

Provisions regulating issue of Debentures

1.	The power to issue debentures can be exercised on behalf of the company at a meeting of the Board of Directors {Section 292(1)(b) of the Companies Act}.	
2.	A public company may, however, require the approval of shareholders to borrow money <u>in excess of the aggregate of its paid up capital and free reserves</u> . {Section 293 (1) (d)}.	
3.	Consent of the shareholders would also be required for selling, leasing or disposing of the whole or substantially the whole of the undertaking of the company under <u>section 293 (1) (a)</u> .	
4.	Debentures have been defined under <u>Section 2 (12)</u> of the Act to include debenture stocks, bonds and any other securities of the company whether constituting a charge on the company's assets or not.	
5.	The attributes of a debenture are:	
>	A movable property	
>	Issued by the company in the form of a certificate of indebtedness.	
>	It generally specifies the date of redemption, repayment of principal and interest on specified dates.	
>	May or may not create a charge on the assets of the company	
6.	Section 372 A of the Companies Act also regulates inter-corporate loan and investments and stipulates the <u>ceiling limits</u> on investments and the amount of loan that can be borrowed by a company. The explanation clause of this section states that the loan shall include debentures	
7.	<u>Section 117 to Sections 123</u> of the Companies Act, 1956 <u>regulate the provisions</u> relating to debentures, appointment of debenture trustees, their duties, creation of Debenture Redemption Reserve Account, liability of trustees etc.	
8.	The debentures issued under the Act shall <u>not carry any voting rights</u>. In the case of public issue of debentures, there would be a large number of debenture holders on the register of the company. As such it shall <u>not be feasible to create charge in favour of each</u> of the debenture holder. A common methodology generally adopted is to create Trust Deed conveying the property of the company. A Trust deed is an arrangement enabling the property to be held by a person or persons for the benefit of some other person known as beneficiary. The <u>Trustees declare the Trust</u> in favour of the debenture holders. The Trust Deed may grant the Trustees fixed charge over the freehold and leasehold property while a floating charge may be created over other assets. The Company <u>shall allow inspection of the Trust Deed</u> and also provide copy of the same to any member or debenture holder of the company on payment of such sum as may be prescribed. Failure to provide the same would invite penalties by way of fine under the Act. Any provision contained in the Trust Deed, which exempts a Trustee from liability for breach of Trust, is void. As per <u>Section 125 (4)</u> of the Companies Act, registration of a charge for	

	purpose of issue of debentures is mandatory. <u>Section 128</u> stipulates that where a company issues series of debentures which is secured by charge, benefit of which will be available to all debenture holders pari passu, the company <u>shall file</u> the prescribed particulars in <u>Form 10 and 13</u> with the Registrar of Companies for registration of charge. These forms shall be filed <u>within 30 days after the execution of the deed</u>.	
9.	Appointment and Duties of Debenture Trustees In terms of <u>Section 117 B</u>, it has been made mandatory for any <u>company making a public/rights issue of debentures</u> to appoint one or more debenture trustees before issuing • the prospectus or • letter of offer and • to obtain their consent .Which shall be mentioned in the offer document The Debenture Trustees shall not: • Beneficially <u>hold</u> shares in a company. • Be beneficially <u>entitled to</u> monies which are to be paid by the company to the debenture trustees. • <u>Enter into</u> any guarantee in respect of principal debt secured by the debentures or interest thereon. This section also lists the <u>functions that shall be performed by</u> the Trustees. These include: • <u>Protecting the interests</u> of the debenture holders by addressing their grievances • Ensuring that the <u>assets</u> of the company issuing debentures <u>are sufficient</u> to discharge the principal amount. • To ensure that the offer document does not contain any clause <u>which is inconsistent</u> with the terms of the debentures or the Trust Deed? • To ensure that the company does not commit any breach of the provisions of the Trust Deed. • To <u>take reasonable</u> steps as may be necessary to undertake remedy in the event of breach of any covenant in the Trust Deed. • To <u>convene a meeting</u> of the debenture holders as and when required. If the debenture trustees are of the opinion that the assets of the company are insufficient to discharge the principal amount, they shall file a petition before the Central Government and the latter may after hearing the parties pass such	

