recommendations that will make the regulation favorable to foreign natural and legal investors.

METHODOLOGY

The preparation of this policy brief involves the use of primary and secondary sources. Key information interviews and focused group discussions were carried out in person with the relevant stakeholder identified. Desk research was carried out to review available literature and reports, special attention was also paid to review existing companies' legislation in varying jurisdictions. Based on the literature review and interactions with stakeholders the issues identified with the acts have been discussed in the sections to follow

KEY POLICY AREAS AND RECOMMENDATIONS FOR FOREIGN INVESTMENT AND TECHNOLOGY TRANSFER ACT

a) Definitions

Foreign Investment

Section 2(j) of the foreign investment act defines foreign investment as the following investment made by a foreign investor in an industry or company. The modes of foreign investment are also prescribed accordingly in the same section from clauses 1 through 9. There are two parts to this definition, the first is the list of applicable and permitted methods through which foreign investment may be made, the second is the permissibility to make foreign investment in any industry or company. On the first part, the list seems exhaustive. From its reading it becomes clear that any mode other than the one prescribed, through which an investment is made by a foreign legal or natural person is not permissible to that extent and not treated as foreign investment. Two particular forms of foreign investment

have been left out of the list. The first, is foreign investment through an establishment of branch industry, and the second is loan borrowed from foreign financial institution. Both forms of foreign investment are in fact permissible and the act provides provisions for the same through sections 8 and sections 12 respectively. It is evident that this is a minor clerical error in the legislation, but minor clerical errors often provide unwarranted and uncheckable power to beauracrats and make room for political agendas to be woven into private market transactions. Foreign investment by its nature demands, that it be apolitical, to his extent it is recommended that any room for political maneuvering and overt bureaucratic power be limited as much as possible by designing a legislation that is as detailed as possible. It is recommended that the section be amended to include foreign loan investment and branch industry operation as a permissible method of foreign investment.

The second part of the definition states that foreign investment can be made in any industry or company. Form its reading, one might assume that foreign investment can be made in any business that is registered as an industry or as a company. Company registration and Industry registration are two entirely different regulatory aspects of Nepal's laws concerning businesses. While the registration of company is mandatory in so far as someone seeking to operate a business with limited liability must register itself as a company, Industry registration is only applicable to those business that fall under the definition of industries as per the Industrial Enterprise act and its annexes. While a company is the legal vehicle of operation, industries are more of a licensing mechanism that are applicable to certain business operations. To this extent, a company may or not be an industry depending on the nature of its business. While the definition provided in the said section, permits foreign investment in either a company or an industry i.e. regardless of whether the company is registered as an industry or not, section 3 of the same act reads that a "A foreign investor may make foreign investment in any industry and derive gains from such investment", accordingly regulating agencies have interpreted it to mean that foreign investment can only be made in businesses that are registered as an industry. To this extent, the practice is in direct contravention of the definition of foreign investment provided. Moreover, a foreign investor is bound to get confused from the reading of the legislation, an effect of which is directly felt on the amount of foreign investment made in Nepal. Additionally, the concept of industries is also alien to most jurisdictions. In the global south, the practice of industry registration is only found in India. However, unlike in Nepal industry registration in case of India is reserved only for those business establishments that require a higher degree of care

in its operation owing to the nature of products and services it offers. Provisions such as these, as mentioned earlier give room for either bureaucratic maneuvering or political maneuvering. **It is therefore recommended that the definition be amended to read "Foreign investment" means the following investment made by a foreign investor in any business except those prescribed in Schedule-1 legally registered with the government. As an extension of this section 3(1) of the act must also be amended to read A foreign investor may make foreign investment in any business except those prescribed in schedule-1 legally registered with the government and derive gains from such investment.**

Institutional Foreign Investor

Institutional foreign investor is defined in section 2(n) of the act as a foreign company, corporate body or international institution that makes foreign investment. Per this definition an institutional investor is merely a legal person which has been registered outside of Nepal. Institutional investors in predominant literature on foreign investment and in other legislations pertaining to other jurisdictions are not merely characterized by a legal personality, rather they are characterized by their investments through the secondary market. As opposed to foreign direct investment which is made into company either through purchase of shares or assets and results in some form of management control, foreign institutional investment is made through purchase of shares or other security instruments through the secondary market, resulting in very little control over the management of the company. Institutional investment is in fact also made by natural persons. Most jurisdictions do not characterize institutional investment as investments made by a legal person, rather they are defined as investment above a certain threshold made through the secondary market. For instance in India Foreign Institutional investment is defined as investment resulting in a stake of 10 percent of less in any company made through the purchase of listed securities, for stakes above 10 percent the investment is treated as direct investment. Both forms of investment necessitate varying degrees of regulation if required at all. Although it is recommended that entry and exit requirements for both forms of investments be made similar, other issues for instance, the timeline for investment, the sector for investment will have differences. Institutional investors make investments though the secondary markets and their regulations therefore are more specialized in nature in the sense that they are regulated by government agencies that regulate the capital markets. While other investments are regulated by government agencies that regulate the domestic industry. Due to the varying

differences in regulation that each form of investment brings, it becomes necessary to define the terminologies properly and make detailed provisions for the same. **It is therefore recommended based on international practices that the current definition of Foreign institutional investor be changed to incorporate the nature of institutional investors i.e. natural or legal persons making investments through the secondary market and the regulation of such investments be completely delegated to the securities board of Nepal.**

