COMPANY LAW : NOTES FOR B.COM SEMESTER 2 STUDENTS

TOPIC: SHARE CAPITAL AND DEBENTURE

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1. Basically, a company has two types of capital: A) Share capital (Equity share capita and Preference share capital) and B) Borrowed capital (Debenture, Public Deposit, Term Loan etc.).

2. Equity share capital may be of two types : a) Equity share capital with voting rights i.e. one vote for one share and fixed(same) rate of dividend in a year and b) Equity share capital with differential rights i.e. different voting rights, say, 3 votes for one share and different rates of dividend. Equity shareholders are the member and owner of the co. and every member has the right to cast vote in proportion to share in paid up capital of the company on every resolution placed before the general meeting of the co.

3. Right shares, Bonus share, Employee stock option plan, Sweat equity share are all equity shares issued both by public and private limited co. However non-voting share can only be issued by private ltd. co. Public limited cos are not allowed to do so. Both Pvt. Ltd. and Public Ltd. companies (Unlisted) can issue shares/securities through Private Placement; but, only listed Public companies may issue shares, debentures, securities to public through Prospectus.

4. What is share: Capital of a company is termed as share capital which is divided into units. Each unit is called a share. U/S 2(84) of the Indian Companies Act “a share is the share capital of a company and includes stock”. A share is movable property (goods as per sale of goods act), having distinctive mark , transferrable, signifies right to participate in profits and interest of shareholders in the co. As per definition share includes stock. But there are differences between the two. Unlike share, a stock has no distinctive mark, must be fully paid, may be different money values, fraction, only issued by public ltd. cos.

5. Share capital: Authorised capital-- Maximum limit of capital mentioned in Memorandum of Association (MOA) and registered by Company Register, beyond which a co. cannot raise its by issue of share.(say 30000 shares nominal or face value RS.10 =RS.300000) Issued capital: portion of authorised capital issued to public for subscription.(say 20000 shares x10 =RS 200000). Subscribed capital: portion issued capital taken up by public and for which money is paid. (say 28000 shares xRS.10 = RS 280000). Called-up capital: portion subscribed capital a co. asked to pay by the public (Say 28000 shares x RS.8 per share called-up=224000. Paid-up capital: portion of called-up capital actually collected (28000xRs.8=224000 less calls-in-arrear 100sharesxRS. 2=200) =RS.223800. Calls-in-arrear is called unpaid capital.

6. What is equity share capita: U/S 43(i), all share capital which is not Preference share capital is Equity share capital. These shares may be issued at par value or at a premium. Except issue of sweat equity share, no co. is allowed to issue share at a discount u/s 53(1). Co. issuing equity shares at a discount will be penalised with a fine of Rs. 100000 to max.Rs.500000 and each person held responsible shall be imprisoned min. 6 months or fine RS.100000 to RS. 500000 or both.

7. Different types of equity share:

A) Equity shares with differential rights: u/s 2(46A) Rule 4, 2014: conditions for such issue------------

i) Authorised by AOA ii) Pass ordinary resolution in general meeting iii) maximum limit of such issue-- 25% of the paid up equity share capital including such issue at any point of time iv) distributable profit in last three consecutive years and not defaulted in filing financial statement and annual returns for last 3 years, v) no default in payment of preference dividend and declared dividend to its shareholders and repayment of matured deposits, redemption of preference share and debenture, term loan and statutory payment relating to employee.vi) The co. has not been penalized by Court or tribunal , R,B.I , FEMA, SEBI. Vii) explanatory statement annexed with notice of G.M.----- number of such shares to be issued, price of such share, justification of such issue, percentage of such shares, rights of such share (listed co. Postal Ballot to be issued),details of total no of shares to be allotted to ,promoters, directors, key managerial persons and other persons. Viii) disclosure in Board's report in this regard.

Note: Mention in register of members. Shareholders having shares with differential rights will enjoy all rights such as right shares, bonus shares etc.

The object of issuing such share is to prevent hostile takeover and dilution of voting rights.

