

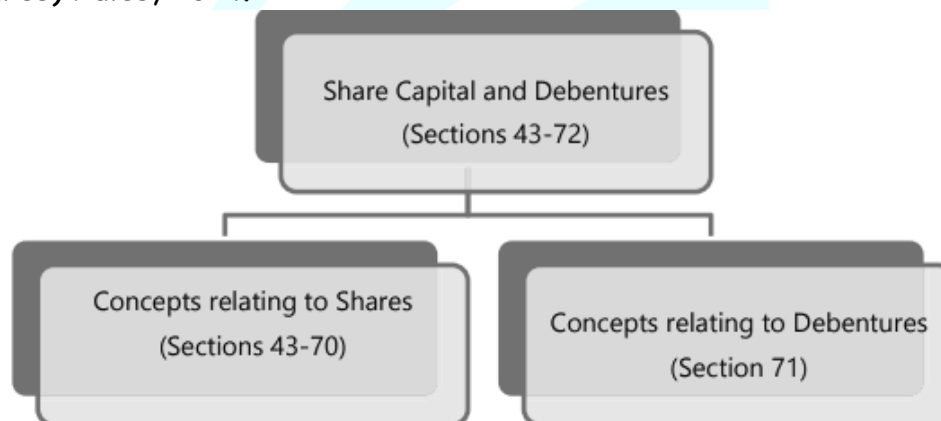
Chapter 4: Share Capital & Debentures

Concepts relating to Shares (Sections 43-70 [excluding sections 44, 45, 60 and 65])

Concepts relating to Debentures (Section 71)

Introduction

This chapter explains the provisions contained in **Chapter IV (comprising Section 43 to 72) of the Companies Act 2013** (hereinafter referred to as the Act or this Act) regarding the 'Share Capital and Debentures', along with relevant procedural aspects explained in the Companies (Share Capital and Debentures) Rules, 2014.



Finance, the lifeblood for running the affairs of a company, can be raised, inter-alia, by issuing shares and debentures. In fact, shares and debentures are financial instruments which help in arranging funds for the company. Under the Companies Act, 2013, they are **jointly referred to as "securities"**.

Shares represent ownership interest in a company with entrepreneurial risks and rewards whereas debentures depict lenders' interest in the company with limited risks and returns.

Sometimes, after the issue of capital, a company may either alter or reduce the share capital depending upon the exigencies of the situation. The company has to follow the requisite provisions for alteration or reduction of share capital.

Both the shares and debentures are presented in the Balance Sheet on the liabilities side of the issuer company and on the assets side of the investor and lender respectively.



Legal provisions relating to these instruments are covered under Chapter IV of the Companies Act, 2013 (comprising sections 43 to 72) and the Companies (Share Capital & Debentures) Rules, 2014 as amended from time to time along with endorsement in the company formation documents or approved at the suitable company forum, wherever necessary.

SHARE CAPITAL-

Types What Are Share and Stock?

Share - Definition & Description

Section 2(84) of the Act defines share as a share in the share capital of a company and includes stock. Capital of a company is termed as share capital, which is divided into units; having a certain face value. Each such unit is termed as share.

New London & Brazilian Bank v. Brockle Bank

A share is not a sum of money..., but is an interest measured in a sum of money, and made up of various rights, contained in the contract, including the right to a sum of money of a more or less amount.

Around **two decade later, J. Farwell** in landmark case of **Borland's Trustee v Steel Brothers & Co Ltd** place his trust in the opinion stated above, and observe that share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place and of interest in the second, and also consists of a series of mutual covenants entered into by all the shareholders inter se in accordance with the provisions of the Companies Act and the Articles of Association.

Example- Sun Bakers Limited has authorized share capital of ` 50.00 lakh. The face value of each unit of capital or 'share' is ` 10. In this case, it can be said that the company has 5.00 lakh shares of ` 10 each. When these shares (either in part or whole) are allotted to various persons, they, on the date of allotment, become shareholders of the company.

Note: Companies limited by share or those which have share capital have to quote in their memorandum - The share capital of the capital is _ _ _ _ _ rupees, divided into _ _ _ _ _ shares of _ _ _ rupees each.

Stock - Description

The definition of 'share' states that the term 'share' includes 'stock'. If a company undertakes to aggregate the **fully paid-up shares of various members as per their requests and merge** those shares into one fund, then such fund is called 'stock'. In more simple words we can say that 'stock' is a collection or bundle of fully paid-up shares.



Section 61 (1) (c) of the Act, empowers a limited company having a share capital to convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination.

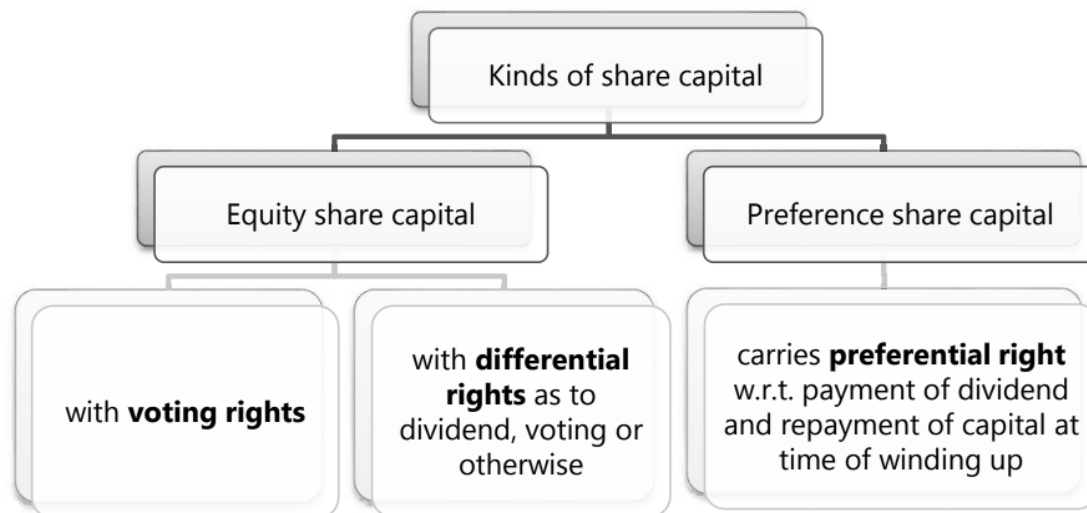
Students are advised to take note of -

What makes stock different?

Stock is stated in lump sum whereas a 'share' being the smallest unit is having face value. Originally shares are issued to the shareholders while in case of stock, the fully paid-up shares of the members are converted into 'stock' afterwards. Thus, 'stock' is not issued originally but is obtained by conversion of fully paid-up shares.

Kinds of Share Capital [Section 43]

Broadly, there are **two kinds of share capital of a company limited by shares: Equity share capital and Preference share capital**. Equity Share capital can be further segregated into two categories based upon rights. Following diagram depicts kinds of share capital;



Preference Share Capital [Explanation II to section 43]

Preference share capital is that part of issued share capital of any company limited by shares which carries preferential right in respect to;

a. Payment of dividend, may be absolute amount or at fixed rate (which may either be free of or subject to income-tax); and

b. Repayment of capital, in the case of winding up or repayment of capital. This preference exists only up to the amount paid up or deemed to have been paid up on the shares, unless there is an agreement in contrary to this.



Example- Ind-swift Pharma Labs Limited and Panacea Biotech Limited issued preference shares. Ind-swift Pharma provides that the preferential dividend may be a fixed amount, say ` 5,00,000 in one year, payable to preference shareholders before anything is paid to the ordinary shareholders. Whereas the Panacea Biotech provides that the amount payable as preferential dividend may be calculated at a fixed rate @ 8 percent of the nominal value of each share.

Authors Note: 1. Nothing contained in this Act shall affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.

2. Preference shareholders **may also participate** in the equity pool post the preferential entitlements.

But to find out their rights of participation we must look within the four corners of the **articles of association** and the terms of the issue. If the right to participate in the surplus is not specified in the **terms of the issue**, preference shares are presumed to be not participating. This was affirmed by the House of Lords in *Scottish Insurance Corpn Ltd vs. Wilsons & Clyde Coal Co Ltd* 3

3. Preference shares are always **presumed to be cumulative** and the accumulation of dividend can be excluded only by a clear provision in the articles of association ***Staples v Eastman Photographic Materials Co (1896)***

Illustration

Can a company have only preference share capital?

Answer - It may be noted that while a company may have only equity share capital but it cannot have only preference share capital. This is because preference shareholders have certain 'preferential rights' over the equity shareholders. Thus, in the absence of equity share capital, there cannot be preferential share capital ***Bihar State Financial Corporation vs. CIT Bihar (1976)***.

Equity Share Capital [Section 43(a) read with explanation I to section 43]

Shares capital which are not preference shares capital are termed as equity shares capital. Equity share capital is further classified as;

a. Equity share with voting right (Plain vanilla, because equitable/same voting rights) or

b. Equity shares with differential rights with respect to dividend or voting rights or otherwise in accordance with ***Rule 4 of the Companies (Share capital and Debenture) Rules, 2014***.



Equity shares are often referred as to ordinary share and sometime as common share

Share Equity Shares with Differential Rights [Rule 4 of the Companies (Share capital and Debenture) Rules, 2014]

I. Conditions to issue shares with differential rights

As per **sub-rule 1**, A company limited by shares may issue equity shares with differential rights as to dividend, voting or otherwise, if it complies with the **following conditions**:

- a. The articles of association of the company authorizes the issue of these shares.
 - b. Approval of the shareholders is obtained by passing of ordinary resolution at **the general meeting**. A listed public company is required to **pass the resolution through postal ballot**
 - c. The voting power in respect of shares with differential rights of the company shall **not exceed Seventy-Four [W.e.f. 16th August 2019 through G.S.R. 574(E) (Note - Earlier limit was 26%)] percent** of total voting power at any point of time
 - d. The company has not defaulted in filing annual accounts and annual returns **for the 3 financial years** preceding the year in which it was decided to issue such shares
 - e. The company has not defaulted in the payment of declared dividend, interest, or coupon; redemption of preference shares or debenture; or repayment of matured deposits.
 - f. The company has **not defaulted in the**
 1. Payment of dividend on preference shares, or
 2. Payment of interest or Repayment of any term loan from a Public Financial Institution (PFI) or State-level Financial Institution (SFI) or Scheduled Bank.
 3. Repayment of any term loan from a PFI or SFI or Scheduled Bank.
 4. Statutory dues relating to its employees
 5. Crediting the amount in Investor Education and Protection Fund
- Authors Note:** A company may issue equity shares with differential rights upon expiry of five years from the end of the financial year in which default mentioned in point f stated above, was made good
- g. the company **has not been penalized** by Court or Tribunal during the last three years of any offence under



1. Reserve Bank of India Act, 1934,
2. Securities and Exchange Board of India Act, 1992,
3. Securities Contracts Regulation Act, 1956,
4. Foreign Exchange Management Act, 1999 or
5. Any other special Act, under which such companies are regulated by sectoral regulators.

Authors Note:

1. Equity shares with differential rights issued by any company under the provisions of the Companies Act, 1956 and the rules made thereunder, shall continue to be regulated under such provisions and rules.
2. Here it is also worth noting that; before the amendment made in 2000, to the Companies Act 1956, the shares with differential voting rights were not permitted to be issued. Though such differential voting rights existed prior to the enactment of the Companies Act 1956.

II. Contents of Explanatory statement (annexed to notice)

Sub-Rule 2 provides the explanatory statement **annexed to the notice of the general meeting or of a postal ballot** shall contain various matters like particulars of the issue including its size, details of differential rights, etc.

III. Prohibition on Conversion

Sub-Rule 3 prohibits the conversion of existing equity share capital **with voting rights into** equity share capital carrying differential voting rights **and vice versa**.

IV. Disclosure in the Board's Report

Sub-Rule 4 requires the Board of Directors to disclose the specified particulars, in the **Board's Report for the financial year** in which the issue of equity shares with differential rights was completed.

V. Rights to the holders of the equity shares with differential rights

Sub-rule 5 states that subject to the differential rights, the holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares, etc., which the holders of equity shares are entitled to.

VI. Particulars of shares to be maintained in the register of members

Sub-rule 6 provides that where a company issues equity shares with differential rights, the Register of Members maintained under **section 88** shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

Section 43 shall not apply to:

1. Specified **IFSC Public Company**, where memorandum of association or articles of association of such company provides for it.
2. Private company, where memorandum or articles of association of the private company so provides; however, this exemption shall be available to only that private company which has **not committed a default in filing its financial statements under section 137 or annual return under section 92** with the Registrar.

Certificate Of Shares [Section 46]

Prima Facie Evidence of Title

Shares Issued and held in physical form

As per **sub-section 1**, a certificate specifying the shares held by any person, shall be **prima facie evidence of the title of the person** to such shares if issued;

- a. Under the **common seal** if any of the company or
- b. Signed by **two directors** or
- c. Signed by **a director and the Company Secretary**, wherever the company has appointed a Company Secretary

Authors Note:

1. Since w.e.f. 29-05-2015 through Companies Amendment Act 2015, requirement to have common seal is optional for companies, hence physical share certificate issued under sign of two directors or of one director along with company secretary is valid.
2. If the composition of the Board permits it, at least one of the aforesaid two directors shall be a person other than the managing or whole-time director
3. A director shall be deemed to have signed the share certificate if his signature is printed thereon as a facsimile signature by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, or digitally signed, but not by means of a rubber stamp, provided that the director shall be personally responsible for permitting the affixation of his signature thus and the safe custody of any machine, equipment or other material used for the purpose.



Shares held in Depository Form

As per **sub-section 4**, where a share is held in depository form, the **record of the depository** is the **prima facie evidence** of the interest of the beneficial owner.

Authors note:

Requirements regarding securities issued in Dematerialised form, can be referred to in Rule 9 and Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

Rule 9A was inserted by the Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018, w.e.f. 2-10-2018 and requires every unlisted public company to issue the securities only in dematerialised form and also facilitate dematerialisation of all its existing securities.

Issue Of Renewed/Duplicate Share Certificate [Sub-Section 2 Read with Rule 6 Of the Companies (Shares and Debentures) Rules, 2014]

Issue of renewed certificate

A case wherein **originally issued share certificate has been defaced, mutilated or torn, a renewed share certificate in replacement** shall be issued, in lieu of surrender of such original certificate, to the company.

Authors Note:

1. A company may replace all the existing certificates by new certificates upon subdivision or consolidation of shares or merger or demerger or any reconstitution without requiring old certificates to be surrendered
2. On renewed certificate it shall be stated that it is "Issued in lieu of share certificate No..... sub-divided/replaced/on consolidation"
3. Company may charge such a fee as the board may think fit, but not exceeding 50 per certificate; and no fee shall be payable pursuant to scheme of arrangement sanctioned by the High Court or Central Government.