Foreign Investor

Section 2(k) of the act defines foreign investor as any foreign individual, firm, company, Non-resident Nepali or foreign government or international agency or other corporate body of similar nature that makes foreign investment, and also includes, in the case of a foreign investor that is an institutional foreign investor, the ultimate beneficiary of such an institution. The final part of the definition includes the ultimate beneficiary of a foreign institution in case of foreign institutional investor within the definition of the foreign investor. However, the terminologies ultimate beneficiary has not been defined properly. This has implications for the foreign investment approval process, in the sense that it is unclear whether the shareholders i.e. the ultimate beneficiary in case of a limited company, of the foreign institution also need to submit their documents such as passports in order for foreign investment approval to be granted. **It is recommended that either the terminology be defined properly or removed entirely.**

b) Industry Registration

Section 3 of the act provides that foreign investment may be made in any industry in Nepal subject to the condition that such industries do not fall in the negative list prescribed by the act. The wording of the act does not suggest that foreign investment can only be made in firms that are registered as in industry. the use of the word “may” in the prescribed section is indicative of the permissibility of investment in firms registered as an industry but not suggestive of restrictions made for investments in businesses not registered as an industry. In fact, the definition of the terminology foreign investment in the act itself provides an either/or terminology, suggestive of the permissibility of foreign investment in companies not registered as an industry. In practice however, foreign investment is only permissible in firms registered as an industry. The registration of industry is deemed mandatory for business activities which is classified as an industry by the prevailing Industrial Enterprise act. The list of business deemed to be an industry provided is exhaustive, to this extent any

business activity that is not categorized as an industry is automatically restricted for foreign investment. Current statistics on the number of companies and industries in Nepal reveal that a large number of companies are not registered as industries. It is hypothesized that there are three reasons for this phenomenon, a) the time taken for registration as an industry is lengthy and cumbersome b) registration as an industry adds to the yearly compliance requirement c) business activity is not classified as an industry. it is evident that a large number of companies are going to miss out on the opportunities of foreign investment by virtue of the mere fact that the list is exhaustive in nature. Furthermore, the concept of industry as such is non-existent in a large number of jurisdiction as stated earlier. The provisions therefore of investment in industries may seem alien and even confusing to prospective foreign investors. Sectoral licensing mechanism largely substitute for registration as an industry in most jurisdictions, Nepal also has sectoral licensing mechanism for several business activities in addition to industry registration. The provision for foreign investment in industries does not therefore seem grounded in any logic, rather it is merely reflective of the failure to move beyond the concept of industries, an idea that was seemingly brought to end the license raj in the liberalization era.

The requirement for foreign investment in industries, although only suggestive in nature has been interpreted as permissibility by government agencies. Since, most companies in Nepal are not registered as an industry, foreign investment procedure itself becomes lengthy since companies only seek industry registration after they successfully enter into some form of agreement with the prospective foreign investor. The industry registration process has not been digitized as of date, and thus manual submission of documents and completion of other procedure significantly increases the amount of time for successful injection of foreign investment. **In account of the ground reality, it is recommended that the section be amended to remove the word industry and replace it with "business except those prescribed in schedule-1 legally registered with the government".**

c) **Screening of foreign investment**

Section 15 of the act provides that any prospective foreign investor must make an an application, setting out the details, accompanied by a time schedule for bringing foreign investment into Nepal and action plan on investment in the industry, to the Foreign Investment Approving Body for approval, to make foreign investment. The application as per section 15(2) of the act is subject to a process of examination, and approval is granted

after the examination is complete. The section also provides that approval is to be provided within a statutory time limit of seven days from the date of receipt of such application. The section in essence is about the screening of foreign investment. Screening of foreign investment is a regular process that seeks to establish whether a particular foreign investment is beneficial or not to the host country and is practiced in several jurisdictions. However, not all foreign investments are subject to the same screening requirements. Countries is usually make a distinction between those investments that require extensive screening and those that would require no screening at all. Usually, the distinction is made based on the amount of investment and the sector of investment, for instance a foreign investment in the telecommunication sector may require extensive screening as opposed to a foreign investment in the hospitality sector. Such a distinction is not made in Nepal, and all foreign investments regardless of the amount of investment and sector of investment are subject to the same screening process. In terms of the statutory time limit, it is observed that the actual time taken for foreign investment approval is within the vicinity of 1-3 months. Specially such time limit as reported by the department of industries also fluctuates based on the number of applications received for foreign investment approval. In reality such a phenomenon is not new to Nepal, the Indian statutory time limit for providing foreign investment approval is reported to be rarely followed. The provision for providing approval within the time limit must also therefore be accompanied by some consequence for not providing the approval within the time limit prescribed. A general practice in developed countries is therefore, automatic approval confirmation once the statutory time limit for providing approval expires i.e. the foreign investor is legally permitted to move the foreign investment process forward if the approval is not granted within the time limit, and such lapse of time on part of government agencies is regarded as evidence for grant of foreign approval. **It is there recommended that the screening process be made mandatory based on the amount of investment and sector of investment for greater efficiency. Similarly, the statutory time limit must be accompanied by provisions that specify consequences for not providing the approval on time.**

d) Branch Industry

Foreign investment through the establishment of branch industry is permissible under section 8 of the foreign investment and technology transfer act. As stated earlier the concept of industries itself is alien to most jurisdiction and by therefore by extension, the use of the word itself and permissibility granted thereof provides little incentive for foreign