B). Sweat Equity Share u/s 2(88) and Rule 8(share and Debenture)2014: such equity shares are issued by a co. to its permanent employees (working at least one year in India or abroad) or its directors (full time or part time) of a subsidiary co., in India or outside India, or of a holding co. of the company. These shares are issued at a favourable terms , at a discount or for consideration other than cash in order to attract talented persons for getting know how, intellectual property or value additions. Sweat Equity Share cannot be issued to Independent Director. Conditions for issuing Sweat Equity Share-----------i) minimum one year from the date of commencement of business ii) pass special resolution in general meeting. The notice of general meeting must mention the date of Board meeting in this regard, reasons for such issue of share, number of shares, nature and name of employees to whom such issue to be made, consideration of such share etc. iii) issue of shares to be made within 12 months from the date of special resolution adopted in general meeting iv) in a year maximum number of sweat share can be issued is 15% of existing paid up equity capital or shares of the issue value of RS. 5 Crores, whichever is higher. However issue of such shares shall not exceed 25% of the paid up capital of the co. at any point of time. V) minimum lock-in period 3 years from the date of allotment. Vi) listed cos. in addition, to follow the guidelines of SEBI. Vii) valuation by the registered valuer viii) on allotment the co. shall maintain Register of Sweat Equity Share in Form SH-3

C) Right share u/s 62(1): If a co. decides to issue fresh shares, it should be offered to existing equity holders (members) in proportion to their share holding. The object is to retain control over the co. Voting rights of existing shareholders is not affected by issue of fresh shares.

Procedure for issuing Right share: i) convene Board Meeting by serving notice in wring to every director at least 7 days' before the meeting. ii) despatch letter of offer to existing shareholders at least 3 days before opening the issue iii) receive acceptance or rejection from shareholders within minimum 15 days maximum 30 days. Beyond which, if offer is not accepted, offer shall deemed to be declined. iv) convene Board meeting by issuing at least 7 days' notice and pass resolution for allotment and issue of shares v) file return to ROC (E-Form PAS-3)within 30 days of allotment of shares vi) update members register and issue share certificate.

Note: listed co. to follow SEBI guidelines in this regard, in addition to Co. Act.

D)Bonus Share u/s 63(1) and Rule 14: Bonus shares are additional shares given to current equity shareholders free of cost, based on number of shares that a shareholders owns. Issue of bonus shares is simply capitalisation of profit. Procedure to be followed for issue of such shares:------

i) a co. may issue fully paid-up bonus shares (equity share) to its members out of free reserves available for distribution of dividend, securities premium and capital redemption reserve account. Revaluation reserve is excluded ii) bonus issue must be authorised by AOA ii) recommendation of the Board Meeting is to be passed in general meeting iii) co. is not defaulted in payment of interest, principal of debt securities and statutory dues of employees (gratuity. P.F. bonus etc.)iii) partly paid-up shares if any, must be fully paid. Iv) bonus share shall not be issued in lieu of dividend.

E} Employees Stock option plan [ESOP u/s 2(37) and 62(1)(b)]: Employee stock option means [u/s 2(37)] the option given to the directors (not independent director or director holding ,directly or indirectly, more than 10% of the outstanding equity share of the co. or promoter employee), officers, or employees of a co. or of its holding co. or subsidiary co. or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or subscribe for, the shares of the co. at a future date at a pre-determined price. Procedure for issue of ESOP-------------

i) drafting of ESOP scheme ii) pass ESOP in Board Meeting and notice is to be served for general meeting. iii) pass special resolution by shareholders in general meeting iv) file special resolution to ROC within 30 days of passing special resolution v) After getting approval of ESOP, grant option to eligible employees vi)there shall be a minimum period of 1 year between the grant of option and vesting of option. Vii) exercise of option by employees. The co. shall have the option to specify a lock-in-period for the shares issued in pursuant to exercise of option. viii) option cannot be transferred excepting in case of death of employees. Ix) co. has freedom to determine exercise price x) allotment of shares and filing of return to ROC xi) maintain register of shares so issued in Form No. SH-6 and issue of share certificate.

Issue of Preference share: As per section 43 (ii), Preference share with respect to any company limited by share, means that part of the issued share capital which enjoys preferential rights as to dividend (fixed rate) and repayment of capital in the event of liquidation of the company over equity share. Section 55 prohibits a company limited by share to issue irredeemable pref. share and can issue preference share which can be redeemed within a period of 20 years subject to the approval of AOA. However, for infrastructure co. the said time limit may be extended maximum up to 30 years.

Types of Prf. share :------- i) cumulative pref. share: cumulate preference dividend if not paid due to insufficient profit in any year and the same to be paid out of profit of subsequent year.

ii) Non-cumulative pref. share : no dividend is paid in the year when profit is insufficient, but dividend is not cumulate. iii) Participating pref. share : this kind of shareholders participate in the surplus profit available after payment of equity dividend and enjoy right to participate in the surplus)assets after meeting liabilities in the event of winding up of co. iv Non- participating pref. share

v) Redeemable pref. share vi) Convertible pref. share: Pref. shares are to be converted into equity shares after a specified time period. vii) Non-convertible pref. share : Pref. shares cannot be converted into equity share at all.