Issue of duplicate certificate

A case wherein share certificate originally issued has been lost or destroyed, a share certificate in duplicate may be issued if board consented for the same based upon evidence produced.

Students are advised to take note;

1. Companies may charge fees as the Board thinks fit, not exceeding rupees fifty per certificate



2. On the face of the duplicate certificate, it shall be stated prominently that it is "duplicate issued in lieu of share certificate No....." and the word "duplicate" shall be stamped or printed prominently
3. In case of unlisted companies, the duplicate share certificates shall be issued within a period of three months and in case of listed companies such certificates shall be issued within fifteen days, from the date of submission of complete documents with the company respectively.

Record of renewed and duplicate certificate to be maintained

Particulars of every renewed and duplicate share certificates maintained in **Form SH 2 with cross reference to the register of members**, in shape of register.

Such a register shall be kept at a registered officer or any other place where a register of members in custody of the company secretary or such other person may be authorized by the Board.

All entries made in such a **register shall be authenticated** by the company secretary or such other person as may be authorized by the Board.

Manner Of Issue of Certificates/Duplicate Certificates

Sub-section 3 overrules the articles of a company, and say the issue of a certificate of shares or the duplicate thereof, the particulars to be entered in the register of members and other matters shall be in manner and form as prescribed in **rule 5, 6, and 7 of the Companies (Shares and Debentures) Rules, 2014**.

Rule 5 of the Companies (Shares and Debentures) Rules, 2014 applies, where shares are not in demat form

Share certificate is in vogue in case of shares which are held in the physical form, not in the demat form (under the depository mode). Hence provisions contained in **rule 5 of the Companies (Shares and Debentures) Rules, 2014** pertaining to share certificates applicable where shares are **not in demat form**.

Pre-requisites for issue of share certificate

Share Certificate shall be issued on **surrender of letter of allotment or fractional coupons of requisite value** (save in cases of issues against letters of acceptance or of renunciation, or in cases of issue of bonus shares); **in pursuance of a resolution passed by the Board**.



Form of share certificate

Certificate of share shall be in **Form SH 1** or as near thereto as possible and shall specify;

- a. The name(s) of the person(s) in whose Favor the certificate is issued,
- b. The shares to which it relates and
- c. The amount paid-up thereon.

Recording of particulars stated in share certificate

The particulars of every share certificate issued in accordance with **sub-rule (1)** shall be entered in the **Register of Members maintained** in accordance with the provisions of section 88 along with the name(s) of person(s) to whom it has been issued, indicating the date of issue.

Maintenance of share certificate forms and related books and documents (Rule 7 of the Companies (Shares and Debentures) Rules, 2014)

All blank forms to be used for issue of share certificates shall be printed and the printing shall be done only on the authority of a resolution of the Board and these shall be consecutively machine-numbered. Such forms shall be kept in the custody of the secretary or such other person as the **Board may authorize** for the purpose.

All books pertaining to record of share certificates shall be preserved in good order not less than thirty years and in case of disputed cases, shall be preserved permanently.

All certificates surrendered to a company shall immediately be defaced by stamping or printing the word "**cancelled**" in bold letters and may be destroyed **after the expiry of three years from the date on which they are surrendered**, under the authority of a resolution of the Board and in the presence of a person duly appointed by the Board in this behalf.

Authors Note:

1. Share Certificate is not a negotiable instrument.
2. Companies shall issue only one share certificate in all those cases where shares are held by more than one person jointly with others and delivery of share certificate to any one of them will amount to delivery to all of them.

Punishment For Issuing Duplicate Certificate of Shares with Intent to Defraud [Sub-Section 5]



If a company with intent to defraud issues a duplicate certificate of shares, the punishment shall be as specified in table;

Liabile	Minimum Fine	Maximum Fine
Company	Five times the face value of the shares involved	Higher of: Ten times the face value of such shares or Rupees ten crores
And		
Every officer of the company who is in default	Liable for action under section 447 Note Provisions of Section 447 already - explained as separate topic under chapter 3 of this module.	

Example- It is observed that Golden Apple Transport Limited issued share certificates in duplicate with intent to defraud. The total shares in regard to which such certificates are issued are nearly 12,00,000. Face value of each share is 10. The maximum fine that can be imposed on a company shall be 12,00,00,000.

Voting Rights [Section 47]

Voting Rights of Members Holding Equity Share Capital [Subsection 1]

Subject to the provisions of **section 43, section 50 (2) and section 188 (1)**

- a. Every member of a company limited by shares and holding equity share capital therein, shall have a right to vote on every resolution placed before the company; and
- b. His voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company. But in case of Nidhi Company, no member shall exercise voting rights on poll in excess of five per cent, of total voting rights of equity shareholders.

Authors Note:

1. As per section 2(93) Voting right means the right of a member of a company to vote in any meeting of the company or by means of postal ballot.
2. Section 106 specifies provisions regarding restriction on voting rights.
3. Section 43 has an overriding effect on section 47, hence holders of equity share capital with differential rights will exercise voting rights as per clauses of article of association or terms of issue; rather on proportional basis.



Voting Rights of Members Holding Preference Share Capital [Sub-Section 2]

Every member of a company limited by shares who is holding any preference share capital shall, in respect of such capital, **have a right to vote on resolution;**

- a. Placed before the company which directly affects the rights attached to his preference shares, and
- b. For the winding up of the company, or for the repayment or reduction of its equity or preference share capital.

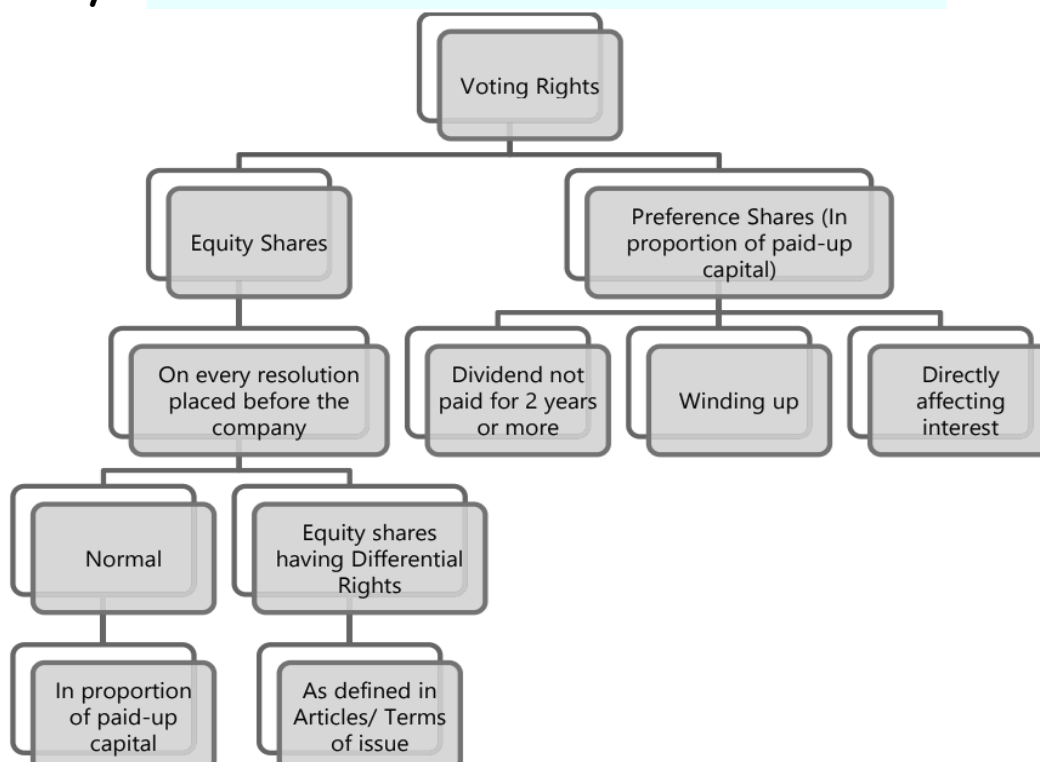
Authors Note:

Voting right of preference share holder, on a poll shall be in proportion to his share in the paid-up preference share capital of the company.

Second Proviso to section 47 (2) empowers preference shareholders with the right to vote on all the resolutions placed before the company, in case where the dividend in respect of his class of preference shares has not been paid for a period of two years or more.

First Proviso to section 47 (2), provides that in case of resolutions wherein both equity shareholders and preference shareholders are entitled to vote, the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

Summary of section 47



Example- Ind Swift Pharma Labs Limited raised the capital of 300 crore through issue of single series of 8% preference share apart from 1200 crore ordinary shares. Indswift last paid a dividend to such preference shareholders, for 2019-20. Preference shareholders w.e.f 1st April 2022 assume the right to vote on any resolution placed before the company. But till 31st March 2022 they can vote only on that resolution which directly affect the rights attached to his preference shares or involve matters of the winding up of the company, or for the repayment or reduction of its equity or preference share capital. The proportion of voting rights of equity shareholders to the voting rights of the preference shareholders shall be 4:1.

Section 47 shall not apply to;

1. A Specified IFSC Public Company, where memorandum of association or articles of association of such company provides for it.
2. A private company, where memorandum or articles of association of the private company so provides, however, this exemption shall be available to only that private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar.

Variation Of Shareholders' Rights [Section 48]

A shareholder who was given the right to purchase the shares of the company on a **pre-emptive basis was held to constitute a special class distinguishing him from other shareholders who did not** have any such right, and consequently, his right was not permitted to be taken away without his consent. (**Cumbrian Newspapers Group Ltd v Cumberland Sf Westmorland Herald Newspaper & Printing Co Ltd (1987) 2 Comp LJ39.**) If it is proposed to change the rights of any class, certain procedures have to be followed.

Section 48 allows the variation, if three conditions (**First two stated by sub-section 1, while third and last one by sub-section 2**) have been met.

First - There should be a provision in the memorandum or articles of the company entitling it to vary such class rights, in absence of the same; the terms of issue of the shares of that class not prohibiting such a variation

Second - The holders of **at-least 75% of the issued shares of that class must have given their consent in writing** or pass a special resolution sanctioning the variation at a separate class meeting.

Proviso to sub-section 1, provided if variation by one class of shareholders affects the rights of any other class of shareholders, **the consent of three-**



fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

Third - The **holders of at least 10 percent of the shares** of that class who did not consent to or vote in Favor of the resolution may apply to the Tribunal and then variation shall not take effect unless and until it is confirmed by the Tribunal.

Procedural Aspects for confirmation from tribunal

An application should be **made within 21 days of the date of consent or resolution**. It can be made by one (or more of their number) as they may appoint in writing; on behalf of the shareholders entitled to make the application

Sub-section 3 provides, the decision of the Tribunal has binding effect upon shareholders of the class. Further **sub-section 4 requires the company** to file a copy of the order with the **Registrar within 30 days of the date** of the order.

Example- A resolution sanctioning the variation has been moved on 1st November 2022, the application with tribunal shall be filled by 22nd November 2022. Further if the tribunal passes its order on 4th January 2023, then a copy of order shall be filed with the registrar by 6th March 2023.

Illustration

DBS Chemicals Limited issued ordinary shares of different classes. DBS planned to vary rights of one the class wherein there were only 105 holders. 100 out of 105 holders own 0.5% shares of that class, whereas each of the remaining 5 holders hold 10% shares of that class. Presuming 100 holders who own 0.5% shares already signed/authorized the consent letter sanctioning the variation, how many holders out of such 5 need to authorize the said letter to approve the variation.

- a. 0
- b. 1
- c. 3
- d. 5

Answer - c. (Refer section 48(1))

The holders of at-least 75% of the issued shares of that class must have given their consent in writing or pass a special resolution sanctioning the variation at a separate class meeting.

Mind it is 75% of issued shares' holders not 75% of holders.



Crux of some of landmark judgements – to better understand the 'variation'

New issue of preference shares **ranking pari-passu with the existing shares does not amount to variation** so as to require the consent of preference shareholders. (*White v Bristol Aeroplane Co Ltd (1953) 2 WLR 144.*)

Cancellation of shares and reduction of capital also do not amount to variation of class rights. (*Essar Steel Ltd, re, (2005) 59 SCL457 (Guj)*)

Calls On Share [Section 49 To Section 51]

The liability of a shareholder to pay the full value of the shares held by him, which is **currently partly paid-up**, is enforced by making **"calls" for payment**.

It is worth noting here that every shareholder is under a statutory liability to pay the full amount of his shares as **Section 10(2)** declares that "all money payable by any member to the company under the memorandum or articles shall be a debt due from him to the company".

But the liability to pay this debt arises only when a valid call has been made. **Section 49** lays down the principle of uniformity, whereas section 50 deals with calls in advance and **section 51** contains the provisions regarding dividend rights on paid up amounts.

Call Shall Be on Uniform Basis [Section 49]

Calls shall be made on a uniform basis on all shares that are falling under the same class.

Authors Note:

1. Usually shares with the same nominal value are considered as the same class, but shares of the same nominal value on which different sums have been paid shall not be deemed, for this purpose, to fall under the same class.

2. A shareholder on whom a regular call for payment has been served may choose to pay only a part of the sum due. Here it is important to consider the debt (of calls made) is not an entire and indivisible debt; therefore, the company may be bound to accept the amount tendered by the shareholder

3. How much to call on a partly-paid share?

This will be the decision of the board, subject to clauses to Article and terms of issue.

Example- Prism Glass Limited issued three series of equity shares, all carrying the nominal value of 100, and the paid-up value for each series is 100, 80 and 55 respectively.



All will be considered as different classes of shares. Since the first-class share is fully paid up, no call can be made, whereas in case of remaining two classes, a call can be made.

Illustration

Where a shareholder paid the first two calls after a great delay and neglected to pay the third call and the directors, being annoyed, called upon him to pay the whole amount due. In your opinion, is the call valid?

Answer - A call can't be made on some of the members only, unless they constitute a separate class of shareholders, hence such a call shall be invalid.

(Galloway v Halle Concerts Society, (1915) 2 Ch 233)

Calls-In-Advance [Section 50]

As per **Section 50**, a company may, if so, authorized by its articles, accept from any member the whole or a part of the amount remaining unpaid on any shares held by him, **although no part of that amount has been called up**.

Authors Note:

1. Such advance payment will not entitle the member to more voting rights as compared with other members until all have been called upon to pay.
2. Interest can be paid on such advance, if permitted by article. Here it is worth noting that, where the rate of interest is permitted by the articles on such advance payment, the same could be varied by shareholders in a general meeting. To illustrate; a rate 6 percent may increase to 10% by shareholders. (CIT v Manipal Industries Ltd, (1997) 12 SCL 15 (ITAT))

Example- Coriander Masale Limited has issued 10,00,000 equity shares of 10 each on which 6 per share has been called till allotment and the first and final call of 4 is yet to be made. Reena holds 10,000 shares on which she has paid a whole of 10 per share. In the upcoming extraordinary general meeting of the company, she wants to exercise her voting rights as the owner of fully paid-up shares. However, the company cannot permit her as she does not have voting rights in respect of the 'advance amount' paid by her in respect of first and final call. The restriction will continue till the amount is duly called up by the company.