investment. Rather, it might act as a disincentive to foreign investor when they are met with alien concepts or concepts drastically different from their previous country of operation. Similarly, it must also be noted that, the companies act already provisions for establishment of branch companies for the operation of foreign companies in Nepal. To this extent the provisions of the Foreign Investment and Technology Transfer Act and company act when read together is bound to create confusions as to the permissibility of establishments in Nepal. Any country that envisions to increase foreign investment must attract foreign investment form the preliminary stage, the preliminary stage being an analysis of the laws governing foreign investment by a prospective foreign investor. Most foreign investors seek laws that are comparable or even similar to laws of other jurisdictions where they have previously operated. This provides a sense of consistency in terms of the general operation of business and the compliances to be met. Our existing laws, therefore need to be similar to laws from other jurisdictions that attract the highest foreign investment, the use of concepts such as branch industries thus only dissuades investors in so far as the terminology and the compliance it brings is unknown. **It is therefore suggested that the terminology industry be replaced with company to create some form of harmony with our own laws as well as with laws of other jurisdictions.**

e) Foreign Loan Investment

Foreign Investment and Technology Transfer Act, 2019 permits industries with foreign investment to borrow project loan from foreign financial institutions subject to the approval of Nepal Rastra Bank and Ministry of Industry Commerce and Supplies. The loan can only be availed from foreign financial institution and more specifically is limited to a particular project. Other forms of loan i.e. general loan and loans made by foreign institutional shareholder is not permissible. It was noted during the consultations that such restrictions limit the scope of financing arrangements that can be made. Nepal has had a history of liquidity crunch and even currently is going through one, as such making foreign avenues for financing open seem like a necessity. Restrictions placed on foreign loan arrangements also do not seem consistent with the current global practices i.e. shareholder lending is permissible in a majority of the country and even permissible to domestic companies under the prevailing companies act. Furthermore, while the provisions of the act donot specify the issue of foreign loan investment form institutional shareholders, circulars in effect from the NRB in reality allow such investment. To that extent the provisions are in conflict with each other. Restrictions therefore on shareholder lending for companies with foreign investment

therefore do not seem in line with the national treatment accorded by the same legislation. **It is therefore recommended that the section be amended to include loans from foreign institutional shareholders within the purview of foreign loan investment.**

f) Minimum Investment Ceiling

Section 3(e) of the act authorizes the government of Nepal to prescribe a minimum ceiling on foreign investment. The current ceiling prescribed is NPR 50 million. During the consultations held with stakeholders, participants were unaware of the rationale behind such ceiling. If the intention is to attract large amounts of investments, there is very little evidence to suggest that large investments are better than smaller and infrequent investments. In fact, smaller investments in Nepal have created more visible jobs than large investments, since large firms employ capital intensive modes of productions. Likewise, if the intention is to weed out unwanted and inefficient investments, the screening process that already exists is built for that specific purpose. Furthermore, it was also pointed out that the current celling amount might not be appropriate for sectors that require low amounts of capital to get the business up and running for instance the IT sector. Although the current decision to allow pre-incorporation expenses to be incorporated within the amount of investment is indeed a welcome decision, it still might not be enough for foreign investors to reach the prescribed minimum. **To this extent it is recommended that the minimum amount be eliminated altogether, since it serves very little purpose altogether.**

g) Other issues

There are some jurisdictional issues that have not been clarified by the act. For instance, the act gives Department of Industries the authority to approve investments worth NPR 6 billion and Investment board the authority to approve investments above NPR 6 Billion. However, the Public Private Partnership and Investment act authorizes the Investment Board of Nepal to approve investments with a project cost of more than NPR 6 billion. This is seemingly problematic when the foreign investor wishes to inject the total estimated project cost in multiple tranches. If the project cost is to be taken as a criterion, IBN approval would be required regardless of the amount of the tranche operation in case the estimated project cost is worth more than NPR 6 billion. If we take the criterion of foreign investment amount, then the DOI would be the approving authority in case of a multiple tranche operation if the amount is less than NPR 6 billion. This seems like a clerical error, regardless conflicting provisions such as these do send a wrong message to the foreign investors, the quality of

legislation and its consistency with other legislation is an important aspect of foreign investment decision. **The host nation to that end has the responsibility of maintaining consistency across various laws.**

There are also some provisions that are important but have been left out of the act. For instance, pre-incorporation expenses to a certain limit can be included in the amount of foreign investment when seeking approval. This is to a larger degree, made so as to make it easier for foreign investors to reach the minimum ceiling on foreign investment. Yet this provision is mentioned in the byelaws of the Nepal Rastra Bank. Such provisions are essential to the foreign investor in terms understanding the preliminary rules of foreign investment, yet there are many such provisions that are applicable to foreign investors when making foreign investment but not provided in the FITTA, for instance the limit of 80 percent investment in the telecommunication sector is provided by the Telecommunication policy. **It is important to recognize that all information relating to foreign investment regime must be provided by a single legislation so as to ensure that when a foreign investor conducts their due diligence, their search costs are reduced.**

KEY POLICY AREAS AND RECOMMENDATIONS FOR COMPANY ACT

a) Definitions

Listed Companies

Section 2(g) of the Company act 2063, defines listed companies as public companies which has its securities listed in the stock exchange. A review of existing literature and companies legislation of other pertinent jurisdiction reveals that private companies are allowed the listing of securities in the stock exchange. More particularly, the prohibition of listing securities for private companies in the stock exchange only applies to shares of any kind. In a majority of the jurisdiction, private companies are allowed to list their debt security in the capital markets. It was noted during our KII and focus group discussion that allowing listing of debt securities in the capital market for private companies could open a new avenue for raising the capital of the private company. Such provisions however must come with its own set of regulations. The relevant agency for such regulation is identified to be the securities investment board of Nepal. Current international practice in this regard also aligns with the issues raised during KII's and FGD's. To this extent the Indian practice serves as a relevant

benchmark in Nepal so far as allowing private companies to raise capital through issuing debt securities and listing debt securities through the approval of Securities Investment Board of India goes.

