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Analysing developments impacting business

THE COMPANIES (SHARE CAPITAL AND DEBENTURES) AMENDMENT RULES 2019 – WELCOME RELAXATIONS FOR PROMOTERS AND START-UPS!

23 August 2019

The Ministry of Corporate Affairs vide notification dated 16 August 2019, notified the Companies (Share Capital and Debentures) Amendment Rules 2019 (Amendment Rules). The Amendment Rules have amended the Companies (Share Capital and Debentures) Rules, 2014 (Original Rules).

The Amendment Rules have brought in certain relaxations with respect to issue of shares with differential rights.

Erstwhile requirements to issue Equity shares with differential rights

Under the erstwhile framework, a company could issue equity shares with differential rights, provided *inter alia*, (i) the shares with differential rights do not exceed 26% of the total post issue paid up share capital (including equity shares with differential rights); and (ii) the issuer company has a consistent track record of distributable profit for the last three years.

Amendments in the Amendment Rules

- Amendments in relation to issue of shares with differential rights: The Amendment Rules have brought in the following relaxations for issue of equity shares with differential rights:

  - Voting power of shares with differential rights upto 74% - The existing cap of 26% of the post issue paid up equity share capital has been replaced with a revised cap of 74% of the total voting power.

  - Three year' track record - The Amendment Rules have done away with the pre-requisite of distributable profits for the last three years.

- Exemption to Start-ups: As per Rule 12 of the Original Rules, the definition of the term "*Employee*" did not include: (a) an employee who is a promoter or a person belonging to the promoter group; or (b) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than 10% of the outstanding equity shares of the company. The start-up companies (as defined in notification number G.S.R. 127(E), dated 19th February 2019) were exempt from the foregoing conditions for a period of 5 years. The Amendment Rules have increased the period of exemption up to 10 years. This implies that employee stock option (ESOPs) can be issued to such persons who would have otherwise not qualified as eligible employees for ESOP purposes.

Observations

The existing laws restricted the issue of shares with differential rights to a mere 26% of the post issue paid up capital. This coupled with the profit history requirement certainly limited such issues.

The Amendment Rules will now enable promoters of Indian companies to retain control of their companies in their pursuit for growth, even as they raise equity capital from global investors. Moreover, the ESOP related amendment will be a big fillip for promoters / founders of start-ups.

Overall, the above changes will provide far greater flexibility while structuring investment deals. It should be interesting for corporate India to start using these in deal constructs.

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