Illustration

Moon Star Machineries Limited is authorized by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member even if no part of that amount has been called up by it. 'Anand', a shareholder, deposits in advance the remaining amount due on his partly



paid-up shares without any calls being made by the company. Advise the company about the validity of accepting money in advance.

Answer - In view of the authorisation given by the Articles, Moon Star Machineries Limited is permitted to accept the advance amount received on unpaid calls from Anand. In other words, this is a valid transaction.

Payment Of Dividend in Proportion to Paid-Up Amount [Section 51]

The company if so, authorized by article, may be permitted to pay dividends in proportion to the amount paid-up on each share

The Board of Directors of a company may decide to pay dividends on a pro rata basis if all the equity shares of the company are **not equally paid-up**.

However, in the case of preference shares, the dividend is always paid at a fixed rate.

Issue Of Shares at A Premium or Discount [Section 52 & Section 53]

Issue Of Shares at A Premium & Application of Premium [Section 52]

Since **there is no restriction imposed by the Act on the sale of shares** at a premium, hence if the market exists, a company may issue its shares at a price **higher than their face/nominal value**. But the Act does regulate the disbursement of the amount collected as premium through **section 52**.

Authors Note:

1. The power to issue shares at premium need not be specifically provided by AOA.
 2. SEBI guidelines have to be observed by listed entities, as regulations indicate when an issue has to be at par and when premium is chargeable.
- When a company issue shares at a price higher than their face value, the shares are said to be issued at premium and the differential amount is termed as premium.

Example- A share having face value of 10 is issued at a price of 14. The amount over and above the face value of 10 i.e. 4 is called premium.



Practical Insight

Lloyds Luxuries IPO opens on Sep 28, 2022, and closes on Sep 30, 2022. The date of listing on NSE SME was October 11, 2022 (Tuesday). Fixed issue price against the Face Value of ₹ 10 per share is ₹ 40 per share. Hence, premium charges are ₹30 per share.

Transfer of premium to Securities Premium Account [Subsection 1]

Sub-section 1 lay-down following principles that shall be observed in regards to premium

- a. Premium may be received in cash or in kind
- b. The amount of premium received, whether in cash or kind, shall be carried to a separate account to be known as the Securities Premium Account.
- c. The amount to the credit of the share premium account has to be maintained with the same sanctity as paid-up share capital
- d. It can be reduced only in the manner of paid-up share capital can be reduced under this act. Liberty is, however, given to use the fund in the **subsection 2 and 3**.

Authors Note:

1. The amount to the credit of the share premium account has to be shown as a separate item in the Balance-sheet under Schedule III, Part B of the Act and if it was disposed of either wholly or partly, then disclosure shall be made 'how it was disposed'?
2. The DCA was of the opinion that the amount of premium can't be treated as a free reserve as it is in the nature of a capital reserve.
3. A reduction of the premium account was allowed under a scheme which experts had approved as fair, just and proper.

Application Of Premium Received On Issue Of Shares [Sub-Section 2 & 3]

Sub-section 2 allows the companies to **apply securities premium account** for;

- a. Issue of fully paid bonus shares;
- b. Writing off the preliminary expenses;
- c. Writing off the issue expenses (expenses including commission paid or discount allowed on any issue of shares or debentures);
- d. Premium payable on the redemption (of any preference shares or of any debentures); or
- e. Buy-back (purchase of its own shares or other securities under section 68).



Sub-section 3 has an **overriding effect over sub-section 1 and 2**. It restricts the application of **Securities Premium Account** in case of;

Such class of companies, as may be prescribed and whose financial statement comply with the **accounting standards prescribed for such class of companies under Section 133**

For the purpose of;

- a. Issue of fully paid bonus shares;
- b. Writing off the issue expenses (expenses including commission paid or discount allowed on any issue of shares);
- c. Buy-back (purchase of its own shares or other securities under section 68).

Prohibition On Issue of Shares at Discount

[Section 53]

Where the issue price is lower than the face value of the shares, such issue of shares is regarded as being issued at discount and the differential amount is known as discount.

Example- A share having face value of 100 is issued at a lower price of ` 95. The differential amount of 5 is known as discount which is being allowed by the company.

Though title of section used the word prohibited, but indeed issue of share at discount is not fully prohibited, it is only restricted especially after the enactment of the Companies (Amendment) Act, 2017 (effective from 09th February 2018).

Sub-section 1, except the issue of 'Sweat Equity Shares' under section 54 of this Act, a company shall not issue shares at discount.

Further, sub-section 2, provides any share issued at discount by company is void.

Sub-section 2A, is overriding provision (**to sub-section 1 and 2**) inserted through Companies (Amendment) Act, 2017 empowers the company to issue shares at discount to its creditors as result of converting their debt on company into shares as a result of;

- a. Statutory resolution plan or
- b. Debt restructuring scheme In accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949

Sub-section 3 provides the penalties that can be imposed where any company fails to comply with the provisions of **Section 53**;



Liabe	Penalty
Every officer who is in default	Up to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less
Company	Refund all monies received with interest at the rate of twelve percent per annum from the date of issue of such shares

Authors Note:

It is to be noted that the restrictions mentioned in **Sections 52 and 53** shall apply only in respect of issue of shares (either equity or preference shares) but not to the issue of any debt related products like bonds or debentures whose pricing is mostly governed by YTM (yield to maturity) considerations.

Issue Of Sweat Equity Shares [Section 54]

Meaning Of 'Sweat Equity Shares' [Section 2(88)]

The term '**sweat equity shares**' means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their **know-how or making available rights** in the nature of intellectual property rights or value additions, by whatever name called.

Hence one can say, sweat equity shares are issued to keep the employees of a company motivated by making them partner in the growth of the company. Mind it, sweat equity shares are a different concept from Employee stock options in multiple ways.

Section 54 lists out the conditions that shall be fulfilled by the company prior to issue of sweat equity share apart from designates these at equal footing to equity shares.

Status Of Sweat Equity Shares and Holder Thereof [Section 54(2)]

Sub-Section 2 Provides;

- a. The **rights, limitations, restrictions and provisions** as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued **under section 54** of the Act
- b. The holders of sweat equity shares **shall rank pari-passu** with other equity shareholders. Pari-passu is a Latin phrase that means "on equal footing"

Conditions For Issue of Sweat Equity Shares [Section 54(1)]



According to **Section 54 (1)**, a company may issue sweat equity shares if all of the following conditions are fulfilled;

- a. Share of that class must be already issued
- b. Issue is authorized by a special resolution passed by the company;
- c. Resolution specifies the details regarding the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- d. The issue of sweat equity shares must be in accordance with regulations / rules as state in table;

Company	Applicable Provisions/Regulations
Listed on Recognised Stock Exchange	Regulations made by the Securities and Exchange Board in this behalf
Other than above	Rule 8 of the Companies (Share and Debentures) Rules, 2014

Illustration

A company that incorporated and commenced the business on 9th Nov 2022, can issue sweat equity shares only after 8th Nov 2023.

Answer - False. Currently there is no condition prescribed by section 54 (1) regarding age of company.

Students are advised to take note: Clause c to section 54(1) omitted by the Companies (Amendment) Act, 2017 w.e.f 7th May 2018 "not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business"

Some Of the Important Provisions Contained in Rule of The Companies (Share and Debentures) Rules, 2014

Meaning Of Employee (Explanation I To Sub-Rule 1)

Employee means

- a. a permanent employee of the company who has been working in India or outside India; or
- b. a director of the company, whether a whole-time director or not; or c. an employee or a director as defined above, either of subsidiary or holding company of concerned company; in India or outside India

Meaning of 'Value additions (Explanation II to sub-rule 1)

The expression 'Value additions' means;

- a. Actual or anticipated economic benefits derived or to be derived by the company **from an expert or a professional**



- b. For providing know-how or making available rights in the **nature of intellectual property rights,**
- c. By such a person to whom sweat equity is being issued
- d. For which the consideration is not paid or included in the normal remuneration payable under the contract of employment (in the case of an employee).

Validity of Special Resolution (Sub-rule 3)

The **special resolution authorizing the issue of sweat equity shares** shall be **valid** for making the allotment within a period of not more than twelve months from the date of passing.

Limit on issue of Sweat Equity Shares (Sub-rule 4)

During a year, the maximum amount/limit for which **sweat equity shares can be issued is higher of:**

- a. **Fifteen percent of the existing** paid up equity share capital or
- b. Shares of the issue **value of rupees five crore.**

The issuance of sweat equity shares (cumulative, including all previous issues, if any) shall **not exceed twenty five percent of the paid-up equity capital** of the Company at any time. This limit for Startup companies is fifty percent of paid-up capital up to ten years from the date of its incorporation or registration.

Lock-in Period [Sub-rule 5]

Sweat equity shares issued to directors or employees shall be locked **in/nontransferable for a period of three years** from the date of allotment.

Valuation of Sweat Equity Shares [Sub-rule 6]

Sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the **fair price giving justification for such valuation.**

Quoted market prices in an active market are the best evidence of fair value and should be used, where they exist, to measure the financial instrument.

Valuation of IPR/know-how/value additions [Sub-rule 7]

The valuation of intellectual property rights or of know-how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.



Treatment of non-cash consideration [Sub-rule 9]

Where the **sweat equity shares** are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the **following manner in the books of account of the company**:

Form of Non-cash consideration	Treatment
Depreciable or amortizable asset	Carried to the balance sheet
Other than above	Shall be recorded as expense

Disclosure in the Directors' Report [Sub-rule 13]

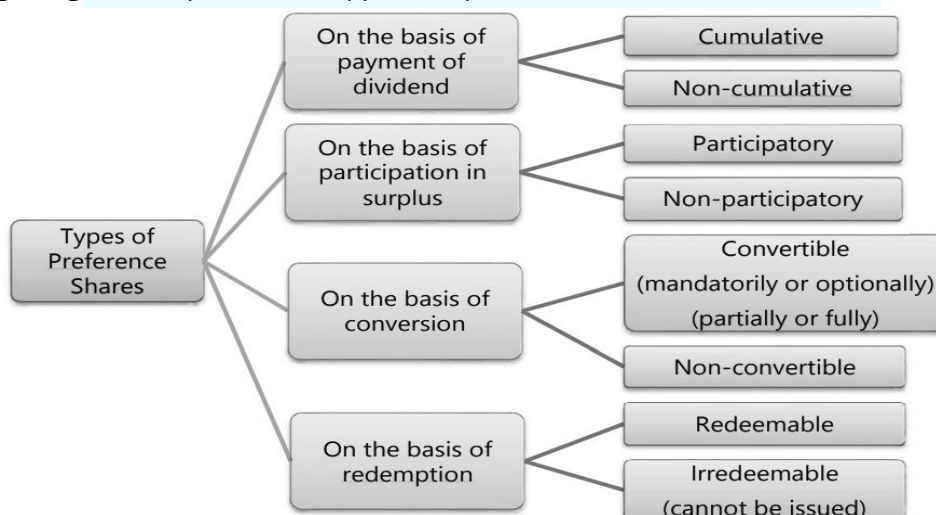
The **Board of Directors** shall, inter alia, disclose in the Directors' Report for the year in which such shares are issued, the specified details of issue of sweat equity shares

Maintenance of Register [Sub-rule 14]

The company shall **maintain a Register of Sweat Equity Shares in Form No. SH. 3**. It shall be maintained at the registered office of the company or such other place as the Board may decide.

Issue And Redemption of Preference Shares [Section 55]

Following diagram depicts the types of preference shares:



Prohibition On Issue of Irredeemable Preference Shares [Subsection 1]

A **company limited by shares shall not issue** any preference shares which are irredeemable. It is worth noting that the amendment of 1988 to the Companies Act 1956, abolished the category of irredeemable preference shares.



Issue And Redemption of Redeemable Preference Share [Subsection 2]

From **sub-section 1**, it can be constructed reasonably that only redeemable preference shares can be issued by a company limited by shares, **sub-section 2** provides for conditions as applicable to the issue and redemption of redeemable preference shares.

Authorized by Article of Association

A company limited by shares may issue redeemable preference shares only if so authorized by its articles.

Example- Medanta Healthcare Limited is planning to raise the capital through issue of preference share. This article is silent about this. The Board of Directors are of the opinion that redeemable shares can be issued.

Since in the given case article is silent, not authorize the issue of preference shares expressly, hence Medanta Healthcare Limited can't issue preference shares. They may alter the article of association.

Maximum Tenor of Redeemable Preference Shares and Exception Thereto

Sub-section 2 also provides preference shares shall be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as are prescribed in **Rule 9 of the Companies (Share Capital and Debentures) Rules, 2014**.

These conditions laid-down by **sub-rule 1** are;

- a. A special resolution in the general meeting of the company shall be passed
- b. At the time of such issue of preference shares, the company should **not** have a subsisting default in the;
 - i. Redemption of preference shares or
 - ii. Payment of dividend due on any preference shares

Sub-rule 2 and 3 enumerates the matters to be specified in resolution and explanatory statement to be annexed to the notice of such general meeting in which resolution has to be passed respectively.

Sub-rule 4 requires a company that issues preference shares, to maintain a Register of Members under **Section 88**, which shall contain the particulars in respect of such preference shareholder(s).

Further sub-rule 5 provides that if a company wishes to list its preference shares on a recognized stock exchange, shall issue such shares in accordance with the regulations made by the SEBI on this behalf.



Exception To Maximum Tenor Limit of Twenty Years (First Proviso to Section 55(2) Read with Explanation to Section 55 And Rule 9 Of the Companies (Share Capital and Debentures) Rules, 2014).

For infrastructure projects specified in schedule VI of this Act, a company may issue preference shares for a period exceeding twenty years but not exceeding thirty years subject to the redemption of **at least 10%** of such preference shares annually, **beginning from 21st year onwards or earlier**, on proportionate basis, at the option of preferential shareholders.

Redemption Of Preference Shares [Second Proviso to Section 55(2)]

Second proviso to section 55(2) provide conditions for redemption and payment of premium on redemption, if any

a. Preference shares shall be **redeemed out of;**

1. Profits of the company which would otherwise, be available for dividend or
2. Proceeds of a fresh issue of shares made for the purposes of such redemption.

b. Shares to be **redeemed shall be fully paid.**

c. Where such shares are proposed to be redeemed out of the profits of the company;

1. A **sum equal to the nominal amount** of the shares to be redeemed, out of such profits (profit & free reserves, which otherwise is available for dividend), shall be **transferred to a reserve**, called **Capital Redemption Reserve**
2. The amount to the credit of Capital Redemption Reserve has to be maintained with the same sanctity as paid-up share capital
3. Capital Redemption Reserve can be reduced only in the manner of paid-up share capital can be reduced under this Act.