It is therefore recommended that the definition of listed companies be amended to read, "**listed companies means public companies which has its securities listed in the stock exchange and private companies that have listed their securities in accordance with the rules prescribed by the Securities Investment Board of Nepal"**.

Holding Company

Section 2(d) definition defines holding company as a company-having control over a subsidiary company. There are two parts to this definition namely, a company and exerting control, Company is defined by section 2(a) as a company incorporated under the companies act and control is further clarified in section 142 of the act as direct or indirect control over the formation of board of directors and holding majority shareholders. The issue in the definition lies with its focus on company, which can only mean that the holding company must also be incorporated in Nepal if the provisions of the definition are to be strictly followed. To this extent, the possibility of a foreign holding company is completely negated by the provisions of the current definition. This is also in contravention with the current Foreign Investment and Technology Transfer Act, 2019 that allows a foreign company to incorporate a wholly owned subsidiary in Nepal. A similar issue with the definition of the holding companies was also highlighted in the Companies Law Committee report, 2016, India, where a similar definition of Holding Company was used. The committee was of the opinion that although it was a minor anomaly, it could lead to further confusions in the future. Although in practice, companies in Nepal have a foreign holding company, the definition provided by the Companies act, if strictly followed would jeopardize the legality and existence of such companies. To this extent, it is recommended that the definition read, "**holding company as a company or a body corporate having control over a subsidiary company".** The inclusion of the term body corporate would signify that a corporate entity regardless of the place where it is registered can be a holding company in Nepal. Concurrently the term, body corporate must also be defined to read, **"Body corporate is a legal entity having limited liability having its place of registration in Nepal or outside Nepal"**.

Foreign Company

Foreign Company is defined by section 2(f) as a company incorporated outside of Nepal. Chapter 16 sections 154 through 158 provides the details on the regulation of foreign companies. Per the definitions and the provisions of chapter 16, no company incorporated outside of Nepal can carry out any significant transaction of business in Nepal without its registration as a branch office. Business or transaction has been defined as any transaction carried out by a foreign company for a period of one month or more through an office established in Nepal or through a contact person in Nepal. To this extent, the definition and the particular sections concerning the regulations thereof, will include all foreign companies, especially those that fall under the domain of information and technology to be incorporated in Nepal. As a global practice, the need for registration of foreign companies carrying out significant transaction relies in so far as the transaction itself is material or not, the mere indication of the location of server or a technological asset in a particular location no longer serves as reason enough to incorporate a foreign company within any domestic jurisdiction. Relevant international jurisdictional examples in this regard is the Indian Companies Law committee report, 2016 and the European Model Companies Law Committee report.

It is recommended that the definition of the foreign companies be amended to read. "**Foreign Companies are companies carrying out significant transaction within Nepal**". More particularly, the word significant transaction must also be defined further to include only those transactions that are material and not merely incidental or occurring because of the location of the web based server.

b) Incorporation of Companies

Paid-Up capital

Section 11(1) of the Company act prescribes the minimum paid-up capital for a public company to be a minimum of ten million rupees. This is a general rule and does not extend to minimum paid-up capital rule prescribed in specific legislations, for instance the minimum paid-up capital for Banks and Financial Institutions prescribed in BAFIA. Minimum capital rules are often arbitrary and their determination is more often than not based on any reasonable justification. In recent years, there has been much debate on the need for minimum capital. Most jurisdictions have either done away with their minimum capital requirement or set the minimum capital requirement very low. Mostly, the minimum capital requirement is set on par with the gross domestic savings per-capita of a person to facilitate the establishment of business. On jurisdictions that have a minimum capital

requirement, the justification is the protection of creditors or a greater analysis on part of the person/persons seeking incorporation about the risks associated with the business establishment. On the point of the protection of creditor risk, it has been argued that simply because money was available at a particular date i.e. during incorporation does not necessarily mean it will be available at a later date. The creditor's risk is mostly gauged through the books of accounts of any particular company. Provisions for gauging the books of accounts in case of a public company have already been made, to the extent that the minimum capital requirement during the incorporation phase serves very little purpose in terms of assessment of creditor risk. Additionally, too high a minimum capital requirement can often lead to forum shopping, i.e. the practice of choosing jurisdictions with the most lenient and reasonable incorporation requirement, this can conversely effect the amount of greenfield foreign investment received. Readily available statistics in this regard also conform that most foreign investment is made through incorporation of private companies, consequently, the number of listed companies in the Nepal stock exchange is significantly lower within the south Asian jurisdiction, something that has prevented the growth of the capital market and even to a certain degree increased risky investments in the absence of multiple alternatives.