	orders as is necessary in the interests of the debenture holders. As per the SEBI (Debenture Trustees) Regulations, 1993, {hereinafter referred to as the 'Regulations'} a Debenture Trustee can be a scheduled bank, an insurance company, a body corporate or a public financial institution.	
10.	Debenture Trust Deed A Debenture Trust Deed shall, inter alia, include the following: • An <u>undertaking</u> by the company to pay the Debenture holders, principal and interest. • <u>Clauses giving the Trustees</u> the legal mortgages over the company's freehold and leasehold property. • Clauses that <u>may make the security enforceable</u> in the event of default in payment of principal or interest i.e. appointment of receiver, foreclosure, sale of assets etc. • A clause <u>giving the Trustees the power</u> to take possession of the property charged when security becomes enforceable. • Register of Debenture holders, meeting of all debenture holders and other administrative matters may be included in the Deed. In addition thereto, the SEBI regulations have laid format of the Trust Deed in Schedule IV to the regulations. Some of the important provisions would include . • <u>Time limit of creation of security</u> for issue of debentures. • Obligations of the body corporate towards the debenture holders. • Obligations towards the debenture holders - equity ratio and debt service coverage ratio. Procedure for the inspection of charged assets by the Trustees	
11.	Creation of debenture Redemption Reserve Section 117 C of the Act casts an obligation on the company to create a Debenture Redemption Reserve. This account will be credited with proceeds from the profits of the company arrived at every year till redemption of the debentures. The Act, however, does not stipulate the time period for creation of security. <u>SEBI regulations provide for creation of security within six months</u> from the date of issue of debentures and if a company fails to create the security within 12 months, it shall be liable to pay 2% penal interest to the debenture holders. If the security is not created even after 18 months, a meeting of the debenture holders will have to be called to explain the reasons thereof. ♪ <u>Further, the issues proceeds will be kept in escrow account until the documents for creation of securities are executed between the Trustees and the company.</u> NOTE: For manufacturing and infrastructure companies, the adequacy of	

	DRR will be 50 per cent of the value of debentures issued through public issue and <u>25 per cent for privately placed debentures</u>	
12	Default In the event of failure on the part of the company to redeem the debentures on the date of maturity, the Company Law Tribunal may, <u>on the application</u> of any debenture holder, direct redemption of debentures forthwith by payment of principal and interest due thereon. If a default is made in complying with the orders of the Tribunal, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine of not less than Rs.500/- for every day during which the default continues. (Section 117C) Further this offence is not compoundable under section 621A of the Act.	
13.	There are contradictions between the Companies Act and the SEBI regulations on issues relating to: • <i>Utilization of Debenture Redemption Reserves.</i> <u>The Act provides</u> that the Debenture Redemption Reserve will be used towards redemption of debentures only whereas the <u>SEBI regulation states</u> that these will be a part of the General Reserves, which can be utilized for the purpose of bonus issues. • Any debentures issued with a maturity period of 18 months or less is exempted from the creation of <i>Debenture Redemption Reserve</i> Account, whereas no such exemption is provided under the Companies Act. • No Public Issue/Rights Issue of Debentures shall be made by a company unless it has appointed one or more <i>Debenture Trustees</i> for such debentures whereas under SEBI guidelines, appointment of Debenture Trustees is compulsory only in case of debentures with maturity of 18 months or more A listed company though subjected to SEBI regulations must comply with stringent norms between the two legislations / regulations made there under. Note: 1. For detailed provision refer SEBI (Issue and Listing of Debt Securities) regulations, 2008 with companies act, 1956 2. For Creation of DRR, also refer General Circular no. 9/2002 (NO. 6/3/2001-CL.V	