For the purpose of this section

1. Redemption of preference shares is not taken as a reduction of the company's authorized share capital.
2. The company may issue new shares up to the nominal amount of the shares redeemed and the capital shall not be deemed to have been increased.

Example- During the current financial year, the Board of Directors of Vintee Lifestyles Garments Limited is to undertake redemption of 20,000 preference



shares of 100 each at a premium of 20 per share. It is made out by the Accounts Department that the profits are sufficient to meet the ensuing liability arising out of redemption of preference shares at premium. In this case, the amount that needs to be transferred to the Capital Redemption Reserve account out of profits which are otherwise available for dividend, is 20,00,000 being the sum equal to the nominal amount of the preference shares to be redeemed. There is no need to transfer to the CRR account any amount paid towards the premium.

d. Source of premium, if any; payable at redemption of preference shares

In case of such class of companies, as may be prescribed and whose financial statements comply with the **accounting standards prescribed for such class of companies under section 133**, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for **out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.**

In a case not falling under the above scenario, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

Summary of above provisions are tabled below:

Category	Source	Timing (Shall be provided)
Such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133	Out of the profits of the company	before such shares are redeemed
Premium payable on redemption of any preference shares issued on or before the commencement of this Act	Out of the profits of the company or out of the company's securities premium account	



Any other case		
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Issue Of Further Redeemable Preference Shares (If A Company Is Unable to Redeem Existing Preference Shares or Pay Dividend) [Sub-Section 3]

Where a company is not in a position to redeem any preference shares or to pay dividend on such preference shares (called unredeemed preference shares) in accordance with the terms of issue; then such company may issue further redeemable preference shares to the holder of unredeemed preference shares; equal to the amount due, including the dividend thereon; with the consent of the holders of three-fourth in value of such unredeemed preference shares, and approval of the tribunal on a petition made by it in this behalf.

In this way the unredeemed preference shares shall be deemed to have been

Where a company is not in a position to redeem any preference shares or to pay dividend on such preference shares (called unredeemed preference shares) in accordance with the terms of issue;

Then such company may issue further redeemable preference shares to the holder of unredeemed preference shares;

Equal to the amount due, including the dividend thereon;

With the consent of the holders of three-fourth in value of such unredeemed preference shares, and approval of the tribunal on a petition made by it in this behalf.

In this way the unredeemed preference shares shall be deemed to have been redeemed.

Authors Note:

In regards to preference shares held by shareholder who have not consented to the issue of further redeemable preference shares, the tribunal shall order the redemption forthwith; while giving approval under section 55(3)

Example- Bell Homes Furnisher Limited (BHFL) unable to redeem the preference shares as they become due. Hence BHFL decided to issue further preference shares against unredeemed preference shares. Holder holding 93% of such unredeemed preference shares in value, gave their consent; tribunal also assented to issue of further preference shares. The 18 holders who own the remaining 7% seek redemption of shares held by them.

In this case while giving approval under section 55(3), tribunal shall order the



redemption forthwith of shares (7% in value) held by dissenting 18 holders.

Utilization Of CRR Account [Sub-Section 4]

The capital redemption reserve account may be applied in paying up unissued shares of the company to be issued to the members as **fully paid bonus shares**

Transfer And Transmission of Securities and The Allied Provisions [Section 56 To Section 59]

The procedures and formalities for the transfer of the securities as laid down by **sections 56-59** are largely applicable to securities that are in other form than demat form.

Transfer And Transmission of Securities or Interest of Member in Company [Section 56]

Requirement for Registering the Transfer of Securities [Sub-section 1]

Except, where the transfer is between persons both of whose names are entered as holders of beneficial interest in the records of a depository A company shall register a transfer of;

- a. securities of the company, or
- b. the interest of a member in the company in the case of a company having no share capital,

Only if, following conditions are fulfilled prior to such registration;

- a. The instrument of transfer must be executed both by the transferor and the transferee.
- b. The instrument must specify the name, address and occupation, if any, of the transferee.
- c. The instrument of transfer should be duly stamped and dated.
- d. The instrument of transfer should be in the prescribed form. As per **Rule 11 (1) of the Companies (Share Capital and Debentures) Rules, 2014, Form No. SH-4** is to be used, in case securities are held in physical form
- e. The instrument should be delivered to the company along with the certificate relating to the shares transferred within 60 days from the date of execution. If the share certificate is not in existence, the letter of allotment of securities should be filed.



The proviso to **Section 56(1)** says that where the instrument of transfer has been lost or it has not been **delivered within the prescribed period (i.e., 60 days from the date of Execution)**, the company may register the transfer on such terms as to **indemnity** as the Board may think fit.

Transfer Of Partly Paid Shares on An Application of Transferor Alone (Subsection 3 Read with Rule 11 (3) Of the Companies (Share Capital and Debentures) Rules, 2014

Where an application is made by the transferor alone and relates to partly paid shares, a company shall not register a transfer of partly paid shares, unless the company has given a notice in **Form No. SH-5** to the transferee and the transferee has given no objection to the transfer within two weeks from the date of receipt of notice.

Example- Himanshu has received a notice from Chaitanya Progressive Books Private Limited on 7th August, 2023 intimating that Shefali has submitted a transfer deed duly signed by her for transfer of 500 partly paid shares (6 paid-up out of Face Value of 10 per share) in his name.

Himanshu as transferee must raise his objection to the proposed transfer of partly paid shares latest by 21st August, 2023.

Exemptions in case of government companies/securities

Government Company, which has not committed a **default in filing its financial statements under section 137 or Annual Return under section 92** with the Registrar given.

Full exemption from conditions laid-down by section 56(1) in respect to transfer of securities held by nominees of the Government. **Partial exemption in respect to transfer** of bonds issued by a government company.

Only an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate relating to the bond; and if **no such certificate is in existence, along with the letter of allotment of the bond.**

There is no requirement of a proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee.

Power to Register Transmission not affected by section 56 (1) (Sub-section 2)



The power of the company to register transmission shall not be affected by the conditions imposed by **Section 56 (1) for registration of transfer**.

Hence, company is empowered to register transmission of right, if it receives an intimation **from any person to whom such right has been transmitted**. There is no need for submission of instrument of transfer in case of transmission.

Transmission (vis-à-vis transfert).

The word '**transmission**' means **devolution of title** to securities otherwise than by transfer, for example, devolution by death, succession, inheritance, bankruptcy, marriage, etc.

On registration of the transmission of securities, the person entitled to transmission of securities become the holder and is entitled to all rights and subject to all liabilities arising therefrom.

While transfer of shares is brought about by delivery of a proper instrument of transfer (viz, transfer deed) duly stamped and executed, transmission of shares is done by forwarding the necessary documents (such as a notarised copy of death certificate) to the company.

Few cases of transmission for better understanding -

In the following cases (mind it this list is not exhaustive, only illustrative), transmission of shares shall take place;

1. **Death:** When a shareholder expires, his shares need to be transmitted to his legal representative.
2. **Insolvency:** When a shareholder becomes insolvent, his shares are to be transmitted to his Official Receiver.
3. **Lunacy:** When a shareholder becomes lunatic, his shares are to be transmitted to his administrator appointed by the Court.

Transfer of Security of the Deceased Person by his Legal Representative [Subsection 5]

The **transfer of any security (or other interest in company)** made by a legal representative of a deceased person, shall be valid as if such legal representative is holder at the time of the execution of the instrument of transfer; even if, in actuality such **legal representative is not a registered holder**.

This subsection is basically bringing ease to legal heir with the deeming effect of being holder of security or other interest in the company of a deceased person.



Example- Richa Daniel, after having obtained a succession certificate, succeeded to 7,000 shares of ` 100 each allotted to her late father Alexander Daniel by Speed Software Limited. To pay off the debt of her cousin Stesley, she wants to transfer the whole of the 7,000 shares to her on the basis of a duly stamped instrument of transfer which has been signed by her as well as Stesley. Accordingly, she has delivered the required documents to the company for transfer of shares.

In terms of Section 56 (5), the company, on receipt of duly stamped instrument of transfer along with requisite share certificates and succession certificate, shall transfer the shares in Favor of Stesley. Thus, even though Richa Daniel, the legal representative of Alexander Daniel, is not a holder of 7,000 shares as per the Register of Members of the company, the transfer effected by her in Favor of her cousin Stesley is a valid transfer as if she had been the holder of securities at the time of executing the transfer deed.

Authors Note - As an alternative, Richa Daniel may choose to get herself registered as holder of the 7,000 shares in which case, she will make an application to Speed Software Limited. Such applications shall be accompanied with share certificates and succession certificates. There is no need to submit an instrument of transfer or transfer deed in such a case of transmission. This is so because the transfer deed cannot be signed by the deceased person as transferor.

On receipt of these documents, the company will scrutinize them and if found in order, it shall proceed to enter the name of Richa Daniel in the Register of Members. Consequently, the name of the deceased person i.e., Alexander Daniel shall be deleted. Further, new share certificates will be issued in the name of Richa Daniel, the legal representative of Alexander Daniel.

Time Period for Delivery of certificates [sub-section 4]

Every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of **all securities allotted, transferred or transmitted;**

Particulars	Time Period for delivering the Certificates
In the case of subscribers to the memorandum.	Within a period of two months from the date of incorporation.
In the case of any allotment of any of its shares by a company.	Within a period of two months from the date of allotment.
In the case of a transfer of securities.	Within a period of one month from the date of receipt of the instrument of



In the case of a transmission of securities.	transfer by the company. Within a period of one month from the date of receipt of the intimation of transmission by the company.
In the case of any allotment of debenture.	Within a period of six months from the date of allotment.
In the case of all securities by specified IFSC public and private company.	Within a period of sixty days incorporation, allotment, transfer transmission.

Authors Note:

In case where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities. **(Proviso to sub-section 4)**

Example- A request for transfer of shares has been received by Ind-swift Pharma Labs Limited in form SH-4 along with instrument of transfer on 25th November 2022. The company shall deliver the certificate to that effect by 24th December 2022.

Penalty [Sub-section 6]

Liable	Default	Penalty
Company and every officer of the company who is in default	In complying with the provisions of sub-sections (1) to (5) to section 56	50,000

Liability of Depository [Sub-section 7]

Where any depository or depository participant, **with an intention to defraud a person, has transferred shares**, it shall be liable under **Section 447** along with the liability mentioned under the Depositories Act, 1996.

Authors Note:

1. With the dematerialisation process becoming a necessity in case of unlisted public companies i.e., they are required to dematerialise all of their securities as per Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014, the chances of forgery are very thin or almost negligible.



2. The provisions contained in Section 447 which describe 'punishment for fraud' are stated in the earlier Chapter 3 relating to 'Prospectus and Allotment of Securities'.

Punishment For Personation of Shareholder [Section 57]

If any person **deceitfully personates**;

- a. as an owner of any security or
- b. interest in a company, or
- c. as an owner of any share warrant or coupon issued in pursuance of this Act,

And, thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner,

Such person shall be punishable with;

- a. Imprisonment for a term which shall not be less than one year but which may **extend to three years and**
- b. Fine which shall **not be less than one lakh rupees but which may extend to five lakh rupees.**

Penalty	Minimum	Maximum up to
Imprisonment	One year	Three years
AND		
Fine	One Lakh	Five lakhs

Authors Note:

Personation for acquisition of securities is an offense under **section 38 punishable under section 447**. **Mind its section 447** is general provision.

Gravity of offense committed by personation **under section 38 and section 57 may be considered** while imposing a penalty out of range provided.

It is worth noting, offense of cheating by personation under **section 416 of Indian Penal Code, 1860 is punishable under section 419** of code, with punishment of either description which may **extend up to three years** or with fine or with both.

Students may refer to section 38 and section 447, both covered under chapter 3 of this module.

Additional Reading on Forged Transfer

A **forged transfer is a 'nullity' and is not legally binding**. Forged transfer takes place when a company affects transfer of shares on the basis of an instrument of transfer containing forged signatures of transferor.



Is it possible for a transferee of 'forged transfer' to acquire ownership of shares contained in the instrument of transfer?

The answer is 'NO'. At the same time, the transferor who is the real owner continues to be the shareholder and accordingly, the company can be forced by him to delete the name of the transferee and to restore his name as owner of shares in the Register of Members.

What will happen if the **transferee of 'forged transfer' transfers** the shares to another buyer who does not know about the forgery and the company also registers the **transfer in the name of the new buyer and endorses the share certificates.**

In fact, the company cannot deny the ownership rights of a new genuine buyer but it can also not deny the ownership rights of original shareholder because **'forged transfer' is void ab-initio** and therefore, the company has to restore his name.

While restoring the name of the original shareholder, the company may be asked to compensate the new genuine buyer who exercised good faith in purchasing the shares.

As a remedy, the company may get itself indemnified by the first transferee who used the forged instrument of transfer to get the shares transferred in his name.

Refusal Of Registration and Appeal Against Refusal [Section 58]

Shares are movable property, hence can be transferred by the shareholders in the manner prescribed by the Articles. The right to transfer shares is absolute in nature and inherently vested with the ownership of the shares. In no case **Articles can take away the rights of members** to transfer shares in absolute, by making shares **non-transferable.**

Shares of a public company are freely transferable, whereas a private company is required under **section 2(68)(i)** to restrict the right of the members to transfer the shares.

The articles of association of private companies contain certain kind of restrictions on the transferability of shares. Generally, the restriction put by a private company is that of **pre-emption whereby the members are required to offer their shares first to the existing members** of the company before offering them to the outsiders.

Section 58 contains the procedure which needs to be followed by a company while refusing to register the transfer of securities. It also contains a process of **filing appeals against such refusal.**



Notice of Refusal to be sent [Sub-section 1]

If a private company limited by shares refuses to register the transfer of, or the transmission by operation of law of the right to any securities or interest of a member in the company, then the company shall;

Send notice of refusal to the transferor and the transferee or to the person giving intimation of such transmission and stating reasons thereto,

Within a period of thirty days from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company.

Securities/other interest in Public Company [sub-section 2]

The securities or other interest of any member in a **public company are freely transferable**.

Any contract or arrangement between **two or more persons** in respect of transfer of securities shall be **enforceable as a contract**.

Appeal to Tribunal against Refusal [Sub-section 3]

The transferee may appeal to the Tribunal against the refusal by a private company to register the transfer or transmission, within a period of:

- a. **Thirty days from the date** of receipt of the notice or
- b. **Sixty days from the date** on which the instrument of transfer or the intimation of transmission, was delivered to the company, in case no notice has been sent by the company.

Example- An application has been received by Private Company for transfer of share on 25th Nov 2022. The transferee didn't get any response from the company, hence may advance an appeal to the tribunal by 24th January 2023.