Nepal falls on the minority list of countries that prescribe a high minimum capital requirement for incorporation of public companies. Most jurisdictions have significantly lowered the minimum capital requirement, rather in view of creditor risk protection, they have standards for maintaining fixed amount of reserves or building up to the amount of reserves in subsequent reserves. **It is therefore, recommended that the minimum capital requirement for public companies be decreased significantly or not prescribed at all, rather prescribing a specified amount of reserves to be maintained seems like a better alternative.**

Memorandum of Association and Articles of Association

Section of the companies' act, prescribes the documents to be submitted when incorporating a company. The memorandum of Association and Articles of Association are documents that need to be submitted during the incorporation phase. The contents of the documents are laid out in section 18 and section 20 respectively. While there are differences in the contents of the documents, there are also overlaps in certain areas, more particularly on areas concerning rights of shareholders, conversion of shares, classes of shares, transfer of shares

etc. Both documents have formats available publicly which does provide a general idea as to how the documents should be made, however, it was noted during the KII's and FGD's that a majority of prospective companies seek professional services in drafting the documents. Since the there are two documents the costs of incorporation becomes higher given the drafting fees. It was also noted during the discussions that most jurisdictions have merged the two documents into one, to ease the process of incorporation through lesser documentary compliances. Since, the content and the subject matter of both the documents are similar, preparation of both documents for incorporation merely increases the cost of incorporation, days required for incorporation including the preparation of the documents as well as the documentary compliance for incorporation. To this extent, the current proposed unregistered amendment bill of the Company Act, prescribes the amalgamation of both documents into one. **It is therefore, recommended that the current provision requiring the submission of both the MoA and AoA, be amended to include the submission of a single document that serves as the company's bye law.**

Objectives of the company

Section 18(1(c)) of the Company act, prescribes the inclusion of the objectives of the company in the company act. The mode of inclusion of objectives is further clarified in the Companies Directive, 2072, number 10, which states that a company can be incorporated with more than one objective, provided the objectives are classified on four broad headings, Manufacturing, Trade and Commerce, Service related and other business. The company can also add the number of objectives at a later date through an amendment of the Memorandum of Association, the provisions for which are also provided by the act itself. Generally, the objectives of the company are not restricted, and a company is free to carry out any activity mentioned in its MoA. The problem however arises when a company seeks to change its current object so as to include new areas of ventures. The process requires calling a general meeting and passing a resolution for the same and recording the changes at the office of the company registrar. This has been known to take up a lot of time since there are separate procedures and compliances for calling a general meeting and passing a resolution for the same. International practice in this regard has been to state a generalized objective of the company i.e. to engage in any lawful activities permitted by the prevailing law". This is a more liberal practice that allows companies to pursue multiple ventures based on their own strengths subject to the restrictions of the specific law. More importantly, since any substantial changes made through the general meetings and resolutions adopted thereof are

periodically reported to the companies regulating authority, the general clause also serves the purpose of disclosures for the current objectives of the companies for regulatory purposes. While, there are no restrictions as such to pursue multiple objectives, it is inconceivable to think that any company can foresee the relevant directions and ventures it will pursue in the future, to this extent, companies in Nepal when pursuing new ventures outside the scope of their objectives, have to follow a lengthy process to start commercial operation of a new venture, the time spent on complying with such procedures has an impact on the return on investment and future profits. **To this extent it is recommended that the manner in which objectives are formulated be more liberal and open to include a general objects clause. The provision for incorporating a general clause in the MoA must be reflected in the Companies act as well as the prevailing Companies Directive.**

Authentication of Documents

The companies act makes provision for submission of any pre-incorporation agreement in case of public companies and consensus agreement if any for private companies during the incorporation process. Directive Number 3 and 4 of the Companies Directives clarifies that such agreements need to be authenticated and submitted to the office of the companies' registrar during the process of incorporation. It is noted that such authentication merely increases the documentary burden during the companies' incorporation process. A similar issue was also highlighted in the Indian Company Law Report, 2013. Our discussions with relevant stakeholder also reveals a similar documentary burden. **It is therefore suggested that instead of authentication provisions for submission of self-declarations be made in the prevailing Company act and Company Document. It is also recommended that in order to made self-declarations more effective, punishment measures for wrong self-declaration as a mechanism of establishing checks.**

c) Director's and Officer-in-charge's liability

The prevailing Company act prescribes some liabilities of the director for non-performance of certain activities. The liabilities of the director can either be in the form of fine or imprisonment depending on the gravity of the offence. The concern here is more specifically with sections 24 (2 and 3) which prescribe for the liability of matters contained in the prospectus in the form of payment of compensation for those who suffer loss or damage by means of their subscription of shares based on the matters contained in the prospectus, section 51: failure to submit inventory of shareholders, section 78: failure to submit report

prior to the holding of Annual General Meeting, Section 120: failure to furnish explanation when called by the office of the Company registrar and section 156: failure to submit annual statements of the foreign companies. In all matters, a fine is levied and the fine is compounded after a specific period of time.

Particularly section 24(2 and 3) places the burden on the directors to ensure that the prospect is technically sound. Generally, the prospectus is prepared by technical experts and the prospectus reflects the capabilities of the technical expert. As such, the Defence of reliance on technical experts to prepare prospectus is not available to directors who sigh the prospectus. International practice in this regard is to either hold technical experts accountable for the prospectus they prepare or to allow directors a defense of claiming that the prospectus was signed in good faith based on the preparation of the technical experts. To this extent the director's liability will only arise in case the director knew of the misleading statement and knowingly signed on the prospectus. Such a defense is not available in Nepal, an amendment to the prevailing section that allows for such defense and for the liability of the technical experts involved in the preparation of the prospectus is needed currently.