Note: Pref. shares can be issued--- by passing of special resolution in the general meeting , AOA to authorise issue of pref. share, no default in the redemption of pref. shares at the time of issue of such shares and the company requires to maintain a register containing particulars in respect of pref. share holder u/s 88. Pref. shares do not carry voting rights except in the case of dividend in arrear for more than 2 years and in case of any decision of the co. that may affect their preferential rights.

Redemption of Preference Share u/s 55 : As per Company act 2013, a company can issue only redeemable Pref. Share. These shares can be redeemed (if they are fully paid) u/s 48 at a fixed time , or at option of the co. or at any time at the shareholder's option. Rules regarding redemption of Pref. share-----

i) shares to be redeemed must be fully paid ii)such shares can be redeemed out of profits available for distribution to its shareholders as dividend or out of the proceeds of shares issued solely for funding the redemption. iii) an amount equals to the nominal value of shares so redeemed out of profits available for distribution shall be transferred to the capital redemption reserve which can only be utilised for issue of fully paid bonus share iv) premium, if any, payable on redemption shall be paid out of securities premium account or out of profits v) if there is any unredeemed pref. share, such shares can be redeemed by issue of further redeemable shares equals to the amount due including the dividend thereon in respect of unredeemed pref. shares, provided consent of $3/4^{th}$ in value of pref. shares and approval from tribunal has been obtained vi) pass resolution of redemption in board's meeting and in general meeting vii)file SH-7 with register within 30 days of passing such resolution.

N.B. Redemption of pref. share does not mean reduction of capital.

Buy Back of Shares u/s 68, 69 and 70 Rule 17 of Rule 2014. For listed co. in addition to these sections and rule , they are to follow SEBI guidelines.

Buyback of shares means purchase by the co. of its own shares (equity share). It is a corporate strategy of capital restructuring which increases earnings per share, return on capital and averting hostile takeovers.

Conditions to be fulfilled before buyback: i) AOA must authorise the buyback ii) a special resolution in general meeting is to be passed. However, buyback up to 10% of paid up equity capital and free reserve can be affected by passing a resolution in board meeting. Every buyback shall be completed within 1 year from the date passing resolution iii) shares for buyback must be fully paid iv) buyback of shares can be done either from existing shareholders on proportionate basis or from open market or from employees to whom shares are offered under ESOP v) buyback of shares can be made out of free reserve or securities premium or from the proceeds of any shares or same kind of other specified securities (not earlier issue of same kind of shares and securities) vi) in case of buyback of shares from free reserve or securities premium , an amount equals to nominal value of shares, so buy back, shall be transferred to capital redemption reserve which can only be used for issuing fully paid bonus share vii) maximum limit of buy back is 25% of its total paid-up capital and free reserve, however, in a financial year, buyback cannot exceed 25% of total paid-up equity capital of that financial year. There can be only one buyback in a year from the date of preceding buyback of share. viii) After buyback debt equity ratio should not exceed 2:1 ix) letter of offer in Form SH-8 and solvency report in Form SH-9 shall be filed with ROC x) letter of offer should be despatched to shareholder within 20 days from the date of filing SH-8 with ROC and the offer shall open for acceptance minimum 15 days and maximum 30 days xi) within 7 days of verification /acceptance cash to be paid to shareholders and 7 days from the date of completion of buyback shares should be physically destroyed. Completion of buyback should be reported to ROC within 30 days in Form SH-11.

Note: Company shall be debarred from buyback if it defaults in re payment of deposits and term loan or interest, redemption of debenture or pref. shares or payment of dividend.

Allotment of Shares: offer of shares is made on application forms supplied by the company. Public Ltd. company wishes to collect capital from public, they have to do it by issuing Prospectus. Persons applied for specific number of shares must have to pay application money along with application form duly filled in. When application money is accepted by the co. , it amounts to allotment. So, an allotment of shares is an acceptance by the co. either through allotment letter or by notice (given by Board of Directors) of the offer to take shares by persons. This makes a valid a contract. Allotment must be given within a reasonable time without attaching an condition. Rules regarding Allotment: i) the amount payable on application for every security must not be less than 5% of the nominal value of security or such % as prescribed by SEBI. Minimum subscription as stated in the prospectus (as per SEBI 90% or more of the offer) must be collected within 30 days(or such other period as prescribed by the SEBI) from the date of issue of prospectus, failing which application money so received must be refunded within 15 days from the date of closure of issue ii) all application money to be deposited in scheduled Bank iii) filing of prospectus or statement in lieu of prospectus to register of co.(ROC) iii) Board meeting is to be convened and resolution regarding allotment of shares is to be adopted iv) issue of letter of allotment to those getting shares and letters of regret to those not getting shares v) refund or adjustment of excess application money vi) collection of allotment money vii) submission of returns of allotment to ROC viii) preparation of register of members and issue of share certificate.