Appeal to Tribunal against Refusal by a Public Company without sufficient cause [Sub-section 4]

If a public company without sufficient cause refuses to register the transfer of securities **within a period of thirty days from** the date on which the instrument of transfer or the intimation of transmission, is delivered to the company, the transferee may appeal to the tribunal, within, within a period of

- a. **Sixty days of such refusal** or
- b. **Ninety days of the delivery** of the instrument of transfer or intimation of transmission, where no intimation has been received from the company

Example- An application has been received by Public Company for transfer of share on 25th Nov 2022. The transferee didn't get any response from the company, hence may advance an appeal to the tribunal by 23rd February 2023.



Order of Tribunal [Sub-section 5]

The Tribunal, while dealing with an appeal may, **after hearing the parties**, either dismiss the appeal, or by order direct:

- a. **Transfer or transmission shall be registered** by the company and the company shall comply with such order **within a period of ten days of the receipt** of the order; or
- b. **Direct rectification of the register and** also direct the company to pay damages, if any, sustained by any party aggrieved

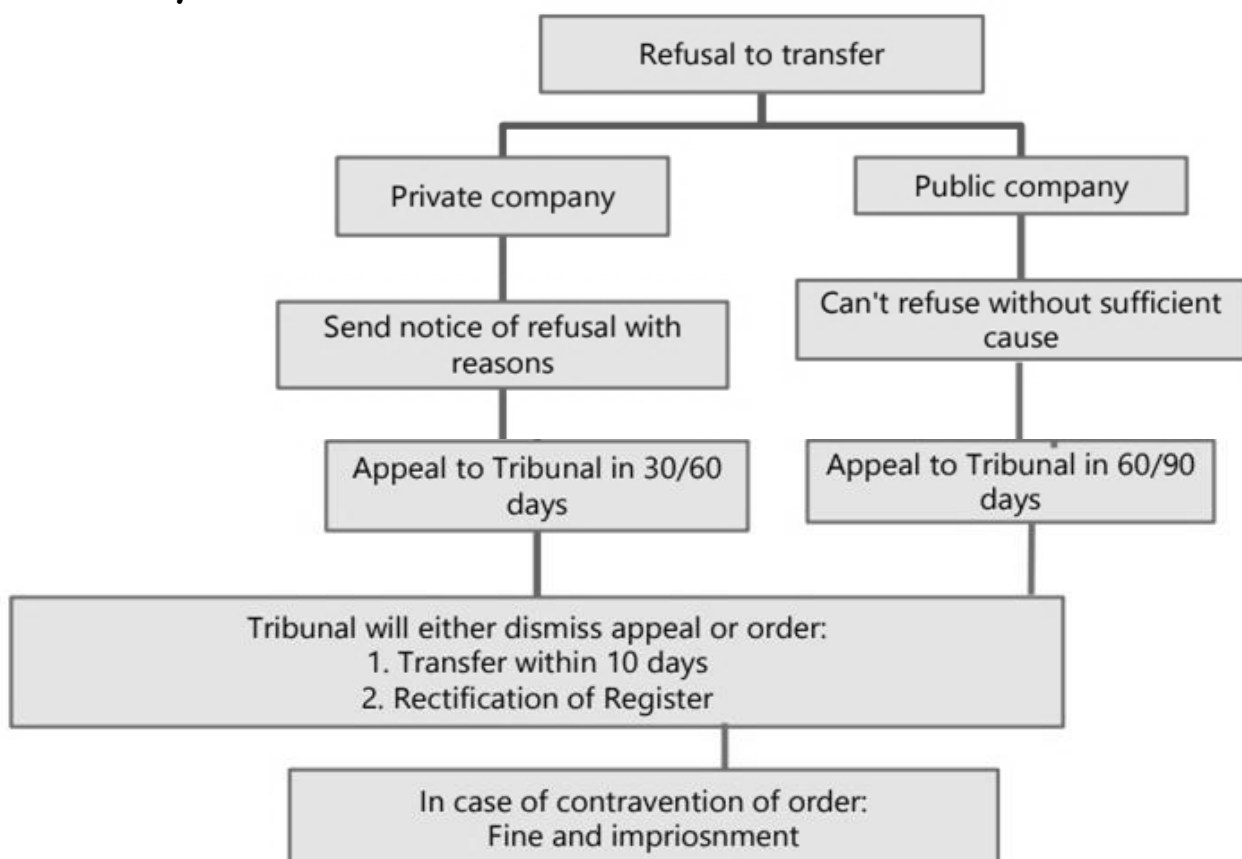
Contravention of the Order of the Tribunal [Sub-section 6]

If a person contravenes the order of the Tribunal, he shall be punishable with imprisonment for a term **not less than one year but may extend to three years and with fine not less than one lakh rupees which may extend to five lakh rupees.**

Summary of penalty

Penalty	Minimum	Maximum up to
Imprisonment	One year	Three years
AND		
Fine	One Lakh	Five lakhs

Summary of section 58



Illustration

Notice of refusal to register transfer of shares by private company shall be sent only to the transferee within 30 days, stating reasons of refusal therein.

Answer - False, notice of refusal shall be given to both transferee and transferor under section 58(1).

Rectification Of Register of Members [Section 59]

It is the duty of the company to keep the register up to date so as to give at all times the accurate and correct position as to particulars of shareholding, because if a person's name appears in the register of members, he is presumed to be the shareholder or member, even if, in fact, **he is not so**.

Contrarily, if a person's name is absent from the register, apparently, he is not a member, although he may have done everything to entitle him to become one.

Section 59 entrusts right to appeal with aggrieved persons, apart from vesting power in **tribunal to order for rectification of register of members**.

Appeal by Aggrieved Person [Sub-section 1]

An aggrieved person, member of company or company may appeal to tribunal or to a competent court (outside India, specified by the Central Government by notification, in respect of foreign members or debenture holders residing outside India), **for rectification of the register if without sufficient cause**,

- a. the name of any person is entered in the register of members of a company, or
- b. the name of any person is omitted, after having been entered in the register, or
- c. if a default is made, or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member

Authors Note: The words "unnecessary delay" have not been defined in the Act and, therefore, it becomes a question of evidence to be decided on the facts of each case. A failure to register a transfer within one month of the application, which was contrary to the listing agreement, was held to be an unreasonable delay.

Every shareholder has an interest in the proper maintenance of the company's register of members. Any member can make an application without showing any injury or prejudice to him. Personal grievance is not necessary for **locus standi**.



Order of the Tribunal [Sub-section 2]

Tribunal may, after hearing the parties to the appeal either dismiss the appeal or by order;

- a. Direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order, **or**
- b. Direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

Example- After hearing both parties of appeal over removal of name of applicant from register of member without sufficient cause, tribunal passes an order to reinstate the name in register with payment of damages to holder as well cost of litigation. Company has to pay damages as ordered apart from rectification of the register.

Rights of the holder are protected [Sub-section 3]

Sub-section 3 protects the right of a holder of securities, to transfer such securities. Further, any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

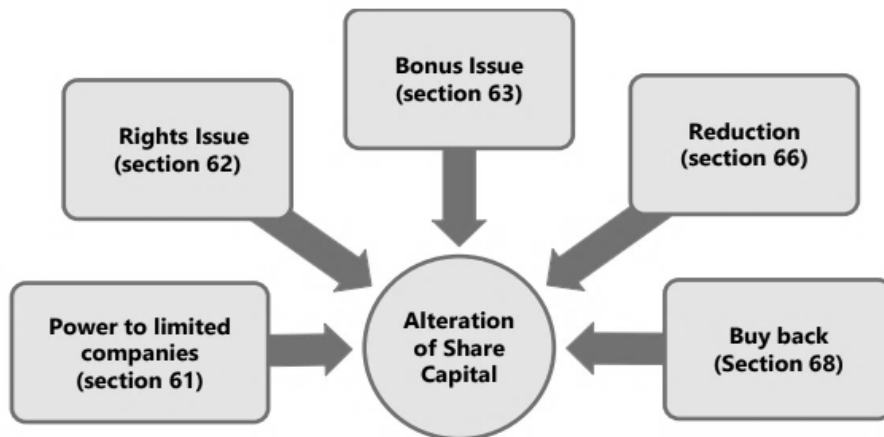
Transfer of Securities contravenes certain Acts and Direction of Tribunal [Sub-Section 4]

Tribunal may, on an application (made by the depository, depository participant, company, the holder of the securities or the Securities and Exchange Board), direct any company or a depository to set right the contravention and rectify its register or records concerned, where the transfer of securities is in contravention of any of the provisions of the;

- a. The Securities Contracts (Regulation) Act, 1956
- b. The Securities and Exchange Board of India Act, 1992
- c. The Companies Act, 2013 or
- d. Any other law for the time being in force



Alteration Of Share Capital [Sections 61-70]



Definition:

1. **Authorized Capital or Nominal Capital** Section 2(8) defines the term authorized capital or nominal capital to mean such capital as is authorized by the memorandum of a company to be the **maximum amount of share capital of the company**.
2. **Called-up Capital** Section 2(15) states that the term called-up capital means such part of the capital, which has been called for payment.

Power Of Limited Company to Alter Its Share Capital [Section 61]

A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, **provided authority to alter is given by the articles**.

- a. It may increase its authorized capital by such an amount as it thinks expedient.
- b. Consolidate and divide the whole or any part of its share capital into shares of larger amounts.
- c. Convert all and any of its fully paid-up shares into stock or vice-versa into any denomination.
- d. **Sub-divide** the whole or any part of its share capital into shares of smaller amounts. The proportion between the amount paid and unpaid (if any) on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived.
- e. **Cancel** those shares which have not been taken up and reduce its capital accordingly.

Example- A share with face value of 100, on which 80 is paid up, can be split into 10 shares of 10 nominal value each, with 8 being paid up.



Authors Note: Any of the above things can be done by the company by passing a resolution at a general meeting.

Approval of the National Company Law Tribunal requires only in the case where consolidation and division [suggested in point (b)] results in changes in the voting percentage of shareholders.

Within 30 days of alteration, a notice must be given in Form SH-7 to the Registrar who will record the same and make necessary alteration in the company's memorandum. (Section 64 read with Rule 15 of the Companies (Share Capital and Debentures) Rules, 2014).

Further subsection 2 provides that the cancellation of shares shall not be deemed to be a reduction of share capital. Mind it, reduction of capital covered under section 66 of the Act.

Further Issue of Share Capital - Rights Issue; Preferential Allotment [Section 62]

A rights issue involves pre-emptive subscription rights to buy additional securities in a company offered to the company's existing security holders. It is a **non-dilutive pro rata way to raise capital**.

Example- If a company announces '1:10 rights issue', it means an existing shareholder can buy one extra share for every ten shares held by him/her. Usually, the price at which the new shares are issued by way of rights issue is less than the prevailing market price of the stock to encourage subscription.

Practical Insight

Right Issue by Suzlon Energy Limited (October 2022)

Suzlon Energy Limited (SEL) is among the world's leading renewable energy solutions providers in India operating in the wind energy segment.

To part finance its needs for repayment/prepayment of certain borrowings (900.00 crore) and general corporate purposes (283.50 crore), SEL is offering a rights issue of 240 crore equity shares (Face Value 2) each at a price of 5 per share (Current Market Price of Share was 8.47) to mobilize 200.00 crore.

The company is offering the right shares in the ratio of 5 shares for every 21 shares held as of the record date of October 04, 2022. Rights entitlements can be renounced up till Oct 14, 2022 (Current Market Price of Rights Entitlement was 1.32)

The issue opens for subscription on October 11, 2022, and will close on October 20, 2022.

Only 50% (i.e., 2.50 per share) is to be paid on application and the balance on one or more calls by the company from time to time.

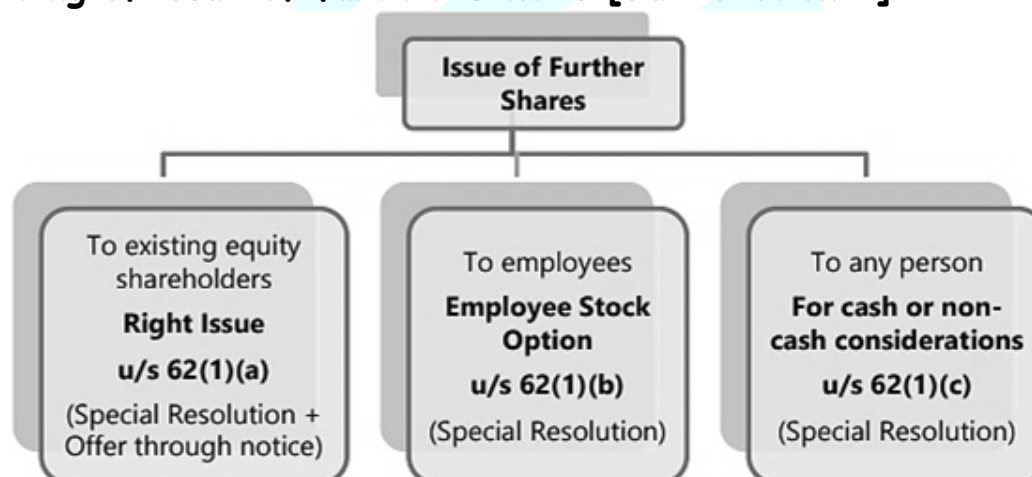
Post allotment, shares will be listed on BSE and NSE.



SEL is proposed to spend 16.50 crore for this Right Issue process.

Class of companies	Power to Right Issue	Applicable Provisions
Listed companies or companies intended to get its securities listed	23(1)(c)	Provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder
Public companies not covered above		Provisions of this Act and rules made thereunder
Private companies not covered above	23(2)(a)	

Offering of issue of further Shares [Sub-section 1]



Whenever a company having a share capital, proposes to increase its subscribed capital by the issue of further shares, such **shares shall be offered**;

- a. To persons who are holders of equity shares (existing on date of such offer),
1. in proportion to the paid-up capital on those shares held by them;
 2. by sending **a letter of offer in form of notice**, such notice shall specify:
 - i. Specify the number of shares to be offered
 - ii. Specify the time period within which the offer must be accepted. The time period should **not be less than 15 days** or such lesser number of days as may be prescribed **but not exceeding 30 days from the date of the offer**

Authors Note - Rule 12A inserted in the Companies (Share Capital and Debentures) Rules, 2014, that provides the time period within which the offer



shall be made for acceptance shall be not less than seven days from the date of offer.