On the nature of director's liability for non-submission of particular documents no defense is available for extra-ordinary situations preventing the submission of documents. In the KII's and FGD's conducted it was revealed that activities related to submissions are often outsourced to a third party service provider. As such when the third-party defaults in the submission of the documents it becomes unreasonable to hold the director accountable for wrong done by someone else. Similarly, although the provisions of the liabilities make room for making the officer, the definition of which includes director, chief executive, manager, company secretary, liquidator and any employee undertaking departmental responsibility of the company, the definition excludes the agency relationship established between the director or the company with any third party service provider. To this extent, when the agent defaults, the provisions of the sections make the director liable for wrong committed by the agent. As a principle of Civil law articulated in the Civil Code i.e. the wrongdoer to bear the penalty of the wrong, the provisions of the act places an unreasonable burden on the director. Similarly, it was also noted that a large number of firms are located outside the capital city, such firms have very little digital awareness of the current provision of submission of necessary documents through the online medium. It was reported that the submission for such firms was manual, and since the office of the company registrar does not have any

effective regional offices outside of the capital city, manual submissions for such firms relies heavily on the services provided by third parties. To this extent, a defense of the default of the third party or extra-ordinary circumstances preventing the submission of the document is felt necessary to shield the directors from liability arising from wrong committed by someone else. **It is therefore recommended that the definition of officer in section 2(j) be amended to include any agent hired by the company and relevant sections concerning the liability of director's be amended to include reasonable defenses for failure to submit annual records and documents.**

d) Hybrid security instruments

The prevailing Company act, allows the issuance of shares and debentures as a means to raise the capital of the company. Share and debentures have been defined in the companies act itself. Debentures are defined as bonds issued by a company whether putting its assets as collateral or not, similarly shares have been defined as the divided portion of the share capital of the company. Both definitions and the procedures prescribed thereof exclude the possibility of issuing hybrid forms of debentures. For instance, it is unclear whether or not debentures or debt securities that re dependent on the economic performance of the company can be issued or not. Similarly, it is unclear as to whether shares can be issued as consideration of a contractual obligation. Both forms of hybrid instruments are commonly found in multiple jurisdictions. The relevant international practice in this regard has been to allow the issuance of securities, the companies legislation however in other jurisdiction does not prescribe the manner in which such instruments are to be issued and the peculiarities of such securities. Specialized agencies such as the securities board are given the responsibility for prescribing such rules. **It is therefore recommended that the prescription of such rules be left to the Securities Board of Nepal and provisions on issuance of shares and debentures from the Company act only contain the minimal provisions on the non-restriction of issuance of securities in accordance with the regulations made by SEBON.**

e) Voting Power v Shareholding

The current provisions of the Company act allows certain rights to shareholder or a group of shareholders. Such rights are in the form of calling an Extra-ordinary general meeting as per section 82, filing a petition challenging the change in the objectives of the company as per section 21(4), and institution of case on behalf of the company against the director or

officer as per section 140. Such power is granted on the basis of the shareholding, for instance a petition challenging the change in objective may be filed by a shareholder or shareholders holding at least 5 percent of the vote and the extraordinary general meeting can be called by shareholder/shareholders holding at least ten percent of the total shares from the paid-up capital. The provisions for such rights excludes the possibility that shareholding does not translate to equal voting power, since the act itself makes the provision for issuance of shares sans any voting power, to this extent, the provisions for making petitions and call for EOGM provided on the basis of shareholding capacity is not in line with the current global practices. The distinction between voting power and shareholding is made in order to restrict the decision making of the company to a short number of people in order to pursue an effective and efficient management of the company. The said distinction is also made in other jurisdiction in order to prevent conflict of interests when an institutional shareholder is involved and to prevent situations in which the institutional shareholder might work against the best interest of the company itself. **In line with the international practices and the reasons put forth in the preceding lines, it is recommended that the privileges of the shareholder be decided on the basis of voting power, more specifically for sections 21(4) and 82 it is recommended that the term shareholding be replaced with voting power.**

KEY POLICY AREAS AND RECOMMENDATIONS FOR INDUSTRIAL ENTERPRISE ACT

a) The intention of the legislation

The industrial enterprise act, 2020 has supplanted the previous acts, which were a continuation of the Industrial Enterprise act, 1992 designed during the liberalization era in order to end the then existing license raj. The act makes it mandatory for registration as an industry for businesses classified as an industry by the annexes of the act. There are some progressive features of the act such as the no-work no pay policy and the generous exemptions it seeks to provide. Yet, even so, the intention of the legislation is unclear. There are two particular reasons for this. First, the act does not provide the definition of an industry. The determining character of whether or not a business activity is an industry is merely

ascertained from whether or not such business activity falls under the list of business activities provided in the annex. The rationale for inclusion of such business activity within the annex is also unclear insofar as the criteria for inclusion is concerned. To that end, it is really difficult to ascertain what exactly is an industry and by extension the purpose of regulating an industry. The second reason is the way in which the annexes are formed. A summary glance of the annexes shows that there are several business activities distinct from each other, with no common characteristics that are regulated in the same manner. For instance, the annex has both a ferocious metal production business and a hair salon. Indeed, both business activities have their own peculiarities and thus require differentiating regulation. Yet, the provisions of the act are equally applicable to both the business activities. Furthermore, there is also a duplication of authority in the sense that most of the functions to be performed by the department are either performed by sectoral regulators or the office of the company registrar. The concept of industry is in reality unique to Nepal insofar as the classification of business as industry is concerned. The Indian and English Industrial regulations, classify only those business activities as industries that require a higher standard of care from the perspective of consumer protection. This serves two purposes, first it helps in designing regulation that is appropriate given the business activity and secondly, it reduces any duplication in authority. **As a resolution it is recommended that the scope of business activities classified as an industry be limited to only those business activities that manufacture goods and require some degree or standard of care from a consumer protection and welfare perspective. It is also recommended that instead of detailing out the list of business activities classified as an industry, conditions and criteria's be framed for determining whether or not a particular type of business activity is an industry**

b) Provision for registration of Industrial Enterprises at provincial level.

