Corporate Securities - Proposed Changes in the Companies Bill, 2008

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With a view to protect the interests of the investors, the Companies Bill has proposed several changes with regard to issue of shares, debentures, transfer and transmission of shares, refusal to register transfers, rectification of register of members and the like. These proposals are briefly outlined here.

The Companies Bill, 2008 was introduced in Lok Sabha on 23 October, 2008. It was prepared by the Ministry of Corporate Affairs after a good deal of consultation with the various stakeholders and deliberations with all concerned for the purpose of re-codification of company law. The Government has also taken into account the expert views of the Dr. J.J. Irani Committee appointed by the Government. The Bill focuses attention , *inter alia*, on segregation of procedural law from substantive law, clubbing of existing provisions of Company law and, retaining desirable features of existing law so as to make the new company law a compact piece of legislation. A good deal of effort seems to have gone into the preparation of the Bill and a few innovative measures are proposed to be introduced. One such effort which is sure to attract the attention of investors in corporate securities relate to the proposed changes in this area of governance. Some of these changes are discussed in the ensuing paragraphs.

Kinds of Share Capital (Clause 37)

Clause 37 takes the place of Section 86 of the Act and proposes to do away with the creation and issue of equity shares with variable voting rights as to dividend, voting or otherwise. This provision was introduced by the Companies (Amendment) Act, 2000 in recognition of the fact that all investors in equity shares may not be interested in exercise of voting power and thus participate in the decision making process to the extent permitted by the Act. They may be satisfied with higher rate of dividend and lesser voting power. The Central Government also issued in March 2001 the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 prescribing certain track record for companies to issue differential voting rights. Many companies considering the new instrument as useful and beneficial have amended their articles and issued equity shares as aforesaid. Should these companies undo what has been done by them?

Clause 37 proposes to do away with the issue of equity shares with differential voting rights and no reasons have been given for the same. The companies which have already introduced the above instrument are in a quandary as to how to deal with the situation. Changing the rules of the game just like that will unsettle the settled position and create confusion for the corporates.

Application of Premium on shares (Clause 46)

Clause 46 corresponds to Section 78 of the present Act and provides for transfer of premiums received on shares to the “Securities Premium Account”. In so far as the manner of utilisation of funds is concerned, the clause provides that it can also be used by the company, *inter alia*, for purchase of its own shares permitted by Clause 61 of the Bill. One other end use provided in the clause relates to meeting the premium payable on the redemption of redeemable preference shares or debentures of a company if the terms of issue provides for the same. As an alternate, the law may also provide for conversion of preference shares into equity shares of the company. Similar provision is there in Foreign Exchange Management Act, 1999 (hereinafter referred to as FEMA) for subscribing to the share capital of an Indian company through mandatorily convertible preference shares under the Foreign Direct Investment (hereinafter referred to as FDI) scheme. Such a conversion will bring in more

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money by way of premium at the time of conversion and also provides an opportunity to such investors to become equity shareholders.

Payment of dividend in proportion to capital paid up (Clause 45)

Clause 45 corresponds to Section 93 of the Act and in substance it is a reproduction of the existing provision. This clause provides that a company may, if so authorised by its articles, pay dividends in proportion to the amount paid up on each share. This clause is misleading as it can be misread to the effect that if the articles do not prevent, dividend can be paid on the full amount of capital including additional capital subscribed subsequent to the year to which dividend relates. Such a provision is contrary to Regulation 88 of Table A which provides that all dividends shall be declared and paid according to the amounts paid or agreed as paid on the shares whereof dividend is paid. Though Table A has limited application, the basic norms for payment of dividend should be the same.

Power to issue shares at a discount (Clause 47)

Clause 47 is a shorter version of Section 79 of the Act and declares issue of shares at a discount as void except in the case of sweat equity shares. The existing law permits issue of shares already issued at a discount upto 10% with the approval of shareholders by a special resolution and with the approval of the Central Govt if the discount exceeds 10%. This is proposed to be withdrawn. The exemption presently available in the case of sick company is also proposed to be withdrawn. There is a strong case in the case of infrastructure companies where gestation period is quite long and no dividend can be paid till the project is completed and the company starts earning profits so as to be able to declare dividend as a return on the capital invested. Similar exemption in the case of sick companies is also required.

Issue & Redemption of Preference Shares (Clause 49)

This clause limits itself to redemption of preference shares which is the existing practice as envisaged in Section 80 and 80A of the Act. This appears to have been done in the context of Section 80A which prohibits issue of irredeemable preference shares. However departure can be made from the existing practice and provide for conversion into equity shares, if the terms of issue provides. The principle of conversion of preference shares into equity is recognized in FEMA as mandatory for the purpose of investment under the FDI scheme.

Further Issue of Capital (Clause 56)

Clause 56 corresponds to Section 81 of the Act and prescribes the manner in which further capital may be issued by a company. While making further capital issue, the company is required to make an issue of shares to the employees of the company, subject to certain conditions as may be prescribed by the Central Govt. This is a new feature and it seeks to incorporate the practice enforced by the Securities and Exchange Board of India (hereinafter referred to as SEBI). This is a welcome measure.