- iii. Specify, if the offer is not accepted within the specified time, it shall be **deemed to have been declined**
- iv. Confirm the right to renounce all or any of shares to existing holders, in Favor of some other person; unless article otherwise provided

Authors Note:

1. If offer declined by existing holder, then at intimation of such decline or after expiry of the specified time given to him for exercise the right, the Board of Directors may dispose of them (such shares, in regard to which offer is declined) in such manner which is not dis-advantageous to the shareholders and the company.
 2. While determining/checking proportion, then as nearly as the circumstances admits shall be acceptable
 3. In case of a Private Company and Specified IFSC Public Company any shorter time periods to accept the offer may be provided, if ninety percent of the members have given their consent in writing or in electronic mode for such shorter period
- b. To employees under a scheme of employees' stock option, subject to:
1. Special resolution passed by company, and
 2. Conditions as may be prescribed in **Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014.**

Authors Note:

1. The term 'employees' stock option' means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a predetermined price (Section 2(37))
 2. Instead of special resolution, ordinary resolution will be sufficient, in following cases;
 - a. Private company which has not defaulted in filing its financial statements under Section 137 or Annual Return under Section 92.4
 - b. Specified IFSC Public Company.
 3. In case of a listed company, conditions prescribed by SEBI (Share Based Employee Benefits) Regulations, 2014 shall be observed.
- c. To any persons, if so, authorized by a special resolution even if they are not within the **two categories mentioned above.**



Authors Note:

1. Where further shares are offered through manner specified in point iii above, then such offer can be for cash or for a consideration other than cash.
2. Further, in case of non-cash consideration, price to be determined by valuation report of a registered valuer subject to such conditions as may be prescribed in Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014.

Example- A company, listed at Bombay Stock Exchange, intends to offer its further shares to the non-members. The existing members of the company consider such offer as invalid in view of the provisions contained in Section 62 (1) (a). However, the company is not prohibited in absolute terms while offering new shares to the non-members. It can do so after passing a special resolution as required in Section 62 (1) (c). Thus, new shares of a company limited by shares may be issued to non-members under certain circumstances.

Illustration

What shall be the length of the period specified by notice of offer of further issue for giving acceptance?

Answer - Notice of offer of further shares shall specify the **time period** within which the offer must be accepted. The time period should not be less than 15 days or such lesser number of days as may be prescribed but not exceeding 30 days from the date of the offer

Authors Note - Rule 12A inserted in the Companies (Share Capital and Debentures) Rules, 2014, provides the time period within which the offer shall be made for acceptance **shall be not less than seven days** from the date of offer.

Dispatch of Notice to the existing Shareholders [sub-section 2]

Notice referred in sub-section (1) shall be dispatched through registered post or speed post or through electronic mode or courier or any other mode having proof of delivery to **all the existing shareholders at least three days before the opening of the issue.**

In case of **a Private Company any shorter length (less than 3 days) of notice period** shall also be acceptable, if ninety percent of the members have given their consent in writing or in electronic mode for such shorter period.

Example- Notice of right issue dispatch to holders at their registered e-mail ID in two days advance to opening of issue. Out of 4230 members, 3075 members



holding 94% of shares acknowledged the mail and consented to shorter length of notice. Despite the mode of dispatching notice and furnishing consent by members to shorter length is valid, the notice stands invalid because at-least 90% of members shall give their consent to shorter length of notice, whereas in the given case nearly 72.70% (3075 out of 4230) given consent. Here the number of members is to be considered not their holding...

Exception - Section 62 shall not be applicable on conversion of debenture or loan into equity shares [Sub-section 3]

Conversion of debenture (pursuant to conditions of issue) or loan (pursuant to conditions of grant of loan) into equity shares leads to increase in the subscribed capital of a company.

Sub-section 3 states section 62 shall not be applicable to such increase in subscribed capital provided;

- a. Those terms and conditions under which such conversion took place,
- b. Must be approved by company in general meeting through special resolution
- c. Prior to issue of debenture and grant of loan.

Compulsorily conversion of Debentures/Loan from government into Shares [Sub-section 4, 5 and 6]

Sub-section 4 empowers the government to direct by order;

- a. Conversion of debentures (issued to government) or loans (issued by government) to a company, either full or in part thereof into shares of such company.
- b. If that Government considers it necessary in the public interest so to do,
- c. on such terms and conditions as appear too the Government to be reasonable in the circumstances of the case,
- d. even if terms of the issue of such debentures or the raising of such loans do not provide for an option for such conversion.

Proviso to sub-section 4 provides remedy to companies against hostile conversion.

Where the terms and conditions of such conversion are not acceptable to the company, it may **appeal to the Tribunal, within sixty days from** the date of communication of such order.

Tribunal after hearing the company and the Government shall pass such an order as it deems fit.



Sub-section 5 requires, government shall consider following while determining the terms and conditions of conversion;

- a. the financial position of the company,
- b. the terms of issue of debentures or loans, as the case may be,
- c. the rate of interest payable on such debentures or loans, and
- d. such other matters as it may consider necessary.

Sub-section 6 states pursuant to order of government for conversion of debenture and loan into equity shares, **under sub-section 4**, the authorized share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into and memorandum shall stand altered.

Section 62 shall not apply to Nidhi Company. While complying with such exception, the Nidhi Companies shall ensure that the interests of their shareholders are protected.

Issue Of Bonus Shares [Section 63]

The **term bonus share is not defined anywhere** in the Companies Act 2013. However, the characteristics of bonus shares along with the condition and manner of issue of fully paid-up bonus share by a company to its member **highlighted by section 63.**

In commercial parlance, the bonus shares are shares issued proportionately by a company to its current shareholders as **fully paid-up shares free of cost.**

Example- If a company decided to issue bonus shares in a ratio of 1:2 (one for every two shares held), then the holder of 100 shares of a company will get 50 bonus shares without making any payment. There his holding of shares will now be 150 instead of 100.

Status of Bonus Shares from lens of the Judiciary

Hon'ble Supreme Court in case of Standard Chartered Bank v Custodian

Bonus share is an accretion. A bonus share is issued when the company capitalizes its profits by transferring an amount equal to the face value of the share from its reserve to the nominal capital.

In other words, the undistributed profit of the company is retained by the company under the head of capital against the issue of further shares to its shareholders. Bonus shares have, therefore, been described as a distribution of capitalized undivided profit.



In the case of issue of bonus shares there is an increase in the capital of the company by transferring of an amount from its reserve to the capital account and thereby resulting in additional shares being issued to the shareholders. A bonus share is a property which comes into existence with an identity and value of its own and capable of being bought and sold as such.

Sources for issue of Bonus Share [Sub-section 1]

A company may issue fully paid-up bonus shares to its members out of;

- a. its free reserves (other than revaluation reserve);
- b. the securities premium account; or
- c. the capital redemption reserve account.

Bonus shares shall not be issued by capitalizing reserves created by the revaluation of assets [Proviso to section 63(1)]

 Bonus shares may be issued from Free Reserves Securities Premium Reserve Capital Redemption Reserve	Bonus shares shall not be issued from Revaluation Reserve
--	---

Prerequisites for issue of bonus shares [Sub-section 2]

No company may capitalize its profits or reserves for the purpose of issuing fully paid-up bonus shares, if

- a. it is authorized by its articles.
- b. it has on the recommendation of the Board, been authorized in the general meeting of the company;
- c. it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it,
- d. it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- e. the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- f. It complies with such conditions as prescribed by Rule 14 of the Companies (Share capital and debenture) Rules, 2014, that a company which has once announced the decision of its **Board recommending a bonus issue, shall not subsequently withdraw the same.**

Authors Note:

1. The bonus shares shall not be issued in lieu of dividend (Sub-section 3 to section 63)

2. Proviso to sub-section 5 to section 123 of this act carries confirmatory provisions to those contained in section 63.

According to the provision to Section 123(5) of the Act, it is permissible for a company to capitalize its profits or reserves for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.

Illustration

Bonus share can be issued to partly paid shares in proportion to paid-up value, **Answer-False**, Bonus shares can only be issued against fully paid, the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.

Notice To Be Given to Registrar for Alteration of Share Capital [Section 64]

As and when, there is an alteration (including increase and decrease) of share capital, the company concerned shall notify the registrar. The provisions in this respect are contained in **Section 64**.

Filing of Prescribed Notice [sub-section 1]

Company shall file a notice in the **Form No. SH-7 as per Rule 15** of the Companies (Share Capital and Debentures) Rules, 2014 with the **Registrar, along with an altered memorandum within thirty days of alteration (including increase or decrease) to its capital in case of,**

- a. Alteration of capital in manner specified in section 61 (1),
- b. Order made by the Government under section 62(4) read with 62(6) has the effect of increasing authorized capital of a company; or
- c. Redemption of any redeemable preference shares,

Penalty for Default in Filing of Notice [Sub-section 2]

Where any company fails to **file notice as manner prescribed in sub-section 1** then such company and every officer who is in default shall be liable to a penalty of five hundred rupees for each day during which such default continues, subject to a **maximum of five lakh rupees in case of a company and one lakh rupees in case of an officer who is in default.**



Summary of penalty

Liabile	Penalty
Company	Five hundred rupees for each day during which such default continues, subject to a maximum of five lakh rupees
Every officer who is in default	Five hundred rupees for each day during which such default continues, subject to a maximum of one lakh rupees

Reduction Of Share Capital [Section 66]

Conservation of capital is one of the main principles of company law, because **any reduction of capital diminishes the fund**; out of which the creditor and other debt holders are to be paid, therefore it adversely impacts them.

But sometimes it may become necessary for the company to bring about a reduction in its capital. Therefore, closely fenced power is given by **Section 66**.

Reduction of Share Capital by Special Resolution to be confirmed by Tribunal [Sub-section 1]

A company being '**company limited by shares**' or '**company limited by guarantee and having a share capital**' may reduce the share capital in any manner and in particular manners as state below-

- a. Extinguish or reduce the liability on any of its shares in respect of the **share capital not paid-up; or**
- b. Cancel any paid-up share capital which is **lost or is unrepresented** by any available assets; or
- c. Pay off any paid-up share capital which is in excess of the wants of the company
 - a. Subject to Passing a special resolution; **and**
 - b. Alter its memorandum by reducing the amount of its share capital and of its shares accordingly, **and**
 - c. Repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon shall not be in arrears.

Example- In respect of a share of 10, a company has called only 7 per share and the same has been paid by all the shareholders. The company decides not to call the remaining 3 per share and reduces its shareholders' liability. If done, the company is said to have reduced its share of ₹ 10 to 7 as fully paid-up shares.



Issue of Notice by the Tribunal [Sub-section 2]

The Tribunal shall give notice of every application made to it;

- a. to the Central Government (power delegated to Regional Directors)
- b. to the Registrar and
- c. to the Securities and Exchange Board, in the case of listed companies, and
- d. the creditors of the company

Tribunal shall consider the representations (if any) made by them **within a period of three months from the date of receipt of the notice.**

Authors Note:

1. Where no representation has been received within the said period of three months, it shall be presumed that they have no objection to the reduction
2. Considering representations is statutorily required, not admitting it in full.

Example- An application for reduction of capital received by NCLT on 22 November 2022 from an unlisted company, he sent a notice of such application to concerned RD, RoC as well as to the creditor on 28th November 2022. Notice to RD and RoC sent in a registered post which reached them on 1st December 2022. Hence in the given case RD and RoC can make representation till 28th Feb 2023. If any representation made thereafter, Tribunal is not bound to consider that

Order of Tribunal [Sub-section 3]

The Tribunal may make an order confirming the reduction of share capital on such terms and conditions as it **deems fit only if it is satisfied that -**

- a. The **debt or claim of every creditor** of the company has been either
 - i. Discharged or
 - ii. Determined or
 - iii. Has been secured or
 - iv. His consent is obtained.
- b. The accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in **Section 133 or any other provision of this Act.**

How can the tribunal determine whether the accounting treatment proposed by the company for such reduction is in conformity with the accounting standards specified in Section 133 or not?

While making an application, a certificate to that effect by the company's auditor has been filed with the Tribunal



Publication of Order of Confirmation of Tribunal (Sub-Section 4)

The order of confirmation of the reduction of share capital by the Tribunal shall be published by the company in such manner as the Tribunal may direct

Delivery of Certified Copy of Order of Tribunal to Registrar (Sub-section 5)

Within thirty days of the receipt of the copy of the order, the company shall deliver, to the Registrar, a certified copy of the tribunal order and minutes (Containing special resolution) approved by the Tribunal showing:

- a. the amount of share capital;
- b. the number of shares into which it is to be divided;
- c. the amount of each share; and
- d. the amount, if any, at the date of registration deemed to be paid-up on each share,

Registrar on receipt, shall register the same and issue a certificate to that effect.

Exemption to Buy-Back [Sub-section 6]

Nothing in this section shall apply to buy-back of its own securities by a company under Section 68.

No Liability of Members [Sub-Section 7]

A member (whether in past or present) shall be liable to pay the amount (call or contribution) maximum up to the difference (if any) between the amount deemed to have been paid on his shares and the nominal value of the reduced shares.

Deemed to have been paid here signifies a reduced amount against the amount that has been actually paid on the share.

In case where Creditor is entitled to object but was not included in the list of Creditors [Sub-section 8]

If a reduction of share capital took place, and where a creditor is entitled to object to a reduction of share capital, but his name and interest (his debt or claim on company) not entered on the list of creditors, either because of.

- a. His ignorance of the proceedings for reduction or
- b. Nature of his interest (debt or claim)

Then in respect of his interest, company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016,



Action to make claim of creditor good (Remedy available to such unpaid creditor)

If company is running its operation

- a. Every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar,
- b. Shall be liable to contribute to the payment of such debt or claim,
- c. But not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the day immediately before the said date.

If company is wound up

The Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit,

- a. Settle a list of persons so liable to contribute, and
- b. Make and enforce calls and orders on the contributories settled on the list, as if they were **ordinary contributories in a winding up**

Example- Name and Interest of Mr. Nilanjan Iyer, a creditor of Modern Furniture Limited has been kept outside the list of creditors while company went into reduction of its capital; later when Mr. Iyer came to know about this and he wishes to take legal action against the company under IBC 2016, as the limitation period has not expired yet. Mr. Iyer entitled to do so. exclusion of his name constitutes an offense under IBC as well.

Authors Note: Period of limitation is a maximum period set by statute within which a legal action can be brought or a right enforced. The Limitation Act 1963 governing the provisions regarding period of limitation.

Rights of Contributories not affected [Sub-section 9]

Sub-section 9 is an overriding provision that prevents the rights of contributories inter-se.

Nothing in sub-section 8 shall affect the rights of the contributories among themselves.

Liability of Officers [Sub-section 10]

Officer of the company shall be liable for punishment under **section 447, if he:**

- a. Knowingly conceals the name of any creditor entitled to object to the reduction or abets or is privy to any such concealment, or
- b. Knowingly misrepresents the nature or amount of the debt or claim of any creditor or abets or is **privy to any such misrepresentation.**



Authors Note:

1. Abet means to encourage or incite another to commit a crime
2. Privy signifies a co participant; one who has an interest in a matter
3. The provisions contained in Section 447 which describe 'punishment for fraud are stated in the earlier Chapter 3 relating to 'Prospectus and Allotment of Securities.

Restriction On Purchase by Company or Giving of Loans by It for Purchase of Its Shares

[Section 67]

Conservation of capital is one of the main principles of company law, because the share capital of a company is the only security on which the creditors rely.

Therefore, a company cannot buy its own shares because reduction of capital, results in diminishing of the fund out of which creditors are to be paid; hence adversely affecting the creditors. However, this restriction is not absolute.