Note: violation of above rules of allotment is called irregular allotment.

Calls on share: It is a demand made by a co. on its shareholders to pay a part or the whole of the unpaid balance within a specified time. Call on shares is to be made by passing resolution in Board Meeting. No call shall exceed $1/4^{th}$ of the nominal value of share and be payable at less than 1 month from the date of payment of the last preceding call. Each member should get at least 14 days notice to pay the call money.

Forfeiture of shares: If a shareholder fails to pay the called up capital then his/her shares may be taken back after giving at least 14 days notice. This is known as forfeiture of share. For forfeiture of share, resolution at a Board Meeting , approval from AOA , provisions in Table F etc. are required. Forfeiture of share does not mean reduction of capital. Forfeited shares are the property of the company (money paid on shares is forfeited) and can be re-issued at par, at a premium, or at a discount or such share may be cancelled. The defaulting shareholders whose shares are forfeited are no longer members of the co. and name is struck off from the register of members.

Capital reduction u/s 66: A co. limited by share or limited by guarantee may, on confirmation from Tribunal and by passing special resolution, reduce its share capital in the following ways----

i) Extinguishing or reducing liability in case of share not paid up. ii) cancel any paid-up share capital which is lost or is unrepresented by available assets. iii) pay off any paid-up capital in excess of need. iv) alter its memorandum by reducing the amount of its share capital and of its share.

Share certificate u/s 46: A share certificate is a document issued by co. evidencing that the person named in the certificate is owner of number shares of co. as specified in the certificate. In case of one person co., certificate is signed by one director or by a secretary or there authorised person. In case of companies other than one person co., certificate is signed by 2 directors (1 director shall be a director other than managing director / whole time director) as authorised by Board and a co. secretary or one person authorised by Board in case of cos. which have not appointed secretary. Signature may be digital or printed on the certificate. A duplicate certificate of shares may be issued if share certificate is lost, destroyed, mutilated or torn or consolidated etc. within 3 months from the date of submission.

Demat system: If one to buy or sell stock, he/she has to open a Demat account (Dematerialized account). Under this system one need not to hold stock physically, transfer stock immediately with no stamp duty, reduce paperwork and reduce transaction cost etc. Now person holding Demat account must have PAN.

Transfer of share: As per section 56, Share which represents interest of member in a company is a moveable property and can be transferable in the manner provided in AOA. However, there are some restrictions in transferability of shares both for private and public ltd. company. In case of private ltd. co. share transfer is restricted among the existed members in first instance, before offering them to non-members. Procedure of share transfer -------i) transfer must be made through share transfer form ii) the prescribed must be filled and stamped iii)name, address and occupation must be mentioned in the form iv) transfer has to be executed on behalf of transferor or transferee etc.

Transmission of share or debenture(u/s 56) may occur when the registered shareholder o debenture holders die or insolvent. Transfer of share may occur voluntarily but transmissions occur operation of law. In case of transfer instrument of transfer is required but for transmission no such instrument is required.

Debenture : A debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the asset of the company or not u/s 2(30)

Features: i) a legal document which evidences a loan made to a co. ii) interest is paid at a predetermined rate iii)original sum is payable /converted into share/other debenture at specific future date iii) debenture may be secured/unsecured iv) may be bought or sold through stock exchange v)it is movable property.

Types of Debentures: on the basis of i) security--- secured debenture (fixed charge or floating charge) and unsecured deb. Ii) convertibility----convertible into equity and non-convertible iii)permanency------redeemable debenture (maximum period 20 years) iv) Negotiability------- registered debenture and bearer debenture v)priority---- 1st mortgage and 2nd mortgage deb.

Rules regarding debenture: i) a debenture redemption reserve is to be created out of profits ii) issue of convertible debenture must be approved by passing special resolution at the general meeting of the equity shareholders. Iii) appointment of debenture trustee for a company issued debenture by prospectus to public or its members exceeding 500 for the subscription of its debenture.