Section 4 subsection 2, provides for the registration of certain categories of industries at the provincial level for. This provision arranged in this act is first of its kind after the inception of Federalism to allow registration and renewal of certain category of enterprises at Provincial level, and therefore is definitely commendable. However, the conditions whereby an enterprise already registered at Provincial registration authority will have to also deal with Federal registering authority during certain circumstances will only add compliance requirements and increase amount of time and cost required to fulfil certain

legal procedure for enterprises. For instance, enterprises registered at Provincial registering authority will have to retrieve permission from Federal registering authority for transfer of location and establishment of an industry in another location. Likewise, such enterprises when expanding across multiple Provincial jurisdictions will also have to get reregistered with Federal Government if previously registered at Provincial authority in order to meet the condition of Clause 4 of Section 4(1). **The issue of access of regulator avenues in rather centralizing the entire aspects of enterprise related affairs can be tackled by strategically positioning "the one stop centres" composed of agents representing Federal registration avenues in multiple localities that are easily accessible to enterprises located across the country. Meanwhile, Provincial and local tiers of governments can necessarily assist in effectively positioning and operating such one stop service centre though operated by the representing members of Federal avenues. And importantly, the provision of online registration provided for enterprise registering at Federal department through electronic/digital signature as mentioned in Sub-section 4 of Section 4 can be taken advantage of as an alternative medium to register enterprises.**

c) Unspecified time period

Sub section 6 of section 4 elaborates that the government entities responsible for registration of enterprise shall immediately order applicants for further documentation incase such documentation is required. Sub-section 7 also states that the government body can reject the application for registration with the adequate explanation should the documents not be presented within the stipulated time. Both sub-sections of the act does not state how many specific days will the registering avenues take in deciding to order the applicants to submit further required documentation or rejecting the application altogether with explanation after the documents have been submitted by the applicants. Though the sub-section 6 of the section 4 states that the concerned enterprise registering avenue shall "immediately" deicide and order the applicants to submit further required documents after receiving the first issue of documents, the use of vague terms as "immediately" can have multiple interpretations, and therefore is open to exploitation by the officers of the registering offices. In other words, such unspecific time limits allow opportunities for registering officers to extend number of days to fulfil the task on their own discretion, thus compromising the speed of the service delivery. Such anomaly has direct implication on the number of days required to register a business, and therefore affects ease of doing business. **As a resolution,**

amendment should be made in Sub-section 6 of the Section 4 by providing the provision of specific timeframe within when the enterprise registering avenue should submit further required documentation if necessary or reject the application altogether after it being submitted for the first time.

d) Unspecified criteria for receipt of permission

Section 8 subsection 5 of the act provides the authority to Industrial and Investment Promotion Board established as per the act to add further conditions and criteria to approve applications for enterprises falling under schedule-1. It can be argued that such discretion to add unspecified conditions and criteria while allowing permission to register enterprises can lead into misuse of authority by the board members. In other words, the board members on their own personal judgment may add unnecessary restrictive conditions for enterprises that do not fall into their favour or opposite for enterprises that do fall into their favour. **Provisions in terms of limit of conditions and criteria that can be prescribed by the board with genuine explanations should be kept in this act that prevent the board members from restricting or promoting certain enterprises based on the judgment that does not meet the purpose of the board.**

e) Composition of the board

Section 20 of the act details out the composition of the board. The board comprises entirely of ex-officio members. The chances for the board to accomplish their assigned task within the stipulated time period is less likely as the ex-officio status will often hold them with primary responsibilities leaving less time to meet regularly, or timely carry out the functions that they are required to as members of the board. Importantly, such status of the board may not allow them to make decisions regarding whether to provide permission to operate enterprise requiring permission even within 30 days which is required by the act as mentioned in the Sub-section 4 of the Section 8. **Instead, the act should contribute towards fine tuning the composition of the board by at least demanding authorized representing members of the government offices, ministries, or department than summoning Chiefs, secretaries, and governors of the offices whom are mostly engaged in handling the strategic direction of the offices they are primarily responsible for. As a moderate adjustment, at least the core functioning members of the board should be of the status whereby they are primarily responsible for fulfilling the decision-making task of the board even though the chief of the board fulfilling mostly figurative role can**

still be the Minister of Commerce and Supplies.