Reduction according to the applicable Provisions (Sub-section 1)

'Company limited by shares or company by guarantee that having a share capital shall not buy its own shares unless the consequent reduction of share capital is affected under the provisions of this Act.

Restriction on giving Loan, Guarantee or provision of Security, etc. [Sub- section 2]

Public company shall not give any financial assistance:

- a. Whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise
- b. For the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

Exceptions [Sub-section 3]

Company may provide the financial assistance, in following case; a. Lending of money by a banking company in the ordinary course of its business;

Authors Note:

1. The words "lending in the ordinary course of business" are not defined
2. Banks have to make loans in the ordinary course of their business and they can hardly supervise the purpose for which the borrower uses the loan money. Hence if a borrower from a bank uses the money for purchasing the bank's shares, the bank and its officers will be protected from liability.



3. An English court held that where money is given for the very purpose of purchasing the bank's shares that would not be lending in the ordinary course of business, then the provision would be said to be violated.

b. The provision of money for the purchase of fully paid shares in the company or its holding company by trustees for and on behalf of the company's employees in accordance with any scheme (Employee share schemes) approved by company through special resolution with such requirements as may be prescribed in Rule 16 of the Companies (Share Capital and Debentures) Rules, 2014,

Authors Note:

1. In case the shares of the company are listed - Such purchase of shares shall be made only through a recognized stock exchange and not by way of private offers or arrangements.

2. Where shares of a company are not listed - the valuation at which shares are to be purchased shall be made by a registered valuer.

3. The value of shares to be purchased or subscribed in the aggregate shall not exceed five percent of the aggregate of paid up capital and free reserves of the company;

4. Disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates shall be made in the Board's report for the relevant financial year, namely:

(a) Names of the employees who have not exercised the voting rights directly;

(b) Reasons for not voting directly;

(c) Name of the person who is exercising such voting rights;

(d) Number of shares held by or in Favor of, such employees and the percentage of such shares to the total paid up share capital of the company;

(e) Date of the general meeting in which such voting power was exercised;

(f) Resolutions on which votes have been cast by persons holding such voting power;

(g) Percentage of such voting power to the total voting power on each resolution;

(h) Whether the votes were cast in Favor of or against the resolution.

c. Lending money by a company to its employees (other than its directors or key managerial personnel), not exceeding six months' salary of the employees to enable them to buy or subscribe fully paid shares in the company or its holding company and to hold them by way of beneficial ownership.



Redemption of Preference Shares Permitted [Sub-section 4]

Nothing in Section 67 shall affect the right of a company to redeem any preference shares issued under this Act or under any previous company law.

Punishment for Contravention [Sub-section 5]

If a company contravenes the provisions of this section, the punishment shall be;

Liabe	Penalty		
Company	Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees		
Every officer of the company who is in default	Imprisonment for a term which may extend to three years	&	Fine which shall not be less than one lakh rupees but may extend to twenty-five lakhs rupees.

1. Section 67 shall not apply to private companies (if not defaulted in filing its financial statements under Section 137 and Annual Return under Section 92) and Specified IFSC Public Company in whose case all of following 3 conditions fulfilled;

- in whose share capital no other body corporate has invested any money;
- if the borrowings of such a company from banks or financial institutions or anybody corporate is less than twice its paid-up share capital or fifty crore rupees, whichever is lower; and
- such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section.

2. Section 67 (1) shall not apply to Nidhi Companies, when shares are purchased by the company from a member on his ceasing to be a depositor or borrower and it shall not be considered as reduction of capital under Section 66 of the Companies Act, 2013. While complying with such exception, the Nidhi Companies shall ensure that the interests of their shareholders are protected.

Power Of Company to Purchase Its Own Securities [Section 68] -

Buy Back of Securities

Buy back is the re-acquisition by a company of its own securities. It is a way of returning money to its investors. Section 68 contains provisions which describe the power of a company to purchase its own securities subject to the applicable conditions.



Sources of Funds for Buy-Back of Shares [Sub-section 1]

A company may purchase its own shares or other specified securities. The purchase should be made out of its:

- a. Free reserves; or
- b. Securities premium account; or
- c. Proceeds of the issue of any shares or other specified securities.

However, buy-back of shares or other specified securities cannot be made out of the proceeds of earlier issued shares or other specified securities of the same kind.

Specified securities include employees' stock option or other securities as may be notified by the Central Government from time to time (**Explanation I to section 68**)

Conditions for Buy-Back [Sub-section 2]

A company may purchase its own shares or other specified securities, if met with following conditions, namely:

- a. The buy-back is **authorized by its articles**;
- b. A **special resolution authorizing the buy-back is passed** in general meeting of the company;
A special resolution is not necessary where:
 1. The buy-back is, **not exceeding ten percent** of the total paid-up equity capital and free reserves of the company; **and**
 2. Such buy-back has been **authorized by the Board resolution** passed at its meeting;
- c. The amount involved in buy-back should **not be more than 25%** of the aggregate of paid-up capital and free reserves of the company; further in case of buyback of equity shares, the **maximum limit is 25% of its total paid-up equity capital in any financial year.**
- d. After the buyback, the ratio between the debts (secured and unsecured) owed by the company **should not be more than twice the paid-up capital** and free resources of the company (Central Government may prescribe a higher ratio for a class or classes of companies).
- e. Shares or other specified securities for **buy-back shall be fully paid-up**;
- f. The buy-back should be in accordance with the **Rule 17 of the Companies (Share Capital and Debentures), Rules, 2014**; but in case of listed shares or other specified securities should be in accordance with regulations made by the Securities and Exchange Board of India in this behalf.



No offer of buy-back shall be made within one year reckoned from the date of the closure of the preceding offer of buy back [**Proviso to section 68(2)**] **Free reserves includes securities premium account (Explanation II to section 68**

Illustration

Buy-back with board resolution is allowed, if amount involved is

- a. Not exceeding twenty five percent of the total paid-up equity capital and free reserves of the company
- b. Not exceeding twenty five percent of the total paid-up equity capital
- c. Not exceeding ten percent of the total paid-up equity capital and free reserves of the company
- d. Not exceeding ten percent of the total paid-up equity capital

Answer- c [refer Section 68(2)]

Procedure before Buy-Back [Sub-section 3]

The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an **explanatory statement stating -**

- a. a full and complete disclosure of all the material facts;
- b. the necessity for the buy-back;
- c. the class of shares or securities intended to be purchased under the buy back;
- d. the amount to be invested under the buy-back; and
- e. the time limit for completion of buy-back.

Rule 17(1) of the Companies (Share Capital and Debentures), Rules, 2014 specify list of 14 matters, regarding which particulars shall be stated in explanatory statement.

Securities to be purchased under 'Buy-Back' [Sub-section 5]

The buy-back may be from;

- a. the existing shareholders or security holders on a proportionate basis; or
- b. the open market; or
- c. the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Declaration of Solvency [Sub-section 6]

A declaration of solvency has to be filed, **before** the resolution for buying back is implemented; **with the Registrar and also with SEBI**, if such shares of such company are listed on any stock exchange.

Declaration of solvency has to be on a **Form SH-9 and verified by an affidavit**, stating that the Board of directors has made a full inquiry into the



affairs of the company and have found that it is capable of meeting all its liabilities and will **not be rendered insolvent for a period of 12 months from the date of the declaration.**

It has to be **signed by at least two directors of the company**, one of whom should be the managing director, if any.

Example- Form SH-9 filed by a listed company, Rainbow Sports Limited with registrar as well as SEBI stating Board of directors has made a full inquiry into the affairs of the company and have found that it is capable of meeting all its liabilities and will not be rendered insolvent for a period of 6 months from the date of the declaration. Declaration was duly signed by 3 directors, none of them being MD, as MD is out of the country to attend FIFA world cup event in Qatar (being one of the sponsors).

There are two lacuna in compliance to sub-section 6, first being declaration shall be for a period of 12 months; secondly if managing director is appointed then he shall sign the declaration of solvency.

Time limit for Completion of Buy-Back [Sub-section 4]

Every buy-back shall be completed within twelve months from the date of passing the special resolution or board resolution authorizing the buy-back.

Time Check Points and Procedural aspects of Buy-Back

The company before the buy-back of shares, **file with the Registrar a letter of offer in Form No. SH.8**, along with the fee. The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies **but not later than twenty days from its filing with the Registrar of Companies.**

The offer for buy-back shall **remain open for a period of not less than fifteen days and not exceeding thirty days from** the date of dispatch of the letter of offer, but where all members of a company agree, the offer for buy-back may remain open for a period less than fifteen days.

In case the number of shares or other specified securities offered by the shareholders or security holders is **more than the total number of shares or securities to be bought back by the company**, the acceptance per shareholder shall be on proportionate basis out of the total shares offered for being bought back.

The company shall complete the **verifications of the offers received within fifteen days from** the date of closure of the offer and the shares or other



securities lodged shall be deemed to be accepted unless a communication of rejection is made **within twenty-one days from the date of closure of the offer.**

The company shall make payment **within seven days of verification process and make payment** in cash to those shareholders or security holders whose securities have been accepted. Company will return the share certificates to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance.

Extinguishment of Securities [Sub-section 7]

Where a company buy's back its **own securities or other specified securities**, it shall extinguish and physically destroy the shares or securities so bought-back **within seven days of the last date of completion of buy-back.**

Cooling Period - No fresh Issue [Sub-section 8]

When a company completes a buy-back of its shares or other specified securities, it shall **not make further issue of the same kind of shares or other specified securities within a period of six months.**

It may, however, make a bonus issue and discharge its existing obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Authors Note: This restriction applies only to the type of securities bought back. The company is free to issue other types of security.

Register of Buy Back [Sub-section 9]

The company shall maintain a register of shares or **other securities which have been bought-back in Form No. SH.10** containing details of,

- a. Shares or securities so bought,
- b. Consideration paid for the shares or securities bought-back,
- c. Date of cancellation of shares or securities,
- d. Date of extinguishing and physically destroying the shares or securities and
- e. Such other particulars as may be prescribed

Authors Note:

1. This register shall be maintained at the registered office in the custody of the secretary of the company or any other person authorized by the board on this behalf.
2. The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.



Filing of Return of Buy-back [Sub-section 10]

A **return of buy-back in Form No. SH.11** along with the fee shall be filled with;

- The Registrar and also SEBI, if shares of company are listed on any recognised stock exchange
- Containing such particulars relating to the buy-back
- Within thirty days of such completion.

Authors Note: Along with return, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder

Penalty for Default [Sub-section 11]

If a company makes default in complying with the provisions of this section or any regulations made by Securities Exchange Board of India specified for the purposes of **section 68(2) (f)**, the company shall be punishable with fine which shall **not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.**

Summary of punishment

Liabe	Minimum Fine	Maximum Fine
Company		
Every officer of the company who is in default	One lakh rupee	Upto three lakh rupee

Illustration

Passing an ordinary resolution is sufficient where the buy-back is, not exceeding ten percent of the total paid-up equity capital and free reserves of the company.

Answer - False, such buy-back has to be authorized by the Board resolution passed at its meeting.

Transfer Of Certain Sums to Capital Redemption Reserve Account [Section 69]

Section 69 requires a certain amount to be **transferred to the capital redemption reserve (CRR) account** in case a company buys back its own shares.



Amount to be transferred to CRR Account [Sub-section 1]

Where a company purchases its own shares out of free reserves or securities premium account, then;

- a. Sum equal to the nominal value of the share so purchased shall be transferred to the capital redemption reserve account, and
- b. Details of such transfer shall be disclosed in the balance sheet.

Application of CRR Account [Sub-Section 2]

The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Similar use of CRR is also specified under-section 55(4) of this Act, that created when preference shares redeemed out of profit, as provided under section 55(2)(c).

Illustration

CRR can be used to issue partly paid bonus shares or finance discount portion of sweat equity shares.

Answer - False, the capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Prohibition For Buy-Back in Certain Circumstances [Section 70]

Sub-section 1 states no company shall directly or indirectly purchase its own shares or other specified securities:

- a. Through any subsidiary company including its own subsidiary companies, or
- b. Through any investment company or group of investment companies; or
- c. If a default, is made by the company, in
 - i. repayment of deposits or interest thereon, or
 - ii. redemption of debentures, or
 - iii. redemption of preference shares or
 - iv. payment of dividend to any shareholder or
 - v. repayment of any term loan or interest thereon to any financial institutions or banking company

Authors Note:

1. Specified securities includes employees' stock option or other securities as may be notified by the Central Government from time to time (Explanation I to section 68)



2. Where the default is remedied and a period of three years has lapsed after such default ceased to subsist, such buy-back is not prohibited.

Further sub-section 2 prohibits the company from directly or indirectly purchasing its own shares or other specified securities in case such company has not complied with provisions of

- a. Section 92 (Annual Report),
- b. Section 123 (Declaration and Payment of Dividend),
- c. Section 127 (Punishment for failure to distribute dividends), and
- d. Section 129 (Financial Statement)

Example- Sigma Electronic Limited (SEL) was financial unstable in 2018 due to economic slowdown, finally it made default in repayment of loan that it has taken from public finance corporation in June 2020 pursuant to cash crunch caused by nation-wide lock down. SEL's account was marked in defaulters list by lender and classified in NPA category. But stimulus package helped SEL to pass the high turbulence phase, it able to repay the due amount on December 2020. In February 2021 SEL account removed from NPA category. SEL won a tender in mid of 2021 and become supplier to military retail canteens. SEL accumulate reasonable amount of reserve and attain the position cash surplus. SEL decided to Buy-back 10% of its equity shares in December 2022.

Consider the facts stated in case, SEL shall not be allowed to buy-back its securities as 3 years has not been elapsed since when default is remedied.

Debenture [Sections 71]

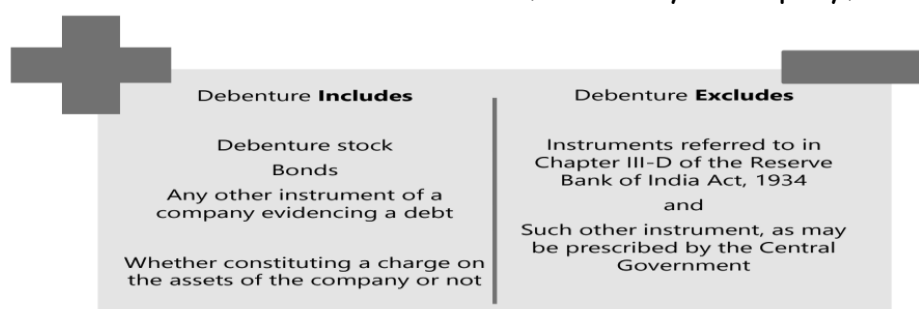
Definition And Features of Debenture

Definition [Section 2(30)]

Debenture **includes** debenture stock, bonds or any other instrument of a company evidencing a debt, **whether constituting a charge on the assets of the company or not**

Provided that the following shall not be treated as debenture

- a. the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; **and**
- b. such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company,



Features of Debentures

- a. A debenture is the **smallest unit** of a sizable amount of loan.
- b. When debentures are issued, the applicants are given **certificates** representing the **money they have lent** to the company
- c. A debenture certificate is issued by the company under its **common seal**, if any, or under the signatures of two directors or a director and the company secretary, if he has been appointed.
- d. The company pays **periodic interest** on the amount raised by issuing debentures till they are fully redeemed.
- e. A debenture is generally **pre-fixed with the rate of interest** which the company intends to pay.