Another repeat provision in Clause 56 relates to issue of further shares to persons who are not members of the company either for cash or for consideration other than cash, supported by a special resolution. This includes preferential allotment of shares either to the promoters or to a strategic partner on private placement basis in which case the price of such shares has to be determined by a valuation of shares by a registeredvaluer, subject to such conditions as may be prescribed by the Central Government. This requirement does not apply in the case of exercise of option for conversion in the case of debentures or loans raised by the company. However Clause 2 of the Bill does not define the word "valuer". The question that is left unanswered relates to the situation where the strategic partner happens to be a non-resident, what should be the basis of valuation of shares and it cannot be different from what FEMA regulations prescribe. In the case of a listed company SEB1 regulations provide for disclosure of certain information in support of price of the security offered through IPO, whereas the Bill proposes valuation of shares in the case of private placement of shares. Even in the case of private placement by a listed company certain norms based on quoted value of shares has been prescribed in the SEBI Investors Protection guidelines. In the circumstance, the concept of valuation requires closer examination. The objective of the proposed measure is to prevent undue enrichment at the cost of the company.

Issue of Debentures (Clause 64)

Clause 64 replaces present sections 117, 117A, 117B and I17C and deals with issue and redemption of debentures. It also provides for the first time conversion of debentures into equity shares of a company. There is a prohibition to issue prospectus or letter of offered to more than 500 persons inviting the public or members of the company to subscribe to debentures unless one or more Debenture Trustee is appointed by the company. The Bill seeks to extend appointment of Debenture Trustee to all issue of debentures offered to more than 500 persons, whether the issuer is a listed or unlisted company. This means that there is no need to appoint a Debenture Trustee if the invitation to subscribe to debentures is made to less than 500 persons, be they be members of the company or the public. This number appears to be too big to manage by any company without an external agency like the Debenture Trustee. Another feature relates to the provision in the clause which provides for issue of secured debentures by such class of companies and subject to such terms and conditions as may be prescribed. This means derivatively that the companies may be permitted to issue unsecured debentures. How to secure the interest of debenture holders in such a case is an issue to be considered.

Presently the aforesaid sections have not provided for any remedy in the event of default on the part of the company to redeem the debentures. It is now proposed by Clause 64 that in the event of failure on the part of the company to redeem the debentures on maturity or payment of interest when due, the aggrieved debenture holders may approach the Tribunal for relief. Similar facility is also provided if the security for debentures becomes inadequate or likely to become inadequate in the opinion of the debenture trustee, he may petition to the Tribunal for relief. Failure to comply with the orders of the Tribunal attracts penalty and it is punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakhs of rupees. This is again a new provision and the Bill seeks to redress and recognizes the increasing popularity of debentures as a means of raising corporate finance.

Transfer & Transmission of Securities (Clause 50)

This Clause corresponds to sections 108, 109B and 110 of the Act and re-enacts the substantive provisions of law in the matter of transfer and transmission of securities. Transfer of interest of a member of a company having no share capital and transfer between persons whose names are entered in the records of a depository are kept out of the purview of Clause 50. A novel feature relates to the power given to the Tribunal to entertain application made by the depository, company, depository participant the holder of securities alleging contravention of the SEBI Act, or the Company law or any other law for the time being in force. Default in complying with the provisions of the Clause(registration of securities and issue of certificates within the time frame) attracts enhanced fine which shall not be less than 25,000 rupees but may extend to 5,00,00 lakhs of rupees. Every officer of the company who is in default is also punishable with imprisonment for a term extending to six months or with fine which shall not be less than 10,000 rupees but may extend to one lakh of rupees or both. Definition of "Officer who is in default" is re-defined to include in relation to issue or transfer of any shares of a company, the transfer agents, bankers, registrars and merchant bankers to the issue or transfer.

Clause 50 discussed above refers to "securities" and it includes, *inter alia*, shares, debentures. But the definition of "officer who is in default" in clause 2(zzi) (vii) refers to shares only and there is no reference to the "company" as the issuer of security. The above clause aptly recognises the need for giving effect to transfer and transmission of securities in the books of the company and provides for deterrent punishment.

Refusal to Register Securities & Relief against Refusal (Clause 52)

Clause 52 corresponds to sub-sections (1) and (2) of section 111 of the Act and provides for appeal to NCLT against refusal to register securities giving reasons for such refusal. Clause 52 combines in itself the provisions applicable to private and public companies. Default in non compliance is punishable with imprisonment for a term extending to not less than one year but it may extend to three years and with fine which shall not be less than one lakh of rupees but may extend to five lakhs of rupees. This clause recognises and enforces the importance of transferability of securities, the need for redressal of grievances on the part of the investors and deterrant punishment to those who flout the law. This provision should reinforce the confidence of the investors in the legal framework within which the corporates will have to give effect to transactions in the securities market.

Rectification of Register of Members (Clause 53)

Clause 53 corresponds to section 111A of the Act and seeks to provide relief in the event of the name of any person has been entered or omitted therefrom from the Register of Members without sufficient cause, the person or the member aggrieved or the company may appeal to the Tribunal. The Tribunal may also direct payment of damages to the aggrieved party.

There is a new provision in Clause 53 to the effect that in the case of foreign members or debenture holders, residing outside India, the appeal will lie to a Special court outside India as may be specified by the Central Government by notification. This clause recognises the entry of foreign investors through FDI and their investment in securities in India and provides for relief without having to visit India. This clause will reinforce the confidence of the foreign investors in the Indian securities. ❑