f) Submission of fees for retrieving information about the industry

Section subsection 2 and 3 of section 16 provide that Records relating to enterprise registration, renewal, entity transfer, relocation, capacity upgrade, capital upgrade, objective addition or change, or enterprise registration revocation kept securely by the enterprise registering avenue (also in electronic format) can only be made available to the concerned enterprise after receiving formal application and Fees stipulated by the registering avenue should be paid while submitting application for such request. Requiring to lodge a formal application to access such records by paying certain fees stipulated by the registering avenues not only creates an unnecessary procedural hassle for the enterprises but also exhibits a rent-seeking mentality of the government willing to unscientifically extract revenue from the private enterprises. Besides, the elaboration in the sub-section 3 whereby the amount of fees to be levied for such records retrieval be as stipulated by the registering avenue may allow officers of the registering avenues to charge any amount for the service as per their personal discretion. Instead, the clauses in the act should allow authentic documentations and records concerning a particular enterprise to be shared with the owner of the enterprise in electronic format accessible freely whenever required. **Such information if required to be transacted securely may also be transacted through the encryption mechanism of digital signature. Nevertheless, access of such records of enterprise details should be fundamental rights of the concerned enterprise**.

g) Provisions relating to sick industries

Section 39 provides the criteria for declaration as a sick industry and also the facilities and exemptions provided for revival of sick industries. At first and foremost, the market left to its own devices is bound to evolve continuously and shall lead certain industries and nature of businesses to become obsolete over time. In fact, the rate of market evolution in the contemporary era is likely to make a five years old business model out of favour mostly as a result of market forces introducing innovative business processes and products more adaptive to the consumer's requirement. Illustrations concerning demise of Video Disc retailers and Cyber cafes once popular in the city neighbourhood amid availability of cheaper multimedia supportive personal devices, online video streaming applications, and Home Internet service providers is a vivid case observed in the entertainment retailing industry of Nepal whereby a particular nature of business has been purely made obsolete

as a result of change in external or market circumstances.

As such, the provision in the latest Industrial Enterprise Act to offer financial or non-financial assistance to a crumbling enterprise operating on at least five years old business model just because the cause of its despair is completely independent of management ineffectiveness or their sole intention and only due to ongoing external circumstances shall only lead to spending of government efforts for intervening the dynamics of the market for worse. Such intervention, though carried out with pure intention to support the economy, shall not only lead to unnecessary spending of public money but also deter the market from becoming competitive and efficient. This practice purely goes against the theory of Creative Destruction believed to promote innovation and growth in the economy.

While this provision for sick enterprises in the act if followed with benevolent intent is not beneficial for the welfare of the self-governing market and the economy of the nation, the two clauses of the act detailing the provision is not without loopholes available for exploitation. Firstly, the use of the phrase "as per specified criteria" in Sub-section 1 of Section 39 while declaring a particular enterprise as a sick enterprise even when the clause details that the very enterprise should have come under water purely as a result of external circumstances creates room for the authorized officials of the declaring office to categorize a particular enterprise as sick enterprise based on any criteria that he or she can claim to be a part of the specified criteria which however is not elaborated in the act. The unscrupulous officer may exploit the clause purely with the intent to advantage a particular enterprise on his or her favour with government sponsored facilities and exemptions that are also unspecified in nature as expressed in the Sub-section 2 of the section 39 of the act.

Other than not specifying the nature of facilities and exemptions to be provided to an enterprise declared as sick in the Sub- section 2 of the Section 39 of the act, the very clause also fails to specify the exact time until when the declared sick enterprise shall be privileged with government sponsored facilities and exemptions. As such, it is not only uncertain until what extent shall the taxpayer's money be deployed in subsidizing the sick enterprises but it is also uncertain until when the unspecified extent of facilities and exemptions be provided to the enterprises that are declared sick on unspecified grounds. Not to mention, such vagueness in multiple areas of the Sub-section 1 and 2 of the Section 39 provides significant opportunities for the officers of the government to unscrupulously exploit the clauses to largely benefit personal favours while also enables the government itself to eternally support

its loss-making Public Enterprises through taxpayer's money. As a resolution, the updated Industrial Enterprise Act should not offer privileged provision for faltering enterprises with exemptions and facilities just because their dire status is purely the consequence of external circumstances. The lawmakers concerned about the long-term Industrial and economic welfare of the economy should primarily understand the fundamental principle of free market, and therefore should not promote regulatory provisions that attempt to distort the market mechanism. If it is not practical to completely scrap the provision of sick enterprises in the act, then the act should at least be very specific and rigid about the circumstances during when an enterprise is declared sick, the limit and nature of exemptions and facilities to be privileged, and the extent of time until when such privilege can be provided. Such amendments can at least reduce the intensity of the loophole present in this section of the act for it to be less exploitable in fulfilling personal discretion of the authority at the cost of taxpayer's money.

h) Similar provisions for small and medium sized industry

Section 4 of the industrial enterprise act, provides that any person or firm or Conccompany intending to establish an industry must submit an application along with prescribe document. The document and the format is prescribed in the Industrial enterprise act. While the act makes distinct provision for exemptions based on the capital invested and the size of industry, registration process has been made similar for all categories of industry except micro, cottage industries. One aspect that is hindering the registration process is the technical proposal to be submitted to the department. Many small and medium sized enterprises are reported to not have any knowledge on how to prepare such reports. To that end, there have been instances when registration is either refused or has taken a long time owing to corrections to be made the technical proposal. The differences in the operation of medium sized enterprises and large industries must be acknowledged, it must also be acknowledged that not all categories of industry may require the submission of technical proposal. It is also unclear as to why a technical proposal is demanded in the first place and there exists no criteria for judgment of technical proposal, which is likely to result in some form of rent seeking mentality. **To this end it is recommended that differing provisions be made for small, medium industries and large industries for documents to be submitted during registration.**