Example- The name '10% Debentures' indicates that the company shall pay interest at the rate of 10% on the outstanding amount till maturity of such debentures.

- f. Voting rights are not available in case of debentures as section 71 (2) of the Act, clearly states that no company shall issue any debentures carrying any voting rights.
- g. As per section 44 of the Act, a debenture is in the nature of movable property which is transferable as per the provisions contained in the Articles of the company issuing the debentures
- h. A debenture may be **secured or unsecured**. In case of secured debentures, a charge is created on the assets of the company in Favor of the debenture trustee.
- i. As per the terms of the issue of debentures, they may be redeemed (i.e. repaid) at the end of full term or in installments, say yearly or bi-yearly or any other period like in two installments.
- j. The terms of issue may also provide for conversion of debentures at maturity into equity shares at the option of the debenture holders.
- k. The debenture certificates are required to be delivered within a period of six months under section 56(4)(d) of the Act, from the date of allotment of debentures, unless the company is prohibited by any provision of law or any order of Court, Tribunal or any other authority.

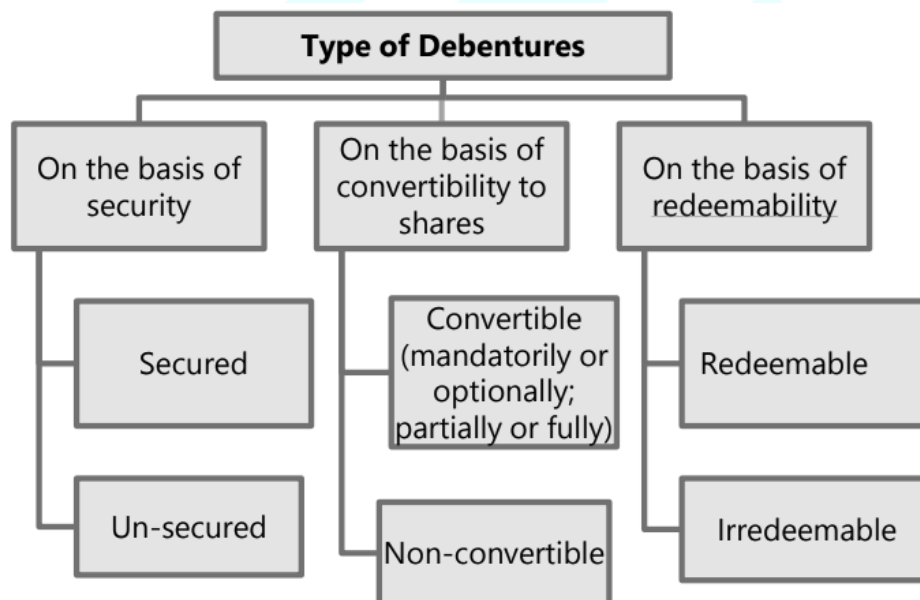
Example- Sigma Computers Limited desires to borrow ₹50,00,000 from the public by issuing 7% debentures. It is intended that each unit of debenture shall be of 100. Thus, it can issue 50,000 debentures of 100 each carrying a 7% rate of interest which can be paid at the end of every quarter. If such debentures (secured by a charge on the assets of the company) are issued for six-year duration, the principal amount shall be repaid by the end of sixth year.



The terms of issue may even allow repayment of principal amount in equal yearly installments, in which case a portion of debentures shall be redeemed on yearly basis and the company shall be required to pay interest only on the outstanding amount. The debenture holders may also be given the option of converting their debentures into equity shares at the time of maturity.

Thus, Sigma Computers Limited is able to borrow a large sum of money from different borrowers with the help of debentures and it is not required to approach a single borrower for such a big amount.

In other words, 'issue of debentures' is the most convenient way of borrowing large sums of money and at the same time the debenture holders do not exert any influence over the ownership and working of the company unless their interest is jeopardized by certain decisions.



Manner Of Issue of Debentures and Applicable Provision Thereto [Section 71]

Issue of Debentures with an Option to Convert [Sub-section 1]

A company, if authorized by **passing special resolution at general meeting**, then it may issue debentures with an **option to convert such debentures into shares, either wholly or partly at the time of redemption.**

No Voting Rights [Sub-section 2]

No company shall issue any debentures **carrying any voting rights.**



Issue of Secured Debentures [Sub-Section 3]

Secured debentures may be issued by a company subject to such terms and conditions as are prescribed in **Rule 18 (1) of the Companies (Share Capital and Debentures) Rules, 2014**; which are explained below,

a. Maximum Period of Secured Debenture

The tenor of secured debenture shall **not be more than 10 years from the date of issue**, except in following cases where tenor can be up to 30 years

- i. Companies engaged in **setting up of infrastructure projects**;
- ii. **Infrastructure Finance Companies** as defined in **clause (vii) of sub direction (1) of direction 2** of Non-Banking Financial (Non-deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
- iii. **Infrastructure Debt Fund NBFCS'** as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011;
- iv. Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing Bank or by any other statutory authority to issue debentures for a period exceeding ten years.

b. Appointment of Debenture Trustee

Debenture trustee shall be **appointed by the company** before the issue of prospectus or letter of offer for subscription of its debentures.

c. Security by Creation of Charge

Security for the debenture can be provided by way of creating a charge or mortgage in **Favor of debenture trustee**, on;

- i. **Specified movable** of the company or its subsidiaries or its holding company or its associates' companies, or
- ii. **Specified immovable properties** wherever situate, or any interest therein.

Authors Note: 1. Value of such assets or properties upon which charge is created shall be sufficient for the due repayment of the number of debentures and interest thereon.

2. In case of NBFCS, the charge or mortgage may be created on any movable property.

3. In case of any issue of debentures by a Government company which is fully secured by the guarantee, given by the Central Government or one or more State Government or by both, as per the requirement for creation of charge



under rule 18(1) of the Companies (Share Capital and Debentures) Rules, 2014 shall not apply.

d. Debenture Trust Deed

Debenture trust deeds shall be executed in **Form SH-12** to protect the interest of the debenture holders, within three months of closure of the issue or offer.

Creation of Debenture Redemption Reserve (DRR) Account [Sub-section 4 read with Rule 18 (7) of the Companies (Share Capital and Debentures) Rules, 2014]

Company shall create a debenture redemption reserve (DRR) account out of the profits of the company available for payment of dividend.

The amount credited to such DRR account shall not be utilized by the company except for the redemption of debentures.

a. Requirement of DRR

Category	Publicly placed debenture	Privately places debenture
All India Financial Institutions (regulated by RBI)	Exempted	Exempted
Banking Companies	Exempted	Exempted
Listed companies (other than All India Financial Institutions and Banking	Exempted Except NBFCs Not registered	Exempted except
Companies covered above)	with RBI u/s 451A of RBI Act, and for House Finance companies not registered with National Housing bank	with RBI u/s 451A of RBI Act, House Finance companies not registered with National Housing bank
Unlisted Companies (other than All India Financial Institutions and Banking Companies covered above)	DRR equal to 10% of Outstanding Debenture	DRR equal to 10% of Outstanding Debenture Except NBFCs registered with RBI u/s 451A of RBI House Finance Companies registered with National Housing bank



Authors Note:

1. The main purpose of these relaxations was introduced by the MCA for the reduction of the cost of borrowings incurred by companies.
2. Other Financial Institution covered under 2(72) of the Companies Act 2013 for purpose of creating and maintaining DRR shall be dealt in manner as Non-Banking Finance Companies registered with Reserve Bank of India
3. In case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture

b. Amount and methods of Investment or deposits for debentures maturing during the fiscal

By 30th April of each year, the in case of;

Company	In case of
Listed Company, other than All India Financial Institutions and Banking Companies	Publicly placed debenture
Unlisted companies, other than All India Financial Institutions, Banking Companies	Publicly placed debenture & Privately placed debenture (other than those by NBFCs registered with RBI u/s 45IA of RBI and House Finance companies registered with National Housing bank)

An amount equal to 15% of its debentures maturing during the financial year, ending on the 31st day of March of the next year, shall be invested or deposited in any of following methods of deposits or investments, namely;

- a. Deposits with any scheduled bank, free from any charge or lien;
- b. Unencumbered securities of the Central Government or any State Government
- c. Unencumbered securities mentioned in sub-clause (a) to (d) and (ee) of section 20 or unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882

The amount remaining invested or deposited, as the case may be, shall not any time fall below fifteen percent of the amount of the debentures maturing during the year ending on 31st day of March of that year. Meaning thereby that amount shall be invested or deposited by 30th April and maintained thereafter till end of financial year (or till maturity if fall earlier).



Restrictions on the issue of Prospectus/Offer/Invitation to the public [Sub- section 5]

Prior to issuing a prospectus or making an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, the company shall appoint one or more debenture trustees. Except in case of public offer of debenture, in all other cases appointment and removal of debenture trustee governed by provisions prescribed in Rule 18 (2) of the Companies (Share Capital and Debentures) Rules, 2014; namely:

a. Name and Consent of Debenture Trustee

The names of the debenture trustees shall be stated in offer related letters and notices or subsequent thereto. Written consent before the appointment of debenture trustee must be obtained and a statement to that effect shall appear in the letter of offer.

b. Who can be a debenture trustee?

Following persons shall not be appointed as a debenture trustee,

- i. A beneficiary holders of shares in the company;
- ii. A promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;
- iii. Relative of any promoter, director or key managerial personnel of the company;
- iv. A beneficiary entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;
- v. Who is indebted to the company, or its subsidiary, holding or associate company or a subsidiary of such holding company;
- vi. Who has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;
- vii. Who has any pecuniary relationship with the company amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

c. Removal of debenture trustee prior to his term

Any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three fourth in value of the debentures outstanding, at their meeting.

d. Filling of vacancy of debenture trustee

Nature of vacancy	How to fill
Casual Vacancy*	Board themselves may fill any casual vacancy
Caused by the	With the written consent of the majority of the



resignation	debenture holders.
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*While any such vacancy continues, the remaining trustee or trustees, if any, may act till appointment is made.

Debenture Trustee to protect Interest of Debenture Holders [Sub-section 6]

A debenture trustee shall take steps to protect the interests of the debenture- holders and redress their grievances. Duties of debenture trustee enumerated under **rule 18(3) of the Companies (Share Capital and Debentures) Rules, 2014**. Further, **Rule 18 (4) of the Companies (Share Capital and Debentures) Rules, 2014** requires debenture holders to convene the meeting of all the debenture holders on:

- a. Receiving a request (duly signed and in writing) from debenture holders holding at least one-tenth in value of the debentures
- b. Happening of any such event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

Note: Rule 18(3) and 18(4) are not applicable in case of public offer of debenture

Example-Roshan Bulb Limited took a bank loan in contravention to covenant regarding permissible debt-equity ratio, stated in offer document issued for subscription of its debentures. In this case debenture trustees are bound to convene the meeting of all the debenture holders as decision of taking loan by company is not only breach but also a default that will affect the interest of the debenture holders.

Liability of Debenture Trustee [Sub-section 7]

Where the debenture trustee fails to show the degree of care and due diligence

required of him as a trustee.

Any provision, that exempt or indemnify a debenture-trustee from any liability for breach of trust; as contained in;

- a. A trust deed for securing the issue of debentures or
- b. Any contract with debenture holders secured by a trust deed Shall be **void**.

Authors Note: Exemptions given to debenture trustees, shall be agreed upon by debenture holders holding at least 75% value of debentures at time of meeting held for this purpose.

How to determine the reasonable degree of care and due diligence - Means a yardstick to determine failure - One has to determine in regard to the



provisions of the trust deed conferring any power, authority or discretion on such debenture trustee.

Example- Debenture trustee fails in keeping a close watch on change in value of asset against which such debenture is secured, which is specified a preliminary responsibility marked upon him; it can be said debenture trustee fails to show degree of care and due diligence required of him as a trustee.

To pay Interest and Redeem Debentures [Sub-section 8]

A company shall **pay interest and redeem the debentures** in accordance with the terms and conditions of their issue.

Filing of Petition before Tribunal by Debenture Trustee [Sub-section 9]

Where debenture trustees reach the conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, may file a petition before the Tribunal.

The tribunal may pass order:

- a. To impose restrictions on the incurring of any further liabilities by the company as it may consider necessary in the interests of the debenture-holders.
- b. After hearing the company and any other person interested in the matter

Order of Tribunal on Failure to Redeem Debentures/Pay Interest [Sub-section 10]

Tribunal may direct by order;

- a. On the company to redeem the debentures forthwith on payment of principal and interest due thereon
- b. After hearing the parties concerned, on the application of any or all of the debenture-holders, or debenture trustee
- c. Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due,

Specific Performance of the Contract [Sub-section 12]

A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

Debenture holders have the right to seek relief under the Specific Relief Act, 1963 for specific performance. Court may pass a decree (in favor of the debenture holder in this case) **under 2(2) of the Civil Procedure Code, 1908 (CPC) and the same can be executed under order 21 of CPC.**



Specific performance means, forcing the other party (company in this case) of contract to perform his part of contract (repayment of debenture) through court's decree.

Decree is the final order passed by court as outcome of adjudication, explaining the right of parties.

Procedure to be prescribed by Central Government [Sub-section 13]

Sub-section 13 empowers the Central Government to prescribe the:

- a. Procedure for the securing the issue of debentures,
- b. Procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof
- c. Form of debenture trust deed,
- d. Quantum of debenture redemption reserve required to be created and
- e. Such other matters.

Illustration

If interest to debenture holders remains unpaid for two years, then they may vote on resolutions affecting their interests.

Answer - False, no debenture holder can never assume voting right, unless their debenture is converted into equity as per terms of issue. Though similar provisions exist in case of preference dividend remain unpaid for two years to preference shareholders.

Authors Note:

1. If issue results in debt-equity ratio more than 1 - In case of company other than private company, the Board of Directors of the company shall obtain approval of the shareholders through special resolution, if the borrowings by issuing debentures together with the amount already borrowed exceed the aggregate of company's paid-up share capital, free reserves and securities premium amount, then prior to the issue of debentures.

Note - Borrowing shall not include short term or temporary loan in nature.

2. Pursuant to rule 12 (1) of the companies (Prospectus and allotment of securities) Rules 2014, a company having share capital, when makes allotment of any debentures (falls within the definition of 'securities'), it is required to file a Return of Allotment in form No. PAS-3 within thirty days of such allotment with the jurisdictional Registrar.

